State of California
Franchise Tax Board

Summary of Federal Income Tax Changes 2009

Laws Affected

Personal Income Tax Laws
Corporation Tax Laws
Administration of Franchise and Income Tax Laws

Summary of Federal Income Tax Changes
2009

Prepared by the Staff of the

Franchise Tax Board

STATE OF CALIFORNIA

This report is submitted in fulfillment of the requirement in Revenue and Taxation Code section 19522.

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EXECUTIVE SUMMARY

2009 FEDERAL INCOME TAX CHANGES

Prepared by the Staff of the
Franchise Tax Board (FTB)
State of California

During 2009, the Internal Revenue Code (IRC) or its application by California was changed by:

PUBLIC LAW	TITLE	DATE
111-3	Children's Health Insurance Program Reauthorization Act of 2009 (CHIPRA)	February 4, 2009
111-5	American Recovery and Reinvestment Act of 2009 (ARRA)	February 17, 2009
111-32	Consumer Assistance to Recycle and Save Act of 2009	June 24, 2009
111-92	Worker, Homeownership, and Business Assistance Act of 2009 (WHBAA)	November 6, 2009
111-97	Military Spouses Residency Relief Act	November 11, 2009
111-118	Department of Defense Appropriations Act, 2010	December 19, 2009
111-8, 111-12, 111-42, 111-46, 111-68, 111-69, 111-88, 111-116, 111-117, and 111-124	2009 Miscellaneous Federal Acts Impacting the IRC Not Requiring a California Response	Various

This report explains the new federal laws along with the effective dates, the corresponding California law, if any, including an explanation of any changes made in response to the new federal law, and the impact on California revenue were California to conform to the federal changes. This report also contains citations to the section numbers of federal Public Laws, the IRC, and the California Revenue and Taxation Code (R&TC) impacted by the federal changes.

2009 EXPIRING TAX PROVISIONS

Following is a list of California tax provisions that expire in 2009.

California Sunset[1]	California Section	Federal Section	Federal Sunset	Description
12/31/09	17039.2[2] 23036.2[3]	N/A	N/A	Temporary Limit on Business Credits
12/31/09	18510	N/A	N/A	Payment and Reporting of Qualified Use Tax
12/31/09	18845 – 18845.3	N/A	N/A	Voluntary Contribution: California Prostate Cancer Research Fund
12/31/09	17651 23732	512	12/31/09	Exclusion of Gain or Loss on Sale or Exchange of Certain Brownfield Sites from Unrelated Business Taxable Income
12/31/09	17276.9[4] 24416.9[5]	N/A	N/A	Temporary Suspension of Net Operating Losses
12/31/09	24990	1202	12/31/09	Increased Exclusion of Gain on Sale of Qualified Business Stock of an Empowerment Zone Business

This report contains the following exhibits:

Exhibit A — 2009 Miscellaneous Federal Acts Impacting the IRC Not Requiring a California Response - Short explanations of federal law changes that are either not administered by the FTB or are not applicable to California.

Exhibit B — Expiring Tax Provisions - A complete listing of expiring provisions in California tax law.

Exhibit C — Revenue Tables - The impact on California revenue were California to conform to the federal changes.

[1] In general, this is the last taxable year to which the provision applies. Fiscal years beginning within this taxable year are, in general, also covered by the provision. In some cases, the repeal date of the section is listed or the expiration applies to transactions occurring after this date.

[2] The limitation does not apply to taxpayers with net business income of less than $500,000.

[3] The limitation does not apply to taxpayers with taxable income of less than $500,000.

[4] The suspension does not apply to taxpayers with net business income of less than $500,000.

[5] The suspension does not apply to taxpayers with taxable income of less than $500,000.

CHILDREN'S HEALTH INSURANCE PROGRAM REAUTHORIZATION ACT OF 2009 (CHIPRA)
Public Law 111-3, February 4, 2009

SUBTITLE B of TITLE III – COORDINATING PREMIUM ASSISTANCE WITH PRIVATE COVERAGE

Section	Section Title
311	Special Enrollment Period Under Group Health Plans in Case of Termination of Medicaid or CHIP Coverage or Eligibility for Assistance in Purchase of Employment-Based Coverage; Coordination of Coverage

Background

A group health plan is required to permit an employee who is eligible, but not enrolled, for coverage under the terms of the plan to enroll for coverage under the plan if certain conditions are satisfied. Included among the conditions are (1) the employee was covered under a group health plan or had health insurance coverage at the time coverage was previously offered to the employee, and (2) such other coverage terminated as a result of loss of eligibility for such coverage.[6] This special enrollment right must also be extended to a dependent of an employee if the dependent is eligible, but not enrolled, for coverage under the terms of the group health plan and the dependent satisfies the conditions for special enrollment. The special enrollment rights apply without regard to the dates on which the employee (or dependent) would otherwise be able to enroll under the plan. If a plan receives a request for special enrollment, coverage under the plan must generally begin no later than the first day of the first calendar month beginning after the date that notice of the request is received by the plan.

An excise tax is imposed if a group health plan fails to comply with the special enrollment rights requirement.[7] The rate of the tax on any failure is $100 for each day in the noncompliance period with respect to each individual to whom the failure relates. In the case of a single employer plan, the tax is imposed on the employer that maintains the plan.

Special enrollment rights that are parallel to the IRC's rules are set forth in the Employee Retirement Income Security Act of 1974 ("ERISA") and the Public Health Service Act ("PHSA").

New Federal Law (IRC section 9801)

Under the provision, a group health plan is required to permit an employee who is eligible, but not enrolled, for coverage under the plan to enroll for coverage if either (1) the employee is covered under a Medicaid plan or a state child health plan under titles XIX and XXI of the Social Security Act, respectively (a "Medicaid plan" or a "state child health plan"), and coverage is terminated as a result of loss of eligibility for the Medicaid plan or state child health plan and the employee requests coverage under the group health plan within 60 days of coverage loss; or (2) the employee becomes eligible for assistance with respect to coverage under the group health plan

[6] IRC section 9801(f).

[7] IRC section 4980D.

under a Medicaid plan or state child health plan, and the employee requests coverage not later than 60 days after the employee is determined to be eligible for such assistance. The special enrollment rights of the provision also apply to a dependent of an employee if the dependent is eligible, but not enrolled, for coverage under the terms of the group health plan and the dependent satisfies the conditions for special enrollment. The provision requires an employer to provide employees with written notice of the availability of premium assistance programs under Medicaid or state child health plans. In addition, the administrator of a group health plan must provide information upon request of a state regarding the benefits available under the plan with respect to a participant or beneficiary who is covered under a Medicaid or state child health plan. The provision makes parallel amendments to ERISA and PHSA.

Effective Date

The provision is effective on April 1, 2009.

California Law (None)

Federal ERISA provisions apply to all health plans in California. There are no California modifications because federal law precludes states from modifying ERISA provisions.

Impact on California Revenue

Baseline.

TITLE VII – REVENUE PROVISIONS

Section	Section Title
701	Increase in Excise Tax Rate on Tobacco Products

Background

Rates of excise tax on tobacco products and cigarette papers and tubes

Tobacco products and cigarette papers and tubes manufactured in the United States or imported into the United States are subject to federal excise tax at the following rates:[8]

- Cigars weighing not more than three pounds per thousand ("small cigars") are taxed at the rate of $1.828 per thousand;

[8] IRC section 5701.

- Cigars weighing more than three pounds per thousand ("large cigars") are taxed at the rate equal to 20.719 percent of the manufacturer's or importer's sales price but not more than $48.75 per thousand;
- Cigarettes weighing not more than three pounds per thousand ("small cigarettes") are taxed at the rate of $19.50 per thousand ($0.39 per pack);
- Cigarettes weighing more than three pounds per thousand ("large cigarettes") are taxed at the rate of $40.95 per thousand, except that, if they measure more than six and one-half inches in length, they are taxed at the rate applicable to small cigarettes, counting each two and three-quarter inches (or fraction thereof) of the length of each as one cigarette;
- Cigarette papers are taxed at the rate of $0.0122 for each 50 papers or fractional part thereof, except that, if they measure more than six and one-half inches in length, they are taxable by counting each two and three-quarter inches (or fraction thereof) of the length of each as one cigarette paper;
- Cigarette tubes are taxed at the rate of $0.0244 for each 50 tubes or fractional part thereof, except that, if they measure more than six and one-half inches in length, they are taxable by counting each two and three-quarter inches (or fraction thereof) of the length of each as one cigarette tube;
- Snuff is taxed at the rate of $0.585 per pound, and proportionately at that rate on all fractional parts of a pound;
- Chewing tobacco is taxed at the rate of $0.195 per pound, and proportionately at that rate on all fractional parts of a pound;
- Pipe tobacco is taxed at the rate of $1.0969 per pound, and proportionately at that rate on all fractional parts of a pound; and
- Roll-your-own tobacco is taxed at the rate of $1.0969 per pound, and proportionately at that rate on all fractional parts of a pound.

In general, excise taxes on tobacco products and cigarette papers and tubes manufactured in the United States are determined at the time of removal.

Floor stocks tax and foreign trade zones

Special tax and duty rules apply with respect to foreign trade zones. In general, merchandise may be brought into a foreign trade zone without being subject to the general customs laws of the United States. Such merchandise may be stored in a foreign trade zone or may be subjected to manufacturing or other processes there. The United States Customs and Border Protection agency of the Department of Homeland Security ("Customs") may determine internal revenue taxes and liquidate duties imposed on foreign merchandise in such foreign trade zones. Articles on which such taxes and applicable duties have already been paid, or which have been admitted into the United States free of tax, that have been taken into a foreign trade zone from inside the

United States, may be held under the supervision of a customs officer. Such articles may later be released back into the United States free of further taxes and duties.[9]

New Federal Law (IRC section 5701)

Rate increases

Under the provision, the rates of excise tax on tobacco products and cigarette papers and tubes are increased, generally in a proportionate manner. The special rules relating to the application of the tax rates to large cigarettes and cigarette papers and tubes longer than six and one-half inches apply under the provision in the same manner as under present law. The rates under the provision are as follows:

- Small cigars are taxed at the rate of $12.50 per thousand for removals during 2009-10; $25.00 per thousand for removals during 2011-12; $37.50 per thousand for removals during 2013-14; and $50.00 per thousand (the same rate applied to small cigarettes) for removals after 2014;
- Large cigars are taxed at the rate equal to 52.4 percent of the manufacturer's or importer's sales price but not more than $0.40 per cigar;
- Small cigarettes are taxed at the rate of $50.00 per thousand ($1.00 per pack);
- Large cigarettes are taxed at the rate of $105.00 per thousand;
- Cigarette papers are taxed at the rate of $0.0313 for each 50 papers or fractional part thereof;
- Cigarette tubes are taxed at the rate of $0.0626 for each 50 tubes or fractional part thereof;
- Snuff is taxed at the rate of $1.50 per pound, and proportionately at that rate on all fractional parts of a pound;
- Chewing tobacco is taxed at the rate of $0.50 per pound, and proportionately at that rate on all fractional parts of a pound;
- Pipe tobacco is taxed at the rate of $2.8126 per pound, and proportionately at that rate on all fractional parts of a pound; and
- Roll-your-own tobacco is taxed at the rate of $24.62 per pound, and proportionately at that rate on all fractional parts of a pound. The rate for roll-your-own tobacco is intended to approximate the rate for small cigarettes.

Floor stocks tax and foreign trade zone treatment

The provision imposes a tax on floor stocks. Taxable articles (i.e., those articles listed above), except for large cigars, manufactured in the United States or imported into the United States which are removed before any tax increase date and held on that date for sale by any person are

[9] 19 U.S.C. section 81c(a).

subject to a floor stocks tax. A tax increase date means April 1, 2009, January 1, 2011, January 1, 2013, and January 1, 2015. The floor stocks tax is equal to the excess of the applicable tax under the new rates over the applicable tax at the prior rates. The person holding the article on any tax increase date to which the floor stocks tax applies is liable for the tax. Each such person is allowed a $500 credit against the floor stocks tax.

Notwithstanding any other provision of law, the floor stocks tax applies to an article located in a foreign trade zone on any tax increase date, provided that internal revenue taxes have been determined, or customs duties have been liquidated, with respect to such article before such date, or such article is held on a tax-and-duty-paid basis on such date under the supervision of a customs officer.

For purposes of determining the floor stocks tax, component members of a "controlled group" (as modified) are treated as one taxpayer.[10] "Controlled group" for these purposes means a parent-subsidiary, brother-sister, or combined corporate group with more than 50-percent ownership with respect to either combined voting power or total value. Under regulations, similar principles may apply to a group of persons under common control where one or more persons are not a corporation.

The floor stocks tax shall be paid on or before August 1, 2009, or on or before April 1 following any tax increase date on or after January 1, 2011 for small cigars, in the manner prescribed by Treasury regulations. In general, all of the rules, including penalties, applicable with respect to taxes on tobacco products and cigarette papers and tubes apply to the floor stocks tax. The Secretary of the Treasury or his delegate ("Secretary") may treat person who bore the ultimate burden of the floor stocks tax as the person entitled to a credit of refund of such tax.

<u>Effective Date</u>

The provision applies to articles removed after March 31, 2009.

<u>California Law</u>

Tobacco excise taxes are not administered by the Franchise Tax Board. Defer to the Board of Equalization (BOE).

<u>Impact on California Revenue</u>

Defer to the BOE.

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[10] Controlled group is defined in IRC section 1563.

Sections	Section Titles
702 –703	Administrative Improvements and Treasury Study Concerning Magnitude of Tobacco Smuggling in the United States

A. Permit, inventories, reports, and records requirement for manufacturers and importers of processed tobacco

Background

Tobacco products and cigarette papers and tubes are subject to federal excise tax.[11] Tobacco products are cigars, cigarettes, smokeless tobacco, pipe tobacco, and roll-your-own tobacco.[12] Manufacturers and importers of tobacco products and export warehouse proprietors must obtain a permit from the Secretary of the Treasury or his delegate ("Secretary").[13] Manufacturers and importers of tobacco products or cigarette papers or tubes, and export warehouse proprietors, must also periodically make an inventory and certain reports and keep certain records, all as prescribed by the Secretary.[14]

New Federal Law (IRC sections 5702, 5711, 5712, 5713, 5721, 5722, 5723, 5741, and 6103)

The provision creates a new category of manufacturers and importers who are subject to regulation but not to federal excise tax. Under the provision, manufacturers and importers of "processed tobacco" are subject to the present-law permit, inventory, reporting, packaging, and recordkeeping requirements. Processed tobacco is any tobacco other than tobacco products.[15] A manufacturer of processed tobacco is any person who processes any tobacco other than tobacco products, and an importer includes an importer of processed tobacco. However, the processing of tobacco does not include the farming or growing of tobacco or the handling of whole tobacco leaf solely for sale, shipment, or delivery to a manufacturer of tobacco products or processed tobacco. For example, under the provision an importer of "cut rag" tobacco or a leaf processor that manufactures such tobacco is subject to the general permit, inventory, reporting, and recordkeeping requirements of the IRC but is not subject to federal excise tax (unless it also imports or manufactures tobacco products or cigarette papers or tubes).

Under the provision, any person who is engaged in business as a manufacturer or importer of processed tobacco on April 1, 2009, and who submits a permit application within 90 days of such date may continue to engage in such business pending action on their permit application. Such

[11] IRC section 5701.

[12] IRC section 5702.

[13] IRC section 5713.

[14] IRC sections 5721 (inventories), 5722 (reports), 5723 (packaging), and 5741 (records).

[15] IRC section 5702(c) defines tobacco products as cigars, cigarettes, smokeless tobacco, pipe tobacco, and roll-your-own tobacco.

persons will be subject to the requirements of this provision to the same extent as if the person was a permit holder while final action on the permit application is pending.

Effective Date

The provision is effective on April 1, 2009.

B. Basis for denial, suspension, or revocation of permits

Background

Manufacturers and importers of tobacco products and proprietors of export warehouses must obtain a permit to engage in such businesses.[16] A permit is obtained by application to the Secretary. The Secretary may deny the application if (1) the business premises are inadequate to protect the revenue; (2) the activity to be carried out at the business premises does not meet such minimum capacity or activity requirements as prescribed by the Secretary; (3) the applicant is, by reason of his business experience, financial standing, or trade connections, not likely to maintain operations in compliance with the applicable provisions of the IRC; or (4) such applicant has failed to disclose any material information required or made any material false statement in the application.[17] In the case of a corporation, an applicant includes any officer, director, or principal stockholder and, in the case of a partnership, a partner.

A permit is conditioned upon compliance with the rules of the IRC and related regulations pertaining to taxes and regulation of tobacco products and cigarette papers and tubes. The Secretary may suspend or revoke a permit after a notice and hearing if the holder (1) has not in good faith complied with those rules or has violated any other provision of the IRC involving intent to defraud; (2) has violated the conditions of the permit; (3) has failed to disclose any material information required or made any material false statement in the permit application; or (4) has failed to maintain the business premises in such a manner as to protect the revenue.[18]

New Federal Law (IRC sections 5712 and 5713)

The provision broadens the present-law authority of the Secretary to deny, suspend, and revoke tobacco permits. Under the provision, the Secretary may deny an application for a permit if the applicant has been convicted of a felony violation of a federal or state criminal law relating to tobacco products or cigarette papers or tubes, or if, by reason of previous or current legal proceedings involving a violation of federal criminal felony laws relating to tobacco products or cigarette papers or tubes, such applicant is not likely to maintain operations in compliance with the applicable provisions of the IRC.

[16] IRC section 5713.

[17] IRC section 5712.

[18] IRC section 5713.

Similarly, a permit may be suspended or revoked if the holder is convicted of a felony violation of a federal or state criminal law relating to tobacco products or cigarette papers or tubes, or if, by reason of previous or current legal proceedings involving a violation of federal criminal felony laws relating to tobacco products or cigarette papers or tubes, such applicant is not likely to maintain operations in compliance with the applicable provisions of the IRC.

Effective Date

The provision is effective on February 4, 2009.

C. Application of IRC statute of limitations for alcohol and tobacco excise taxes

Background

Under the IRC, amounts of tax must generally be assessed within three years after a tax return is filed, and no proceeding in court without assessment for the collection of such tax may begin after such period has expired.[19] If no return is filed (but is required), the tax may be assessed, or a proceeding in court for the collection of such tax may be initiated without assessment, at any time.[20]

Customs collects duties and excise taxes on imports. Importers of taxable articles relating to tobacco and alcohol must file a tax return with Customs.[21] In general, the limitations period for fixing and assessing duties and taxes with respect to an import is one year from the date of entry or removal.[22] Under the applicable customs law, with some limited exceptions, any duty or tax imposed on an import is final and conclusive upon all persons, including the United States, unless a protest is filed within 180 days or a court action is timely commenced.[23]

New Federal Law (IRC section 6501)

The provision clarifies the tax and customs law in the area of alcohol and tobacco products by providing that, notwithstanding customs law, the general statute of limitations for assessment under IRC section 6501 applies with respect to taxes imposed under chapters 51 (relating to distilled spirits, wines, and beer) and 52 (relating to tobacco products and cigarette papers and tubes) of the IRC.

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[19] IRC section 6501(a).

[20] IRC section 6501(c)(3).

[21] 24 C.F.R. section 41.81(b) (tobacco products and cigarette papers and tubes); IRC section 5061(a) (distilled spirits, wine, and beer).

[22] 19 U.S.C. section 1504(a). The Secretary may extend this period under certain circumstances and with notice to the importer.

[23] 19 U.S.C. section 1514(a) & (c)(3).

No inference is intended regarding the applicability of the statute of limitations under the IRC to pending cases or to excise taxes imposed other than under chapters 51 and 52 of the IRC.

Effective Date

The provision is effective for articles imported into the United States after February 4, 2009

D. Expansion of definition of roll-your-own tobacco

Background

Federal excise taxes are imposed upon tobacco products and cigarette papers and tubes.[24] Tobacco products are cigars, cigarettes, snuff, chewing tobacco, pipe tobacco, and roll-your-own tobacco. A "cigar" is any roll of tobacco wrapped in leaf tobacco or in any substance containing tobacco, other than any roll of tobacco which is a cigarette. A "cigarette" is (i) any roll of tobacco wrapped in paper or in any substance not containing tobacco; and (ii) any roll of tobacco wrapped in any substance containing tobacco which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette. "Roll-your-own tobacco" is any tobacco, which because of its appearance, type, packaging, or labeling, is suitable for use and likely to be offered to, or purchased by, consumers as tobacco for making cigarettes. "Cigarette paper" is paper, or any other material except tobacco, prepared for use as a cigarette wrapper. A "cigarette tube" is cigarette paper made into a hollow cylinder for use in making cigarettes.[25] Wrappers containing tobacco are not within the definition of cigarette papers or tubes because they contain tobacco. They are also not generally within the definition of roll-your-own tobacco because they are usually used to make cigars, not cigarettes. For the same reason, loose tobacco suitable for making roll-your-own cigars is not considered to be roll-your-own tobacco.

New Federal Law (IRC section 5702)

Under the provision, roll-your-own tobacco also includes any tobacco, which because of its appearance, type, packaging, or labeling, is suitable for use and likely to be offered to, or purchased by, consumers as tobacco for making cigars, or for use as wrappers for making cigars.

Effective Date

The provision applies to articles removed after March 31, 2009.

[24] IRC section 5701.

[25] IRC section 5702.

E. Time of tax for unlawfully manufactured tobacco products

Background

Manufacturers and importers of tobacco products and proprietors of export warehouses must obtain a permit to engage in such businesses.[26] A permit is obtained by application to the Secretary.[27] A manufacturer of tobacco products or cigarette papers or tubes, or an export warehouse proprietor, must file a bond and obtain approval of such bond from the Secretary.[28] In general, excise taxes on tobacco products and cigarette papers and tubes manufactured in the United States are determined at the time of removal. In the case of taxes on tobacco products and cigarette papers and tubes removed during any semimonthly period under bond for deferred payment of tax, payment is due no later than the 14th day after the last day of such semimonthly period.[29]

Distilled spirits, wines, and beer produced at any place other than a place required by the IRC are subject to tax immediately on production.[30] There is no such rule imposing immediate tax on tobacco products and cigarette papers and tubes that are produced by an out-of-compliance manufacturer.

New Federal Law (IRC section 5703)

Under the provision, in the case of any tobacco products or cigarette papers or tubes produced in the United States at any place other than the premises of a manufacturer that has obtained a permit (if required) and approval of a bond, the excise tax is due and payable immediately upon manufacture, unless they are produced solely for the person's own personal consumption or use.

Effective Date

The provision is effective on February 4, 2009.

[26] IRC section 5713. A "manufacturer of tobacco products" does not include (1) a person who produces tobacco products solely for the personal consumption or use, and (2) a proprietor of a customs bonded manufacturing warehouse with respect to the operation of such warehouse. IRC section 5702(d).

[27] IRC section 5712.

[28] IRC section 5711.

[29] IRC section 5703.

[30] IRC sections 5006(c)(2) (distilled spirits), 5041(f) (wines), and 5054(a)(3) (beer).

F. Disclosure

Background

IRC Section 6103 provides that returns and return information are confidential and may not be disclosed by the IRS, other federal employees, state employees, and certain others having access to the information except as provided in the IRC.[31] A "return" is any tax or information return, declaration of estimated tax, or claim for refund required by, or permitted under, the IRC, that is filed with the Secretary by, on behalf of, or with respect to any person.[32] "Return" also includes any amendment or supplement thereto, including supporting schedules, attachments, or lists which are supplemental to, or part of, the return so filed.

The definition of "return information" is very broad and includes any information gathered by the IRS with respect to a person's liability or possible liability under the IRC.[33]

However, data in a form that cannot be associated with, or otherwise identify, directly or indirectly a particular taxpayer is not "return information" for IRC section 6103 purposes.

IRC section 6103 contains a number of exceptions to the general rule of confidentiality, which permit disclosure in specifically identified circumstances when certain conditions are satisfied.[34]

For example, under IRC section 6103(o), returns and return information with respect to the taxes imposed on alcohol, tobacco and firearms are open to inspection by or disclosure to officers and employees of a federal agency whose official duties require such inspection or disclosure.

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[31] IRC section 6103(a).

[32] IRC section 6103(b)(1).

[33] IRC section 6103(b)(2). Return information is:

- A taxpayer's identity, the nature, source, or amount of his income, payments, receipts, deductions, exemptions, credits, assets, liabilities, net worth, tax liability, tax withheld, deficiencies, overassessments, or tax payments, whether the taxpayer's return was, is being, or will be examined or subject to other investigation or processing, or any other data, received by, prepared by, furnished to, or collected by the Secretary with respect to a return or with respect to the determination of the existence, or possible existence, of liability (or the amount thereof) of any person under this title for any tax, penalty, interest, fine, forfeiture, or other imposition, or offense.
- Any part of any written determination or any background file document relating to such written determination (as such terms are defined in IRC section 6110(b) which is not open to public inspection under IRC section 6110
- Any advance pricing agreement entered into by a taxpayer and the Secretary and any background information related to such agreement or any application for an advance pricing agreement, and
- Any closing agreement under IRC section 7121, and any similar agreement, and background information related to such an agreement or request for such an agreement.

[34] IRC section 6103(c) – (o). Such exceptions include disclosures by consent of the taxpayer, disclosures to state tax officials, disclosures to the taxpayer and persons having a material interest, disclosures to Committees of Congress, disclosures to the President, disclosures to federal employees for tax administration purposes, disclosures to federal employees for nontax criminal law enforcement purposes and to the Government Accountability Office, disclosures for statistical purposes, disclosures for miscellaneous tax administration purposes, disclosures for purposes other than tax administration, disclosures for taxpayer identity information, disclosures to tax administration contractors and disclosures with respect to wagering excise taxes.

The Fair and Equitable Tobacco Reform Act of 2004[35] repealed the federal tobacco support program and created a Tobacco Trust Fund. Funds from the Tobacco Trust Fund are used to provide transitional payments to tobacco quota holders and eligible tobacco producers. The Tobacco Trust Fund is funded by quarterly assessments paid by manufacturers and importers of tobacco products. The Farm Service Agency receives tax information from the Department of the Treasury's Alcohol and Tobacco Tax and Trade Bureau as part of its administration of the Tobacco Trust Fund assessments.

A September 2008 Department of Agriculture inspector general report indicated that a number of companies were delinquent in paying their assessments and have been referred to the Department of Justice for debt collection. IRC section 6103(o) does not provide for the use of the tax information received in civil actions against the delinquent companies. The Department of Justice could proceed with the lawsuits based on information provided by other entities, other than the tax data.

<u>New Federal Law (IRC section 6103)</u>

The provision provides that returns and return information provided to a federal agency under IRC section 6103(o) may be used in an action or proceeding, or in the preparation for an action or proceeding, brought under section 625 of the Fair and Equitable Tobacco Reform Act of 2004 for any unpaid assessments or penalties arising under such Act.

<u>Effective Date</u>

The provision is effective on or after February 4, 2009.

<u>California Law</u>

Tobacco excise taxes are not administered by the Franchise Tax Board. Defer to the Board of Equalization (BOE).

G. Treasury study concerning magnitude of tobacco smuggling in the United States

<u>Background</u>

Present law does not require the Secretary to submit a tobacco smuggling study to Congress.

<u>New Federal Law</u>

The provision requires the Secretary to submit to Congress a study concerning the magnitude of tobacco smuggling in the United States and to recommend the most effective steps to reduce it. The study would include a review of the loss of federal tax revenue due to illicit tobacco trade in the United States, and the role of imported tobacco products in such illicit trade.

[35] Title VI of the American Jobs Creation Act of 2004.

Effective Date

The study will be completed no later than one year after February 4, 2009.

California Law

None.

Impact on California Revenue (CHIPRA sections 702-703)

Defer to the BOE.

Section	Section Title
704	Time for Payment of Corporate Estimated Taxes

Background

In general, corporations are required to make quarterly estimated tax payments of their income tax liability. For a corporation whose taxable year is a calendar year, these estimated payments must be made by April 15, June 15, September 15, and December 15. For tax years beginning on any date other than January 1, the payments are due in months of the fiscal year that correspond to the calendar-year payment months.

Under the Tax Increase Prevention Act of 2005 ("TIPRA"), as amended, in the case of a corporation with assets of at least $1 billion, the payments due in July, August, and September, 2013, shall be increased to 120.00 percent of the payment otherwise due and the next required payment shall be reduced accordingly.

New Federal Law (IRC section 6655)

The provision increases the otherwise applicable percentage for 2013 (120.00) by 1.00 percentage point.

Effective Date

The provision is effective on February 4, 2009

California Law (R&TC section 19025)

California law does not conform to IRC section 6655 by reference, but instead has its own stand-alone rules for estimated tax payments.

Taxable years beginning before January 1, 2009

For taxable years beginning before January 1, 2009, estimated payments of tax liability are due in quarterly increments of 25 percent of estimated liability each, beginning 3 months and 15 days after the beginning of the taxable year. The first estimated tax payment may not be less than the minimum franchise tax, if applicable. Additional payments of 25 percent of estimated tax are due on the 15th day of the 6th, 9th, and 12th months of the taxable year. Taxpayers are subject to penalties if estimated payments remitted over the course of the year are less than prescribed minimum percentages of tax liability.

Taxable years beginning on or after January 1, 2009, and before January 1, 2010

For taxable years beginning on or after January 1, 2009, and before January 1, 2010, required estimated payments were revised from four equal installments to the following:

Quarter Installment	Percent of Estimated Tax
1st	30
2nd	30
3rd	20
4th	20

Corporate taxpayers who are not required to make an estimate payment installment in the first quarter are required to make the following installment payments in subsequent quarters:

Quarter Installment	Percent of Estimated Tax
2nd	40
3rd	30
4th	30

Corporate taxpayers who are not required to make an estimate payment installment in the first two quarters are required to make the following installment payments in subsequent quarters:

Quarter Installment	Percent of Estimated Tax
3rd	50
4th	50

Corporate taxpayers who are not required to make an estimate payment installment in the first three quarters are required to pay 100 percent in the fourth quarter.

Taxable years beginning on or after January 1, 2010

For taxable years beginning on or after January 1, 2010, required estimated payments are revised to the following percentages:

Quarter Installment	Percent of Estimated Tax
1st	30
2nd	40
3rd	0
4th	30

Corporate taxpayers who are not required to make an estimate payment installment in the first quarter are required to make the following installment payments in subsequent quarters:

Quarter Installment	Percent of Estimated Tax
2nd	60
3rd	0
4th	40

Corporate taxpayers who are not required to make an estimate payment installment in the first two quarters are required to make the following installment payments in subsequent quarters:

Quarter Installment	Percent of Estimated Tax
3rd	70
4th	30

Corporate taxpayers who are not required to make an estimate payment installment in the first three quarters are required to pay 100 percent in the fourth quarter.

Impact on California Revenue

Not applicable.

PART I of SUBTITLE A of TITLE I – GENERAL TAX RELIEF

Section	Section Title
1001	Making Work Pay Credit

Background

Earned income tax credit

Low- and moderate-income workers may be eligible for the refundable earned income tax credit (EITC). Eligibility for the EITC is based on earned income, adjusted gross income, investment income, filing status, and immigration and work status in the United States. The amount of the EITC is based on the presence and number of qualifying children in the worker's family, as well as on adjusted gross income and earned income.

The EITC generally equals a specified percentage of earned income[36] up to a maximum dollar amount. The maximum amount applies over a certain income range and then diminishes to zero over a specified phaseout range. For taxpayers with earned income (or adjusted gross income (AGI), if greater) in excess of the beginning of the phaseout range, the maximum EITC amount is reduced by the phaseout rate multiplied by the amount of earned income (or AGI, if greater) in excess of the beginning of the phaseout range. For taxpayers with earned income (or AGI, if greater) in excess of the end of the phaseout range, no credit is allowed.

The EITC is a refundable credit, meaning that if the amount of the credit exceeds the taxpayer's federal income tax liability, the excess is payable to the taxpayer as a direct transfer payment. Under an advance payment system, eligible taxpayers may elect to receive the credit in their paychecks, rather than waiting to claim a refund on their tax return filed by April 15 of the following year.

Child credit

An individual may claim a tax credit for each qualifying child under the age of 17. The amount of the credit per child is $1,000 through 2010 and $500 thereafter. A child who is not a citizen, national, or resident of the United States cannot be a qualifying child.

The credit is phased out for individuals with income over certain threshold amounts. Specifically, the otherwise allowable child tax credit is reduced by $50 for each $1,000 (or fraction thereof) of modified adjusted gross income over $75,000 for single individuals or heads of households, $110,000 for married individuals filing joint returns, and $55,000 for married individuals filing separate returns. For purposes of this limitation, modified adjusted gross income includes certain

[36] Earned income is defined as (1) wages, salaries, tips, and other employee compensation, but only if such amounts are includible in gross income, plus (2) the amount of the individual's net self-employment earnings.

otherwise excludable income earned by U.S. citizens or residents living abroad or in certain U.S. territories.

The credit is allowable against the regular tax and the alternative minimum tax. To the extent the child credit exceeds the taxpayer's tax liability, the taxpayer is eligible for a refundable credit (the additional child tax credit) equal to 15 percent of earned income in excess of a threshold dollar amount (the "earned income" formula). The threshold dollar amount is $12,550 (for 2009), and is indexed for inflation.

Families with three or more children may determine the additional child tax credit using the "alternative formula," if this results in a larger credit than determined under the earned income formula. Under the alternative formula, the additional child tax credit equals the amount by which the taxpayer's social security taxes exceed the taxpayer's earned income tax credit.

Earned income is defined as the sum of wages, salaries, tips, and other taxable employee compensation plus net self-employment earnings. Unlike the EITC, which also includes the preceding items in its definition of earned income, the additional child tax credit is based only on earned income to the extent it is included in computing taxable income. For example, some ministers' parsonage allowances are considered self-employment income, and thus are considered earned income for purposes of computing the EITC, but the allowances are excluded from gross income for individual income tax purposes, and thus are not considered earned income for purposes of the additional child tax credit.

<u>New Federal Law (IRC sections 31, 36A, 6211, and 6213)</u>

The provision provides eligible individuals a refundable income tax credit for two years (taxable years beginning in 2009 and 2010).

The credit is the lesser of (1) 6.2 percent of an individual's earned income or (2) $400 ($800 in the case of a joint return). For these purposes, the earned income definition is the same as for the earned income tax credit with two modifications. First, earned income for these purposes does not include net earnings from self-employment which are not taken into account in computing taxable income. Second, earned income for these purposes includes combat pay excluded from gross income under IRC section 112.

The credit is phased out at a rate of two percent of the eligible individual's modified adjusted gross income above $75,000 ($150,000 in the case of a joint return). For these purposes an eligible individual's modified adjusted gross income is the eligible individual's adjusted gross income increased by any amount excluded from gross income under IRC sections 911, 931, or 933. An eligible individual means any individual other than: (1) a nonresident alien; (2) an individual with respect to whom another individual may claim a dependency deduction for a taxable year beginning in a calendar year in which the eligible individual's taxable year begins; and (3) an estate or trust.

The otherwise allowable making work pay credit allowed under the provision is reduced by the amount of any payment received by the taxpayer pursuant to the provisions of the bill providing economic recovery payments under the Veterans Administration, Railroad Retirement Board, and the Social Security Administration and a temporary refundable tax credit for certain government retirees.[37] The failure to reduce the making work pay credit by the amount of such payments or credit, and the omission of the correct TIN are treated as clerical errors. This allows the IRS to assess any tax resulting from such failure or omission without the requirement to send the taxpayer a notice of deficiency allowing the taxpayer the right to file a petition with the Tax Court.

Each tax return on which this credit is claimed must include the social security number of the taxpayer (in the case of a joint return, the social security number of at least one spouse).

Treatment of the U.S. possessions

Mirror code possessions[38]

The U.S. Treasury will make payments (for 2009 and 2010, respectively) to each mirror IRC possession in an amount equal to the aggregate amount of the credits allowable by reason of the proposal to that possession's residents against its income tax. This amount will be determined by the Treasury Secretary based on information provided by the government of the respective possession. For purposes of these payments, a possession is a mirror code possession if the income tax liability of residents of the possession under that possession's income tax system is determined by reference to the U.S. income tax laws as if the possession were the United States.

Non-mirror code possessions[39]

To each possession that does not have a mirror code tax system, the U.S. Treasury will make two payments (for 2009 and 2010, respectively) in an amount estimated by the Treasury Secretary as being equal to the aggregate credits that would have been allowed to residents of that possession if a mirror code tax system had been in effect in that possession. Accordingly, the amount of each payment to a non-mirror IRC possession will be an estimate of the aggregate amount of the credits that would be allowed to the possession's residents if the credit provided by the proposal to U.S. residents were provided by the possession to its residents. This payment will not be made to any U.S. possession unless that possession has a plan that has been approved by the Secretary under which the possession will promptly distribute the payment to its residents.

[37] The credit for certain government employees is available for 2009. The credit is $250 ($500 for a joint return where both spouses are eligible individuals). An eligible individual for these purposes is an individual: (1) who receives an amount as a pension or annuity for service performed in the employ of the United States or any state or any instrumentality thereof, which is not considered employment for purpose of Social Security taxes, and (2) who does not receive an economic recovery payment under the Veterans Administration, Railroad Retirement Board or the Social Administration.

[38] Possessions with mirror code tax systems are the United States Virgin Islands, Guam, and the Commonwealth of the Northern Mariana Islands.

[39] Possessions that do not have mirror code tax systems are Puerto Rico and American Samoa.

General rules

No credit against U.S. income taxes is permitted under the proposal for any person to whom a credit is allowed against possession income taxes as a result of the proposal (for example, under that possession's mirror income tax). Similarly, no credit against U.S. income taxes is permitted for any person who is eligible for a payment under a non-mirror code possession's plan for distributing to its residents the payment described above from the U.S. Treasury.

For purposes of the payments to the possessions, the Commonwealth of Puerto Rico and the Commonwealth of the Northern Mariana Islands are considered possessions of the United States.

For purposes of the rule permitting the Treasury Secretary to disburse appropriated amounts for refunds due from certain credit proposals of the IRC, the payments required to be made to possessions under the provision are treated in the same manner as a refund due from the credit allowed under the provision.

Federal programs or federally-assisted programs

Any credit or refund allowed or made to an individual under this proposal (including to any resident of a U.S. possession) is not taken into account as income and shall not be taken into account as resources for the month of receipt and the following two months for purposes of determining eligibility of such individual or any other individual for benefits or assistance, or the amount or extent of benefits or assistance, under any federal program or under any state or local program financed in whole or in part with federal funds.

Income tax withholding

Taxpayers' reduced tax liabilities under the provision are implemented through revised income tax withholding schedules produced by the Internal Revenue Service. These revised income tax withholding schedules are designed to reduce taxpayers' income tax withheld for the remainder of 2009 in such a manner that the full annual benefit of the provision is reflected in income tax withheld during the remainder of 2009.

Effective Date

The provision applies to taxable years beginning after December 31, 2008.

California Law (None)

California has no comparable credit.

Impact on California Revenue

Not applicable.

Section	Section Title
1002	Temporary Increase in Earned Income Tax Credit

Background

Low- and moderate-income workers may be eligible for the refundable earned income tax credit (EITC). Eligibility for the EITC is based on earned income, adjusted gross income, investment income, filing status, and immigration and work status in the United States. The amount of the EITC is based on the presence and number of qualifying children in the worker's family, as well as on adjusted gross income and earned income.

The EITC generally equals a specified percentage of earned income[40] up to a maximum dollar amount. The maximum amount applies over a certain income range and then diminishes to zero over a specified phaseout range. For taxpayers with earned income (or adjusted gross income (AGI), if greater) in excess of the beginning of the phaseout range, the maximum EITC amount is reduced by the phaseout rate multiplied by the amount of earned income (or AGI, if greater) in excess of the beginning of the phaseout range. For taxpayers with earned income (or AGI, if greater) in excess of the end of the phaseout range, no credit is allowed.

An individual is not eligible for the EITC if the aggregate amount of disqualified income of the taxpayer for the taxable year exceeds $3,100 (for 2009). This threshold is indexed for inflation. Disqualified income is the sum of: (1) interest (taxable and tax exempt); (2) dividends; (3) net rent and royalty income (if greater than zero); (4) capital gains net income; and (5) net passive income (if greater than zero) that is not self-employment income.

The EITC is a refundable credit, meaning that if the amount of the credit exceeds the taxpayer's federal income tax liability, the excess is payable to the taxpayer as a direct transfer payment. Under an advance payment system, eligible taxpayers may elect to receive the credit in their paychecks, rather than waiting to claim a refund on their tax return filed by April 15 of the following year.

Filing status

An unmarried individual may claim the EITC if he or she files as a single filer or as a head of household. Married individuals generally may not claim the EITC unless they file jointly. An exception to the joint-return filing requirement applies to certain spouses who are separated. Under this exception, a married taxpayer who is separated from his or her spouse for the last six months of the taxable year shall not be considered as married (and, accordingly, may file a return as head of household and claim the EITC), provided that the taxpayer maintains a household that constitutes the principal place of abode for a dependent child (including a son, stepson, daughter,

[40] Earned income is defined as (1) wages, salaries, tips, and other employee compensation, but only if such amounts are includible in gross income, plus (2) the amount of the individual's net self-employment earnings.

stepdaughter, adopted child, or a foster child) for over half the taxable year,[41] and pays over half the cost of maintaining the household in which he or she resides with the child during the year.

Presence of qualifying children and amount of the EITC

Three separate credit schedules apply: one schedule for taxpayers with no qualifying children, one schedule for taxpayers with one qualifying child, and one schedule for taxpayers with more than one qualifying child.[42]

Taxpayers with no qualifying children may claim a credit if they are over age 24 and below age 65. The credit is 7.65 percent of earnings up to $5,970, resulting in a maximum credit of $457, for 2009. The maximum is available for those with incomes between $5,970 and $7,470 ($10,590 if married filing jointly). The credit begins to phase down at a rate of 7.65 percent of earnings above $7,470 ($10,590 if married filing jointly) resulting in a $0 credit at $13,440 of earnings ($16,560 if married filing jointly).

Taxpayers with one qualifying child may claim a credit in 2009 of 34 percent of their earnings up to $8,950, resulting in a maximum credit of $3,043. The maximum credit is available for those with earnings between $8,950 and $16,420 ($19,540 if married filing jointly). The credit begins to phase down at a rate of 15.98 percent of earnings above $16,420 ($19,540 if married filing jointly). The credit is phased down to $0 at $35,463 of earnings ($38,583 if married filing jointly).

Taxpayers with more than one qualifying child may claim a credit in 2009 of 40 percent of earnings up to $12,570, resulting in a maximum credit of $5,028. The maximum credit is available for those with earnings between $12,570 and $16,420 ($19,540 if married filing jointly). The credit begins to phase down at a rate of 21.06 percent of earnings above $16,420 ($19,540 if married filing jointly). The credit is phased down to $0 at $40,295 of earnings ($43,415 if married filing jointly).

If more than one taxpayer lives with a qualifying child, only one of these taxpayers may claim the child for purposes of the EITC. If multiple eligible taxpayers actually claim the same qualifying child, then a tiebreaker rule determines which taxpayer is entitled to the EITC with respect to the qualifying child. Any eligible taxpayer with at least one qualifying child who does not claim the EITC with respect to qualifying children due to failure to meet certain identification requirements with respect to such children (i.e., providing the name, age and taxpayer identification number of each of such children) may not claim the EITC for taxpayers without qualifying children.

[41] A foster child must reside with the taxpayer for the entire taxable year.

[42] All income thresholds are indexed for inflation annually.

New Federal Law (IRC section 32)

Three or more qualifying children

The provision increases the EITC credit percentage for three or more qualifying children to 45 percent for 2009 and 2010. For example, taxpayers with three or more qualifying children may claim a credit in 2009 of 45 percent of earnings up to $12,570,[43] resulting in a maximum credit of $5,656.50.

Provide additional marriage penalty relief through higher threshold phase-out amounts for married couples filing joint returns

The provision increases the threshold phase-out amounts for married couples filing joint returns to $5,000[44] above the threshold phase-out amounts for singles, surviving spouses, and heads of households for 2009 and 2010. For example, in 2009 the maximum credit of $3,043 for one qualifying child is available for those with earnings between $8,950 and $16,420 ($21,420 if married filing jointly). The credit begins to phase down at a rate of 15.98 percent of earnings above $16,420 ($21,420 if married filing jointly). The credit is phased down to $0 at $35,463 of earnings ($40,463 if married filing jointly).

Effective Date

The provision is effective for taxable years beginning after December 31, 2008.

California Law (None)

California has no comparable credit.

Impact on California Revenue

Not applicable.

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[43] All income thresholds are indexed for inflation annually.

[44] All income thresholds are indexed for inflation annually.

Section	Section Title
1003	Temporary Increase of Refundable Portion of Child Credit

Background

An individual may claim a tax credit for each qualifying child under the age of 17. The amount of the credit per child is $1,000 through 2010, and $500 thereafter. A child who is not a citizen, national, or resident of the United States cannot be a qualifying child.

The credit is phased out for individuals with income over certain threshold amounts. Specifically, the otherwise allowable child tax credit is reduced by $50 for each $1,000 (or fraction thereof) of modified adjusted gross income over $75,000 for single individuals or heads of households, $110,000 for married individuals filing joint returns, and $55,000 for married individuals filing separate returns. For purposes of this limitation, modified adjusted gross income includes certain otherwise excludable income earned by U.S. citizens or residents living abroad or in certain U.S. territories.

The credit is allowable against the regular tax and the alternative minimum tax. To the extent the child credit exceeds the taxpayer's tax liability, the taxpayer is eligible for a refundable credit (the additional child tax credit) equal to 15 percent of earned income in excess of a threshold dollar amount (the "earned income" formula). The threshold dollar amount is $12,550 (for 2009), and is indexed for inflation.

Families with three or more children may determine the additional child tax credit using the "alternative formula," if this results in a larger credit than determined under the earned income formula. Under the alternative formula, the additional child tax credit equals the amount by which the taxpayer's social security taxes exceed the taxpayer's earned income tax credit (EITC).

Earned income is defined as the sum of wages, salaries, tips, and other taxable employee compensation plus net self-employment earnings. Unlike the EITC, which also includes the preceding items in its definition of earned income, the additional child tax credit is based only on earned income to the extent it is included in computing taxable income. For example, some ministers' parsonage allowances are considered self-employment income, and thus are considered earned income for purposes of computing the EITC, but the allowances are excluded from gross income for individual income tax purposes, and thus are not considered earned income for purposes of the additional child tax credit since the income is not included in taxable income.

Any credit or refund allowed or made to an individual under this proposal (including to any resident of a U.S. possession) is not taken into account as income and shall not be taken into account as resources for the month of receipt and the following two months for purposes of determining eligibility of such individual or any other individual for benefits or assistance, or the amount or extent of benefits or assistance, under any federal program or under any state or local program financed in whole or in part with federal funds.

New Federal Law (IRC section 24)

The provision modifies the earned income formula for the determination of the refundable child credit to apply to 15 percent of earned income in excess of $3,000 for taxable years beginning in 2009 and 2010.

Effective Date

The provision is effective for taxable years beginning after December 31, 2008.

California Law (None)

California has no comparable credit.

Impact on California Revenue

Not applicable.

Section	Section Title
1004	American Opportunity Tax Credit

Background

Individual taxpayers are allowed to claim a nonrefundable credit, the Hope credit, against federal income taxes of up to $1,800 (for 2009) per eligible student per year for qualified tuition and related expenses paid for the first two years of the student's post-secondary education in a degree or certificate program.[45] The Hope credit rate is 100 percent on the first $1,200 of qualified tuition and related expenses, and 50 percent on the next $1,200 of qualified tuition and related expenses; these dollar amounts are indexed for inflation, with the amount rounded down to the next lowest multiple of $100. Thus, for example, a taxpayer who incurs $1,200 of qualified tuition and related expenses for an eligible student is eligible (subject to the adjusted gross income phaseout described below) for a $1,200 Hope credit. If a taxpayer incurs $2,400 of qualified tuition and related expenses for an eligible student, then he or she is eligible for a $1,800 Hope credit.

The Hope credit that a taxpayer may otherwise claim is phased out ratably for taxpayers with modified adjusted gross income between $50,000 and $60,000 ($100,000 and $120,000 for

[45] IRC section 25A. The Hope credit generally may not be claimed against a taxpayer's alternative minimum tax liability. However, the credit may be claimed against a taxpayer's alternative minimum tax liability for taxable years beginning prior to January 1, 2009.

married taxpayers filing a joint return) for 2009. The adjusted gross income phaseout ranges are indexed for inflation, with the amount rounded down to the next lowest multiple of $1,000.

The qualified tuition and related expenses must be incurred on behalf of the taxpayer, the taxpayer's spouse, or a dependent of the taxpayer. The Hope credit is available with respect to an individual student for two taxable years, provided that the student has not completed the first two years of post-secondary education before the beginning of the second taxable year.

The Hope credit is available in the taxable year the expenses are paid, subject to the requirement that the education is furnished to the student during that year or during an academic period beginning during the first three months of the next taxable year. Qualified tuition and related expenses paid with the proceeds of a loan generally are eligible for the Hope credit. The repayment of a loan itself is not a qualified tuition or related expense.

A taxpayer may claim the Hope credit with respect to an eligible student who is not the taxpayer or the taxpayer's spouse (e.g., in cases in which the student is the taxpayer's child) only if the taxpayer claims the student as a dependent for the taxable year for which the credit is claimed. If a student is claimed as a dependent, the student is not entitled to claim a Hope credit for that taxable year on the student's own tax return. If a parent (or other taxpayer) claims a student as a dependent, any qualified tuition and related expenses paid by the student are treated as paid by the parent (or other taxpayer) for purposes of determining the amount of qualified tuition and related expenses paid by such parent (or other taxpayer) under the provision. In addition, for each taxable year, a taxpayer may elect either the Hope credit, the Lifetime Learning credit, or an above-the-line deduction for qualified tuition and related expenses with respect to an eligible student.

The Hope credit is available for "qualified tuition and related expenses," which include tuition and fees (excluding nonacademic fees) required to be paid to an eligible educational institution as a condition of enrollment or attendance of an eligible student at the institution. Charges and fees associated with meals, lodging, insurance, transportation, and similar personal, living, or family expenses are not eligible for the credit. The expenses of education involving sports, games, or hobbies are not qualified tuition and related expenses unless this education is part of the student's degree program.

Qualified tuition and related expenses generally include only out-of-pocket expenses. Qualified tuition and related expenses do not include expenses covered by employer-provided educational assistance and scholarships that are not required to be included in the gross income of either the student or the taxpayer claiming the credit. Thus, total qualified tuition and related expenses are reduced by any scholarship or fellowship grants excludable from gross income under IRC section 117 and any other tax-free educational benefits received by the student (or the taxpayer claiming the credit) during the taxable year. The Hope credit is not allowed with respect to any education expense for which a deduction is claimed under IRC section 162 or any other IRC section.

An eligible student for purposes of the Hope credit is an individual who is enrolled in a degree, certificate, or other program (including a program of study abroad approved for credit by the institution at which such student is enrolled) leading to a recognized educational credential at an eligible educational institution. The student must pursue a course of study on at least a halftime basis. A student is considered to pursue a course of study on at least a half-time basis if the student carries at least one half the normal full-time work load for the course of study the student is pursuing for at least one academic period that begins during the taxable year. To be eligible for the Hope credit, a student must not have been convicted of a federal or state felony consisting of the possession or distribution of a controlled substance.

Eligible educational institutions generally are accredited post-secondary educational institutions offering credit toward a bachelor's degree, an associate's degree, or another recognized post-secondary credential. Certain proprietary institutions and post-secondary vocational institutions also are eligible educational institutions. To qualify as an eligible educational institution, an institution must be eligible to participate in Department of Education student aid programs.

Effective for taxable years beginning after December 31, 2010, the changes to the Hope credit made by the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) no longer apply. The principal EGTRRA change scheduled to expire is the change that permitted a taxpayer to claim a Hope credit in the same year that he or she claimed an exclusion from a Coverdell education savings account. Thus, after 2010, a taxpayer cannot claim a Hope credit in the same year he or she claims an exclusion from a Coverdell education savings account.

New Federal Law (IRC sections 24, 25, 25A, 25B, 26, 904,1400C, and 6211)

The provision modifies the Hope credit for taxable years beginning in 2009 or 2010. The modified credit is referred to as the American Opportunity Tax Credit. The allowable modified credit is up to $2,500 per eligible student per year for qualified tuition and related expenses paid for each of the first four years of the student's post-secondary education in a degree or certificate program. The modified credit rate is 100 percent on the first $2,000 of qualified tuition and related expenses, and 25 percent on the next $2,000 of qualified tuition and related expenses. For purposes of the modified credit, the definition of qualified tuition and related expenses is expanded to include course materials.

Under the provision, the modified credit is available with respect to an individual student for four years, provided that the student has not completed the first four years of post-secondary education before the beginning of the fourth taxable year. Thus, the modified credit, in addition to other modifications, extends the application of the Hope credit to two more years of postsecondary education.

The modified credit that a taxpayer may otherwise claim is phased out ratably for taxpayers with modified adjusted gross income between $80,000 and $90,000 ($160,000 and $180,000 for married taxpayers filing a joint return). The modified credit may be claimed against a taxpayer's alternative minimum tax liability.

Forty percent of a taxpayer's otherwise allowable modified credit is refundable. However, no portion of the modified credit is refundable if the taxpayer claiming the credit is a child to whom IRC section 1(g) applies for such taxable year (generally, any child under age 18 or any child under age 24 who is a student providing less than one-half of his or her own support, who has at least one living parent and does not file a joint return).

In addition, the provision requires the Secretary of the Treasury to conduct two studies and submit a report to Congress on the results of those studies within one year after the date of enactment. The first study shall examine how to coordinate the Hope and Lifetime Learning credits with the Pell grant program. The second study shall examine requiring students to perform community service as a condition of taking their tuition and related expenses into account for purposes of the Hope and Lifetime Learning credits.

Under the provision, bona fide residents of the U.S. possessions (American Samoa, Commonwealth of the Northern Mariana Islands, Commonwealth of Puerto Rico, Guam, Virgin Islands) are not permitted to claim the refundable portion of the American opportunity credit in the United States. Rather, a bona fide resident of a mirror code possession (Commonwealth of the Northern Mariana Islands, Guam, Virgin Islands) may claim the refundable portion of the credit in the possession in which the individual is a resident. Similarly, a bona fide resident of a non-mirror code possession (Commonwealth of Puerto Rico, American Samoa) may claim the refundable portion of the credit in the possession in which the individual is a resident, but only if that possession establishes a plan for permitting the claim under its internal law.

The provision provides that the U.S. Treasury will make payments to the possessions in respect of credits allowable to their residents under their internal laws. Specifically, the U.S. Treasury will make payments for to each mirror code possession in an amount equal to the aggregate amount of the refundable portion of the credits allowable by reason of the provision to that possession's residents against its income tax. This amount will be determined by the Treasury Secretary based on information provided by the government of the respective possession. To each possession that does not have a mirror code tax system, the U.S. Treasury will make two payments (for 2009 and 2010, respectively) in an amount estimated by the Secretary as being equal to the aggregate amount of the refundable portion of the credits that would have been allowed to residents of that possession if a mirror code tax system had been in effect in that possession. Accordingly, the amount of each payment to a non-mirror code possession will be an estimate of the aggregate amount of the refundable portion of the credits that would be allowed to the possession's residents if the credit provided by the provision to U.S. residents were provided by the possession to its residents. This payment will not be made to any U.S. possession unless that possession has a plan that has been approved by the Secretary under which the possession will promptly distribute the payment to its residents.

<u>Effective Date</u>

The provision is effective for taxable years beginning after December 31, 2008.

<u>California Law (None)</u>

California has no comparable credit.

Impact on California Revenue

Not applicable.

Section	Section Title
1005	Computer Technology and Equipment Allowed as a Qualified Higher Education Expenses for Section 529 Accounts in 2009 and 2010

IRC section 529 provides specified income tax and transfer tax rules for the treatment of accounts and contracts established under qualified tuition programs.[46] A qualified tuition program is a program established and maintained by a state or agency or instrumentality thereof, or by one or more eligible educational institutions, which satisfies certain requirements and under which a person may purchase tuition credits or certificates on behalf of a designated beneficiary that entitle the beneficiary to the waiver or payment of qualified higher education expenses of the beneficiary (a "prepaid tuition program"). In the case of a program established and maintained by a state or agency or instrumentality thereof, a qualified tuition program also includes a program under which a person may make contributions to an account that is established for the purpose of satisfying the qualified higher education expenses of the designated beneficiary of the account, provided it satisfies certain specified requirements (a "savings account program"). Under both types of qualified tuition programs, a contributor establishes an account for the benefit of a particular designated beneficiary to provide for that beneficiary's higher education expenses.

For this purpose, qualified higher education expenses means tuition, fees, books, supplies, and equipment required for the enrollment or attendance of a designated beneficiary at an eligible educational institution, and expenses for special needs services in the case of a special needs beneficiary that are incurred in connection with such enrollment or attendance. Qualified higher education expenses generally also include room and board for students who are enrolled at least half-time.

Contributions to a qualified tuition program must be made in cash. IRC section 529 does not impose a specific dollar limit on the amount of contributions, account balances, or prepaid tuition benefits relating to a qualified tuition account; however, the program is required to have adequate safeguards to prevent contributions in excess of amounts necessary to provide for the beneficiary's qualified higher education expenses. Contributions generally are treated as a completed gift eligible for the gift tax annual exclusion. Contributions are not tax deductible for federal income tax purposes, although they may be deductible for state income tax purposes. Amounts in the account accumulate on a tax-free basis (i.e., income on accounts in the plan is not subject to current income tax).

[46] For purposes of this description, the term "account" is used interchangeably to refer to a prepaid tuition benefit contract or a tuition savings account established pursuant to a qualified tuition program.

Distributions from a qualified tuition program are excludable from the distributee's gross income to the extent that the total distribution does not exceed the qualified higher education expenses incurred for the beneficiary. If a distribution from a qualified tuition program exceeds the qualified higher education expenses incurred for the beneficiary, the portion of the excess that is treated as earnings generally is subject to income tax and an additional 10-percent tax. Amounts in a qualified tuition program may be rolled over to another qualified tuition program for the same beneficiary or for a member of the family of that beneficiary.

In general, prepaid tuition contracts and tuition savings accounts established under a qualified tuition program involve prepayments or contributions made by one or more individuals for the benefit of a designated beneficiary, with decisions with respect to the contract or account to be made by an individual who is not the designated beneficiary. Qualified tuition accounts or contracts generally require the designation of a person (generally referred to as an "account owner") whom the program administrator (oftentimes a third-party administrator retained by the state or by the educational institution that established the program) may look to for decisions, recordkeeping, and reporting with respect to the account established for a designated beneficiary. The person or persons who make the contributions to the account need not be the same person who is regarded as the account owner for purposes of administering the account. Under many qualified tuition programs, the account owner generally has control over the account or contract, including the ability to change designated beneficiaries and to withdraw funds at any time and for any purpose. Thus, in practice, qualified tuition accounts or contracts generally involve a contributor, a designated beneficiary, an account owner (who oftentimes is not the contributor or the designated beneficiary), and an administrator of the account or contract.[47]

New Federal Law (IRC section 529)

The provision expands the definition of qualified higher education expenses for taxable years beginning in 2009 and 2010 to include expenses for computer technology and equipment.

Effective Date

The provision is effective for expenses paid or incurred after December 31, 2008.

California Law (R&TC sections 17140, 17140.3, 23711, 23711.5, and 24306)

California law conforms by reference to IRC section 529, relating to qualified tuition programs, as of the "specified date" of January 1, 2005, with modifications. Because this federal change was made after the "specified date" of January 1, 2005, California is not conformed.

[47] IRC section 529 refers to contributors and designated beneficiaries, but does not define or otherwise refer to the term account owner, which is a commonly used term among qualified tuition program.

Impact on California Revenue

Estimated Revenue Impact of Computer Technology and Equipment Allowed as Higher Education Expense for Section 529 Accounts in 2009 and 2010 For Taxable Years Beginning On or After January 1, 2010 Enactment Assumed After June 30, 2010		
2010-11	2011-12	2012-13
- $20,000	$0	$0

Estimates are based on a proration of federal projections developed for ARRA. The provision would sunset on January 1, 2011.

Section	Section Title
1006	Extension of and Increase in First-Time Homebuyer Credit; Waiver of Requirement to Repay

Background

A taxpayer who is a first-time homebuyer is allowed a refundable tax credit equal to the lesser of $7,500 ($3,750 for a married individual filing separately) or 10 percent of the purchase price of a principal residence. The credit is allowed for the tax year in which the taxpayer purchases the home unless the taxpayer makes an election as described below. The credit is allowed for qualifying home purchases on or after April 9, 2008 and before July 1, 2009 (without regard to whether there was a binding contract to purchase prior to April 9, 2008).

The credit phases out for individual taxpayers with modified adjusted gross income between $75,000 and $95,000 ($150,000-$170,000 for joint filers) for the year of purchase.

A taxpayer is considered a first-time homebuyer if such individual had no ownership interest in a principal residence in the United States during the 3-year period prior to the purchase of the home to which the credit applies.

No credit is allowed if the D.C. homebuyer credit is allowable for the taxable year the residence is purchased or a prior taxable year. A taxpayer is not permitted to claim the credit if the taxpayer's financing is from tax-exempt mortgage revenue bonds, if the taxpayer is a nonresident alien, or if the taxpayer disposes of the residence (or it ceases to be a principal residence) before the close of a taxable year for which a credit otherwise would be allowable.

The credit is recaptured ratably over fifteen years with no interest charge beginning in the second taxable year after the taxable year in which the home is purchased. For example, if the taxpayer purchases a home in 2008, the credit is allowed on the 2008 tax return, and repayments commence with the 2010 tax return. If the taxpayer sells the home (or the home ceases to be used as the principal residence of the taxpayer or the taxpayer's spouse) prior to complete repayment of the credit, any remaining credit repayment amount is due on the tax return for the year in which the home is sold (or ceases to be used as the principal residence). However, the credit repayment amount may not exceed the amount of gain from the sale of the residence to an unrelated person. For this purpose, gain is determined by reducing the basis of the residence by the amount of the credit to the extent not previously recaptured. No amount is recaptured after the death of a taxpayer. In the case of an involuntary conversion of the home, recapture is not accelerated if a new principal residence is acquired within a two-year period. In the case of a transfer of the residence to a spouse or to a former spouse incident to divorce, the transferee spouse (and not the transferor spouse) will be responsible for any future recapture.

An election is provided to treat a home purchased in the eligible period in 2009 as if purchased on December 31, 2008 for purposes of claiming the credit on the 2008 tax return and for establishing the beginning of the recapture period. Taxpayers may amend their returns for this purpose.

<u>New Federal Law (IRC sections 36 and 1400C)</u>

The provision extends the existing homebuyer credit for qualifying home purchases before December 1, 2009. In addition, it increases the maximum credit amount to $8,000 ($4,000 for a married individual filing separately) and waives the recapture of the credit for qualifying home purchases after December 31, 2008, and before December 1, 2009. This waiver of recapture applies without regard to whether the taxpayer elects to treat the purchase in 2009 as occurring on December 31, 2008. If the taxpayer disposes of the home or the home otherwise ceases to be the principal residence of the taxpayer within 36 months from the date of purchase, the present-law rules for recapture of the credit will apply.

The provision modifies the coordination with the first-time homebuyer credit for residents of the District of Columbia under IRC section 1400C. No credit under IRC section 1400C shall be allowed to any taxpayer with respect to the purchase of a residence during 2009 if a credit under IRC section 36 is allowable to such taxpayer (or the taxpayer's spouse) with respect to such purchase. Taxpayers thus qualify for the more generous national first-time homebuyer credit rather than the D.C. homebuyer credit for qualifying purchases in 2009. No credit under IRC section 36 is allowed for a taxpayer who claimed the D.C. homebuyer credit in any prior taxable year.

The provision removes the prohibition on claiming the credit if the residence is financed by the proceeds of a mortgage revenue bond, a qualified mortgage issue the interest on which is exempt from tax under IRC section 103.

<u>Effective Date</u>

The provision applies to residences purchased after December 31, 2008.

California Law (R&TC section 17059)

California does not conform to the federal first-time homebuyer credit. However, California provides a state credit for the purchase of a principal residence that has never been previously occupied. The credit is equal to the lesser of 5 percent of the purchase price of the principal residence or $10,000, and applies to homes purchased after February 28, 2009, and before March 1, 2010.

The credit must be claimed on a timely filed original return. The total credit allowable is limited to $100 million. Upon receipt of certification from the seller, the credit was allocated by the FTB allocated on a first-come, first-serve basis. As of July 2, 2009, the FTB received over 12,000 applications, an amount determined to be more than enough to allocate the full $100 million of credit. The determination by the FTB with respect to the date a certification was received, and whether a return has been timely filed, may not be reviewed in any administrative or judicial proceeding.

Qualified taxpayers may claim both the state and federal credits.

Impact on California Revenue

Not applicable.

Section	Section Title
1007	Suspension of Tax on Portion of Unemployment Compensation

Background

An individual must include in gross income any unemployment compensation benefits received under the laws of the United States or any state.

New Federal Law (IRC section 85)

The provision provides that up to $2,400 of unemployment compensation benefits received in 2009 are excluded from gross income by the recipient.

Effective Date

The provision is effective for taxable years beginning after December 31, 2008.

California Law (R&TC section 17083)

California specifically does not conform to IRC section 85, relating to unemployment compensation. For California purposes, unemployment compensation benefits are excluded from gross income.

Impact on California Revenue

Not applicable.

Section	Section Title
1008	Additional Deduction for State Sales Tax and Excise Tax on the Purchase of Certain Motor Vehicles

Background

In general, a deduction from gross income is allowed for certain taxes for the taxable year within which the taxes are paid or accrued. These include state and local, and foreign, real property taxes; state and local personal property taxes; state, local, and foreign income, war profits, and excess profit taxes; generation skipping transfer taxes; environmental taxes imposed by IRC section 59A; and taxes paid or accrued within the taxable year in carrying on a trade or business or an activity described in IRC section 212, relating to expenses for production of income. At the election of the taxpayer for the taxable year, a taxpayer may deduct state and local sales taxes in lieu of state and local income taxes. No deduction is allowed for any general sales tax imposed with respect to an item at a rate other than the general rate of tax, except in the case of a lower rate of tax applicable to items of food, clothing, medical supplies, and motor vehicles. In the case of motor vehicles, if the rate of tax exceeds the general rate, such excess shall be disregarded and the general rate shall be treated as the rate of tax.

New Federal Law (IRC sections 56, 63, and 164)

The provision provides a deduction for qualified motor vehicle taxes. It expands the definition of taxes allowed as a deduction to include qualified motor vehicle taxes paid or accrued within the taxable year. A taxpayer who itemizes and makes an election to deduct state and local sales taxes for qualified motor vehicles for the taxable year shall not be allowed the increased standard deduction for qualified motor vehicle taxes.

Qualified motor vehicle taxes include any state or local sales or excise tax imposed on the purchase of a qualified motor vehicle. A qualified motor vehicle means a passenger automobile, light truck, or motorcycle which has a gross vehicle weight rating of not more than 8,500 pounds, or a motor home acquired for use by the taxpayer after the date of enactment and before January 1, 2010, the original use of which commences with the taxpayer.

The deduction is limited to the tax on up to $49,500 of the purchase price of a qualified motor vehicle. The deduction is phased out for taxpayers with modified adjusted gross income between $125,000 and $135,000 ($250,000 and $260,000 in the case of a joint return).

Effective Date

The provision is effective for purchases on or after the date of enactment and before January 1, 2010.

California Law (R&TC sections 17220 and 24345)

California specifically does not conform to IRC section 164(b)(5), relating to the election to deduct state and local general sales or use taxes. The federal change does not apply to taxable years beginning on or after January 1, 2010.

Impact on California Revenue

Not applicable.

PART II of SUBTITLE A of TITLE I – ALTERNATIVE MINIMUM TAX RELIEF

Section	Section Title
1011	Extension of Alternative Minimum Tax Relief for Nonrefundable Personal Credits

Background

Present law provides for certain nonrefundable personal tax credits (i.e., the dependent care credit, the credit for the elderly and disabled, the adoption credit, the child credit, the credit for interest on certain home mortgages, the Hope Scholarship and Lifetime Learning credits, the credit for savers, the credit for certain nonbusiness energy property, the credit for residential energy efficient property, the credit for plug-in electric drive motor vehicles, and the D.C. first-time homebuyer credit).

For taxable years beginning before 2009, the nonrefundable personal credits are allowed to the extent of the full amount of the individual's regular tax and alternative minimum tax.

For taxable years beginning after 2008, the nonrefundable personal credits (other than the adoption credit, the child credit, the credit for savers, the credit for residential energy efficient property, and the credit for plug-in electric drive motor vehicles) are allowed only to the extent that the individual's regular income tax liability exceeds the individual's tentative minimum tax, determined without regard to the minimum tax foreign tax credit. The adoption credit, the child credit, the credit for savers, the credit for residential energy efficient property, and the credit for plug-in electric drive motor vehicles are allowed to the full extent of the individual's regular tax and alternative minimum tax.[48]

New Federal Law (IRC section 26)

For taxable years beginning in 2009, the provision allows an individual to offset the entire regular tax liability and alternative minimum tax liability by the nonrefundable personal credits.

Effective Date

The provision is effective for taxable years beginning in 2009.

California Law (R&TC section 17039)

California does not conform to the federal limitation on nonrefundable credits. Instead, California has stand-alone law that provides the allowable amount of an individual's state credits.

Impact on California Revenue

Not applicable.

Section	Section Title
1012	Extension of Increased Alternative Minimum Tax Exemption Amount

Background

Present law imposes an alternative minimum tax (AMT) on individuals. The AMT is the amount by which the tentative minimum tax exceeds the regular income tax. An individual's tentative minimum tax is the sum of (1) 26 percent of so much of the taxable excess as does not exceed $175,000 ($87,500 in the case of a married individual filing a separate return) and (2) 28 percent of the remaining taxable excess. The taxable excess is so much of the alternative minimum taxable income (AMTI) as exceeds the exemption amount. The maximum tax rates on net capital gain and dividends used in computing the regular tax are used in computing the tentative minimum tax. AMTI is the individual's taxable income adjusted to take account of specified preferences and adjustments.

The exemption amounts are: (1) $69,950 for taxable years beginning in 2008 and $45,000 in taxable years beginning after 2008 in the case of married individuals filing a joint return and surviving spouses; (2) $46,200 for taxable years beginning in 2008 and $33,750 in taxable years

[48] The rule applicable to the adoption credit and child credit is subject to the EGTRRA (Public Law 107-16) sunset.

beginning after 2008 in the case of other unmarried individuals; (3) $34,975 for taxable years beginning in 2008 and $22,500 in taxable years beginning after 2008 in the case of married individuals filing separate returns; and (4) $22,500 in the case of an estate or trust. The exemption amount is phased out by an amount equal to 25 percent of the amount by which the individual's AMTI exceeds (1) $150,000 in the case of married individuals filing a joint return and surviving spouses, (2) $112,500 in the case of other unmarried individuals, and (3) $75,000 in the case of married individuals filing separate returns or an estate or a trust. These amounts are not indexed for inflation.

New Federal Law (IRC section 55)

The provision provides that the individual AMT exemption amount for taxable years beginning in 2009 is $70,950, in the case of married individuals filing a joint return and surviving spouses; (2) $46,700 in the case of other unmarried individuals; and (3) $35,475 in the case of married individuals filing separate returns.

Effective Date

The provision is effective for taxable years beginning in 2009.

California Law (R&TC sections 17062, 17062.3, and 17062.5)

California law imposes an AMT. The AMT is the amount by which the tentative minimum tax (TMT) exceeds the regular income tax. An individual’s TMT is 7 percent of the amount by which AMTI exceeds the exemption amount. California conforms by reference to IRC sections 55 through 59, relating to the computation of TMT, as of the “specified date” of January 1, 2005, with significant modifications.

For taxable years beginning in 1998 and later, California specifically modifies IRC section 55(d)(1), relating to exemption amount, to provide its own AMT exemption and phase-out amounts that are indexed annually. For the 2009 taxable year, the exemption and phase-out amounts by filing status are as follows:

Filing Status	*Exemption Amount*	*Phase-out Amount*
Joint, or surviving spouse	$78,817	$295,564
Single, or unmarried	$59,114	$221,674
Separate, or an estate or trust	$39,407	$147,781

Impact on California Revenue

Not applicable.

PART I of SUBTITLE B of TITLE I – RENEWABLE ENERGY INCENTIVES

Section	Section Title
1101	Extension of Credit for Electricity Produced from Certain Renewable Resources

Background

In general

An income tax credit is allowed for the production of electricity from qualified energy resources at qualified facilities.[49] Qualified energy resources comprise wind, closed-loop biomass, open-loop biomass, geothermal energy, solar energy, small irrigation power, municipal solid waste, qualified hydropower production, and marine and hydrokinetic renewable energy. Qualified facilities are, generally, facilities that generate electricity using qualified energy resources. To be eligible for the credit, electricity produced from qualified energy resources at qualified facilities must be sold by the taxpayer to an unrelated person.

Credit amounts and credit period

In general

The base amount of the electricity production credit is 1.5 cents per kilowatt-hour (indexed annually for inflation) of electricity produced. The amount of the credit was 2.1 cents per kilowatt-hour for 2008. A taxpayer may generally claim a credit during the 10-year period commencing with the date the qualified facility is placed in service. The credit is reduced for grants, tax-exempt bonds, subsidized energy financing, and other credits.

Credit phaseout

The amount of credit a taxpayer may claim is phased out as the market price of electricity exceeds certain threshold levels. The electricity production credit is reduced over a 3-cent phaseout range to the extent the annual average contract price per kilowatt-hour of electricity sold in the prior year from the same qualified energy resource exceeds 8 cents (adjusted for inflation; 11.8 cents for 2008).

Reduced credit periods and credit amounts

Generally, in the case of open-loop biomass facilities (including agricultural livestock waste nutrient facilities), geothermal energy facilities, solar energy facilities, small irrigation power facilities, landfill gas facilities, and trash combustion facilities placed in service before August 8, 2005, the 10-year credit period is reduced to five years, commencing on the date the facility was originally placed in service. However, for qualified open-loop biomass facilities (other than a facility described in IRC section 45(d)(3)(A)(i) that uses agricultural livestock waste nutrients)

[49] IRC section 45. In addition to the electricity production credit, IRC section 45 also provides income tax credits for the production of Indian coal and refined coal at qualified facilities.

placed in service before October 22, 2004, the five-year period commences on January 1, 2005. In the case of a closed-loop biomass facility modified to co-fire with coal, to co-fire with other biomass, or to co-fire with coal and other biomass, the credit period begins no earlier than October 22, 2004.

In the case of open-loop biomass facilities (including agricultural livestock waste nutrient facilities), small irrigation power facilities, landfill gas facilities, trash combustion facilities, and qualified hydropower facilities the otherwise allowable credit amount is 0.75 cent per kilowatt-hour, indexed for inflation measured after 1992 (1 cent per kilowatt-hour for 2008).

Other limitations on credit claimants and credit amounts

In general, in order to claim the credit, a taxpayer must own the qualified facility and sell the electricity produced by the facility to an unrelated party. A lessee or operator may claim the credit in lieu of the owner of the qualifying facility in the case of qualifying open-loop biomass facilities and in the case of closed-loop biomass facilities modified to co-fire with coal, to co-fire with other biomass, or to co-fire with coal and other biomass. In the case of a poultry waste facility, the taxpayer may claim the credit as a lessee or operator of a facility owned by a governmental unit.

For all qualifying facilities, other than closed-loop biomass facilities modified to co-fire with coal, to co-fire with other biomass, or to co-fire with coal and other biomass, the amount of credit a taxpayer may claim is reduced by reason of grants, tax-exempt bonds, subsidized energy financing, and other credits, but the reduction cannot exceed 50 percent of the otherwise allowable credit. In the case of closed-loop biomass facilities modified to co-fire with coal, to co-fire with other biomass, or to co-fire with coal and other biomass, there is no reduction in credit by reason of grants, tax-exempt bonds, subsidized energy financing, and other credits.

The credit for electricity produced from renewable resources is a component of the general business credit.[50] Generally, the general business credit for any taxable year may not exceed the amount by which the taxpayer's net income tax exceeds the greater of the tentative minimum tax or 25 percent of so much of the net regular tax liability as exceeds $25,000. However, this limitation does not apply to IRC section 45 credits for electricity or refined coal produced from a facility (placed in service after October 22, 2004) during the first four years of production beginning on the date the facility is placed in service. [51] Excess credits may be carried back one year and forward up to 20 years.

[50] IRC section 38(b)(8).

[51] IRC section 38(c)(4)(B)(ii).

Qualified facilities

Wind energy facility

A wind energy facility is a facility that uses wind to produce electricity. To be a qualified facility, a wind energy facility must be placed in service after December 31, 1993, and before January 1, 2010.

Closed-loop biomass facility

A closed-loop biomass facility is a facility that uses any organic material from a plant which is planted exclusively for the purpose of being used at a qualifying facility to produce electricity. In addition, a facility can be a closed-loop biomass facility if it is a facility that is modified to use closed-loop biomass to co-fire with coal, with other biomass, or with both coal and other biomass, but only if the modification is approved under the Biomass Power for Rural Development Programs or is part of a pilot project of the Commodity Credit Corporation.

To be a qualified facility, a closed-loop biomass facility must be placed in service after December 31, 1992, and before January 1, 2011. In the case of a facility using closed-loop biomass but also co-firing the closed-loop biomass with coal, other biomass, or coal and other biomass, a qualified facility must be originally placed in service and modified to co-fire the closed-loop biomass at any time before January 1, 2011.

A qualified facility includes a new power generation unit placed in service after October 3, 2008, at an existing closed-loop biomass facility, but only to the extent of the increased amount of electricity produced at the existing facility by reason of such new unit.

Open-loop biomass (including agricultural livestock waste nutrients) facility

An open-loop biomass facility is a facility that uses open-loop biomass to produce electricity. For purposes of the credit, open-loop biomass is defined as (1) any agricultural livestock waste nutrients or (2) any solid, nonhazardous, cellulosic waste material or any lignin material that is segregated from other waste materials and which is derived from:

- Forest-related resources, including mill and harvesting residues, precommercial thinnings, slash, and brush;
- Solid wood waste materials, including waste pallets, crates, dunnage, manufacturing and construction wood wastes, and landscape or right-of-way tree trimmings; or
- Agricultural sources, including orchard tree crops, vineyard, grain, legumes, sugar, and other crop by-products or residues.

Agricultural livestock waste nutrients are defined as agricultural livestock manure and litter, including bedding material for the disposition of manure. Wood waste materials do not qualify as open-loop biomass to the extent they are pressure treated, chemically treated, or painted. In addition, municipal solid waste, gas derived from the biodegradation of solid waste, and paper which is commonly recycled do not qualify as open-loop biomass. Open-loop biomass does not include closed-loop biomass or any biomass burned in conjunction with fossil fuel (co-firing) beyond such fossil fuel required for start up and flame stabilization.

In the case of an open-loop biomass facility that uses agricultural livestock waste nutrients, a qualified facility is one that was originally placed in service after October 22, 2004, and before January 1, 2009, and has a nameplate capacity rating which is not less than 150 kilowatts. In the case of any other open-loop biomass facility, a qualified facility is one that was originally placed in service before January 1, 2011. A qualified facility includes a new power generation unit placed in service after October 3, 2008, at an existing open-loop biomass facility, but only to the extent of the increased amount of electricity produced at the existing facility by reason of such new unit.

Geothermal facility

A geothermal facility is a facility that uses geothermal energy to produce electricity. Geothermal energy is energy derived from a geothermal deposit that is a geothermal reservoir consisting of natural heat that is stored in rocks or in an aqueous liquid or vapor (whether or not under pressure). To be a qualified facility, a geothermal facility must be placed in service after October 22, 2004, and before January 1, 2011.

Solar facility

A solar facility is a facility that uses solar energy to produce electricity. To be a qualified facility, a solar facility must be placed in service after October 22, 2004, and before January 1, 2006.

Small irrigation facility

A small irrigation power facility is a facility that generates electric power through an irrigation system canal or ditch without any dam or impoundment of water. The installed capacity of a qualified facility must be at least 150 kilowatts but less than five megawatts. To be a qualified facility, a small irrigation facility must be originally placed in service after October 22, 2004, and before October 3, 2008. Marine and hydrokinetic renewable energy facilities, described below, subsume small irrigation power facilities after October 2, 2008.

Landfill gas facility

A landfill gas facility is a facility that uses landfill gas to produce electricity. Landfill gas is defined as methane gas derived from the biodegradation of municipal solid waste. To be a qualified facility, a landfill gas facility must be placed in service after October 22, 2004, and before January 1, 2011.

Trash combustion facility

Trash combustion facilities are facilities that use municipal solid waste (garbage) to produce steam to drive a turbine for the production of electricity. To be a qualified facility, a trash combustion facility must be placed in service after October 22, 2004, and before

January 1, 2011. A qualified trash combustion facility includes a new unit, placed in service after October 22, 2004, that increases electricity production capacity at an existing trash combustion facility. A new unit generally would include a new burner/boiler and turbine. The new unit may share certain common equipment, such as trash handling equipment, with other pre-existing units at the same facility. Electricity produced at a new unit of an existing facility qualifies for the production credit only to the extent of the increased amount of electricity produced at the entire facility.

Hydropower facility

A qualifying hydropower facility is (1) a facility that produced hydroelectric power (a hydroelectric dam) prior to August 8, 2005, at which efficiency improvements or additions to capacity have been made after such date and before January 1, 2011, that enable the taxpayer to produce incremental hydropower or (2) a facility placed in service before August 8, 2005, that did not produce hydroelectric power (a nonhydroelectric dam) on such date, and to which turbines or other electricity generating equipment have been added after such date and before January 1, 2011.

At an existing hydroelectric facility, the taxpayer may claim credit only for the production of incremental hydroelectric power. Incremental hydroelectric power for any taxable year is equal to the percentage of average annual hydroelectric power produced at the facility attributable to the efficiency improvement or additions of capacity determined by using the same water flow information used to determine an historic average annual hydroelectric power production baseline for that facility. The Federal Energy Regulatory Commission will certify the baseline power production of the facility and the percentage increase due to the efficiency and capacity improvements.

Nonhydroelectric dams converted to produce electricity must be licensed by the Federal Energy Regulatory Commission and meet all other applicable environmental, licensing, and regulatory requirements.

For a nonhydroelectric dam converted to produce electric power before January 1, 2009, there must not be any enlargement of the diversion structure, construction or enlargement of a bypass channel, or the impoundment or any withholding of additional water from the natural stream channel.

For a nonhydroelectric dam converted to produce electric power after December 31, 2008, the nonhydroelectric dam (1) must have been placed in service before October 3, 2008, (2) must have been operated for flood control, navigation, or water supply purposes and (3) must not have produced hydroelectric power on October 3, 2008. In addition, the hydroelectric project must be operated so that the water surface elevation at any given location and time that would have occurred in the absence of the hydroelectric project is maintained, subject to any license requirements imposed under applicable law that change the water surface elevation for the purpose of improving environmental quality of the affected waterway. The Secretary, in consultation with the Federal Energy Regulatory Commission, shall certify if a hydroelectric project licensed at a nonhydroelectric dam meets the criteria.

Marine and hydrokinetic renewable energy facility

A qualified marine and hydrokinetic renewable energy facility is any facility that produces electric power from marine and hydrokinetic renewable energy, has a nameplate capacity rating of at least 150 kilowatts, and is placed in service after October 2, 2008, and before January 1, 2012. Marine and hydrokinetic renewable energy is defined as energy derived from (1) waves, tides, and currents in oceans, estuaries, and tidal areas; (2) free flowing water in rivers, lakes, and streams; (3) free flowing water in an irrigation system, canal, or other man-made channel, including projects that utilize nonmechanical structures to accelerate the flow of water for electric power production purposes; or (4) differentials in ocean temperature (ocean thermal energy conversion). The term does not include energy derived from any source that uses a dam, diversionary structure (except for irrigation systems, canals, and other man-made channels), or impoundment for electric power production.

Summary of credit rate and credit period by facility type

Table 1.–Summary of IRC section 45 Credit for Electricity Produced from Certain Renewable Resources

Eligible electricity production activity	Credit amount for 2008 (cents per kilowatt-hour)	Credit period for facilities placed in service on or before August 8, 2005 (years from placed-in-service date)	Credit period for facilities placed in service after August 8, 2005 (years from placed-in-service date)
Wind	2.1	10	10
Closed-loop biomass	2.1	10[1]	10
Open-loop biomass (including agricultural livestock waste nutrient facilities)	1.0	5[2]	10
Geothermal	2.1	5	10
Solar (pre-2006 facilities only)	2.1	5	10
Small irrigation power	1.0	5	10
Municipal solid waste (including landfill gas facilities and trash combustion facilities)	1.0	5	10
Qualified hydropower	1.0	N/A	10
Marine and hydrokinetic	1.0	N/A	10

[1] In the case of certain co-firing closed-loop facilities, the credit period begins no earlier than October 22, 2004.
[2] For certain facilities placed in service before October 22, 2004, the five-year credit period commences on January 1, 2005.

Taxation of cooperatives and their patrons

For federal income tax purposes, a cooperative generally computes its income as if it were a taxable corporation, with one exception: the cooperative may exclude from its taxable income distributions of patronage dividends. Generally, a cooperative that is subject to the cooperative tax rules of subchapter T of the IRC[52] is permitted a deduction for patronage dividends paid only to the extent of net income that is derived from transactions with patrons who are members of the cooperative.[53] The availability of such deductions from taxable income has the effect of allowing the cooperative to be treated like a conduit with respect to profits derived from transactions with patrons who are members of the cooperative.

Eligible cooperatives may elect to pass any portion of the credit through to their patrons. An eligible cooperative is defined as a cooperative organization that is owned more than 50 percent by agricultural producers or entities owned by agricultural producers. The credit may be apportioned among patrons eligible to share in patronage dividends on the basis of the quantity or value of business done with or for such patrons for the taxable year. The election must be made on a timely filed return for the taxable year and, once made, is irrevocable for such taxable year.

New Federal Law (IRC section 45)

The provision extends for three years (generally, through 2013; through 2012 for wind facilities) the period during which qualified facilities producing electricity from wind, closed-loop biomass, open-loop biomass, geothermal energy, municipal solid waste, and qualified hydropower may be placed in service for purposes of the electricity production credit. The provision extends for two years (through 2013) the placed-in-service period for marine and hydrokinetic renewable energy resources.

The provision also makes a technical amendment to the definition of small irrigation power facility to clarify its integration into the definition marine and hydrokinetic renewable energy facility.

Effective Date

The extension of the electricity production credit is effective for property placed in service after the date of enactment. The technical amendment is effective as if included in section 102 of the Energy Improvement and Extension Act of 2008.

California Law (None)

California has no comparable credit.

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[52] IRC sections 1381 – 1383.

[53] IRC section 1382.

Impact on California Revenue

Not applicable.

Section	Section Title
1102	Election of Investment Credit in Lieu of Production Credit

Background

Renewable electricity credit

An income tax credit is allowed for the production of electricity from qualified energy resources at qualified facilities.[54] Qualified energy resources comprise wind, closed-loop biomass, open-loop biomass, geothermal energy, solar energy, small irrigation power, municipal solid waste, qualified hydropower production, and marine and hydrokinetic renewable energy. Qualified facilities are, generally, facilities that generate electricity using qualified energy resources. To be eligible for the credit, electricity produced from qualified energy resources at qualified facilities must be sold by the taxpayer to an unrelated person.

Energy credit

An income tax credit is also allowed for certain energy property placed in service. Qualifying property includes certain fuel cell property, solar property, geothermal power production property, small wind energy property, combined heat and power system property, microturbine property, and geothermal heat pump property.[55]

New Federal Law (IRC section 48)

The provision allows the taxpayer to make an irrevocable election to have certain qualified facilities placed in service during the extension period of IRC section 45 (generally, through 2013; through 2012 for wind facilities) be treated as energy property eligible for a 30 percent investment credit under IRC section 48. For this purpose, qualified facilities are facilities otherwise eligible for the IRC section 45 production tax credit (other than refined coal, Indian coal, and solar facilities) with respect to which no credit under IRC section 45 has been allowed. A taxpayer electing to treat a facility as energy property may not claim the production credit under IRC section 45.

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[54] IRC section 45. In addition to the electricity production credit, IRC section 45 also provides income tax credits for the production of Indian coal and refined coal at qualified facilities.

[55] IRC section 48.

Property eligible for the credit is tangible personal or other tangible property (not including a building or its structural components), and with respect to which depreciation or amortization is allowable but only if such property is used as an integral part of the qualified facility. For example, in the case of a wind facility, only property eligible for five-year depreciation under IRC section 168(e)(3)(b)(vi) is treated as credit-eligible energy property under the election.

Effective Date

The provision applies to facilities placed in service after December 31, 2008.

California Law (None)

California has no comparable energy investment or production credit.

Impact on California Revenue

Not applicable.

Section	Section Title
1103	Repeal of Certain Limitations on Credit for Renewable Energy Property

Background

In general

A nonrefundable, 10-percent business energy credit[56] is allowed for the cost of new property that is equipment that either (1) uses solar energy to generate electricity, to heat or cool a structure, or to provide solar process heat, or (2) is used to produce, distribute, or use energy derived from a geothermal deposit, but only, in the case of electricity generated by geothermal power, up to the electric transmission stage. Property used to generate energy for the purposes of heating a swimming pool is not eligible solar energy property.

The energy credit is a component of the general business credit.[57] An unused general business credit generally may be carried back one year and carried forward 20 years.[58] The taxpayer's basis in the property is reduced by one-half of the amount of the credit claimed. For projects whose construction time is expected to equal or exceed two years, the credit may be claimed as

[56] IRC section 48.

[57] IRC section 38(b)(1).

[58] IRC section 39.

progress expenditures are made on the project, rather than during the year the property is placed in service. The credit is allowed against the alternative minimum tax for credits determined in taxable years beginning after October 3, 2008.

Property financed by subsidized energy financing or with proceeds from private activity bonds is subject to a reduction in basis for purposes of claiming the credit. The basis reduction is proportional to the share of the basis of the property that is financed by the subsidized financing or proceeds. The term "subsidized energy financing" means financing provided under a federal, state, or local program a principal purpose of which is to provide subsidized financing for projects designed to conserve or produce energy.

Special rules for solar energy property

The credit for solar energy property is increased to 30 percent in the case of periods prior to January 1, 2017. Additionally, equipment that uses fiber-optic distributed sunlight to illuminate the inside of a structure is solar energy property eligible for the 30-percent credit.

Fuel cells and microturbines

The energy credit applies to qualified fuel cell power plants, but only for periods prior to January 1, 2017. The credit rate is 30 percent.

A qualified fuel cell power plant is an integrated system composed of a fuel cell stack assembly and associated balance of plant components that (1) converts a fuel into electricity using electrochemical means, and (2) has an electricity-only generation efficiency of greater than 30 percent and a capacity of at least one-half kilowatt. The credit may not exceed $1,500 for each 0.5 kilowatt of capacity.

The energy credit applies to qualifying stationary microturbine power plants for periods prior to January 1, 2017. The credit is limited to the lesser of 10 percent of the basis of the property or $200 for each kilowatt of capacity.

A qualified stationary microturbine power plant is an integrated system comprised of a gas turbine engine, a combustor, a recuperator or regenerator, a generator or alternator, and associated balance of plant components that converts a fuel into electricity and thermal energy. Such system also includes all secondary components located between the existing infrastructure for fuel delivery and the existing infrastructure for power distribution, including equipment and controls for meeting relevant power standards, such as voltage, frequency and power factors. Such system must have an electricity-only generation efficiency of not less than 26 percent at International Standard Organization conditions and a capacity of less than 2,000 kilowatts.

Geothermal heat pump property

The energy credit applies to qualified geothermal heat pump property placed in service prior to January 1, 2017. The credit rate is 10 percent. Qualified geothermal heat pump property is equipment that uses the ground or ground water as a thermal energy source to heat a structure or as a thermal energy sink to cool a structure.

Small wind property

The energy credit applies to qualified small wind energy property placed in service prior to January 1, 2017. The credit rate is 30 percent. The credit is limited to $4,000 per year with respect to all wind energy property of any taxpayer. Qualified small wind energy property is property that uses a qualified wind turbine to generate electricity. A qualifying wind turbine means a wind turbine of 100 kilowatts of rated capacity or less.

Combined heat and power property

The energy credit applies to combined heat and power ("CHP") property placed in service prior to January 1, 2017. The credit rate is 10 percent.

CHP property is property: (1) that uses the same energy source for the simultaneous or sequential generation of electrical power, mechanical shaft power, or both, in combination with the generation of steam or other forms of useful thermal energy (including heating and cooling applications); (2) that has an electrical capacity of not more than 50 megawatts or a mechanical energy capacity of no more than 67,000 horsepower or an equivalent combination of electrical and mechanical energy capacities; (3) that produces at least 20 percent of its total useful energy in the form of thermal energy that is not used to produce electrical or mechanical power, and produces at least 20 percent of its total useful energy in the form of electrical or mechanical power (or a combination thereof); and (4) the energy efficiency percentage of which exceeds 60 percent. CHP property does not include property used to transport the energy source to the generating facility or to distribute energy produced by the facility.

The otherwise allowable credit with respect to CHP property is reduced to the extent the property has an electrical capacity or mechanical capacity in excess of any applicable limits. Property in excess of the applicable limit (15 megawatts or a mechanical energy capacity of more than 20,000 horsepower or an equivalent combination of electrical and mechanical energy capacities) is permitted to claim a fraction of the otherwise allowable credit. The fraction is equal to the applicable limit divided by the capacity of the property. For example, a 45 megawatt property would be eligible to claim 15/45ths, or one third, of the otherwise allowable credit. Again, no credit is allowed if the property exceeds the 50 megawatt or 67,000 horsepower limitations described above.

Additionally, the proposal provides that systems whose fuel source is at least 90 percent open-loop biomass and that would qualify for the credit but for the failure to meet the efficiency standard are eligible for a credit that is reduced in proportion to the degree to which the system fails to meet the efficiency standard. For example, a system that would otherwise be required to meet the 60-percent efficiency standard, but which only achieves 30-percent efficiency, would be permitted a credit equal to one-half of the otherwise allowable credit (i.e., a 5-percent credit).

New Federal Law (IRC sections 25C, 25D, 48, 48A, and 48B)

The provision eliminates the credit caps applicable to qualified small wind energy property. The provision also removes the rule that reduces the basis of the property for purposes of claiming the credit if the property is financed in whole or in part by subsidized energy financing or with proceeds from private activity bonds.

Effective Date

The provision applies to periods after December 31, 2008, under rules similar to the rules of IRC section 48(m) (as in effect on the day before the enactment of the Revenue Reconciliation Act of 1990[59]).

California Law (None)

California has no comparable credit.

Impact on California Revenue

Not applicable.

Section	Section Title
1104	Coordination with Renewable Energy Grants

Background

Under Section 1603 of this Act, the Secretary of Treasury is authorized to provide a grant to each person who places in service during 2009 or 2010 energy property that is either (1) an electricity production facility otherwise eligible for the renewable electricity production credit or (2) qualifying property otherwise eligible for the energy credit. In general, the grant amount is 30 percent of the basis of the property that would (1) be eligible for the energy credit under IRC section 48 or (2) comprise an electricity production (IRC section 45) credit-eligible facility. For qualified microturbine, combined heat and power system, and geothermal heat pump property, the amount is 10 percent of the basis of the property.

Qualifying property must be depreciable or amortizable to be eligible for the grant.

Taxpayers are permitted to claim the credit with respect to otherwise eligible property that is not placed in service in 2009 and 2010 so long as construction begins in either of those years and is completed prior to 2013 (in the case of wind facility property), 2014 (in the case of other

[59] Public Law 101-508.

renewable power facility property eligible for credit under IRC section 45), or 2017 (in the case of any specified energy property described in IRC section 48).

No grant may be awarded to any federal, state, or local government (or any political subdivision, agency, or instrumentality thereof) or any IRC section 501(c) tax-exempt entity.

ARRA section 1603 appropriates to the Secretary of the Treasury the funds necessary to make the grants. No grant may be made unless the application for the grant has been received before October 1, 2011.

New Federal Law (IRC section 48)

This provision provides that the grant provision in Act section 1603 is intended to mimic the operation of the credit under IRC section 48. For example, the amount of the grant is not includable in gross income. However, the basis of the property is reduced by fifty percent of the amount of the grant. In addition, some or all of each grant is subject to recapture if the grant eligible property is disposed of by the grant recipient within five years of being placed in service.

Under the provision, if a grant is paid, no renewable electricity credit or energy credit may be claimed with respect to the grant eligible property.

Effective Date

The provision is effective on February 17, 2009.

California Law (None)

California has no comparable credit or grant.

The exclusion of the grant from federal income and the corresponding fifty percent basis reduction are provided under IRC section 48. California does not conform to IRC section 48; thus, the grant is included in California income and there is no California basis reduction.

Impact on California Revenue

Estimated Revenue Impact of Coordination with Renewable Energy Grants Enactment Assumed After June 30, 2010		
2010-11	2011-12	2012-13
- $36,000,000	-$23,000,000	-$16,000,000

PART II of SUBTITLE B of TITLE I – INCREASED ALLOCATIONS OF NEW CLEAN RENEWABLE ENERGY BONDS AND QUALIFIED ENERGY CONSERVATION BONDS

Section	Section Title
1111	Increased Limitation on Issuance of New Clean Renewable Energy Bonds

Background

New clean renewable energy bonds

New clean renewable energy bonds ("New CREBs") may be issued by qualified issuers to finance qualified renewable energy facilities. [60] Qualified renewable energy facilities are facilities: (1) that qualify for the tax credit under IRC section 45 (other than Indian coal and refined coal production facilities), without regard to the placed-in-service date requirements of that section; and (2) that are owned by a public power provider, governmental body, or cooperative electric company.

The term "qualified issuers" includes: (1) public power providers; (2) a governmental body; (3) cooperative electric companies; (4) a not-for-profit electric utility that has received a loan or guarantee under the Rural Electrification Act; and (5) clean renewable energy bond lenders. The term "public power provider" means a state utility with a service obligation, as such terms are defined in section 217 of the Federal Power Act (as in effect on February 17, 2009). A "governmental body" means any state or Indian tribal government, or any political subdivision thereof. The term "cooperative electric company" means a mutual or cooperative electric company (described in IRC section 501(c)(12) or IRC section 1381(a)(2)(C)). A clean renewable energy bond lender means a cooperative that is owned by, or has outstanding loans to, 100 or more cooperative electric companies and is in existence on February 1, 2002 (including any affiliated entity which is controlled by such lender).

There is a national limitation for New CREBs of $800 million. No more than one third of the national limit may be allocated to projects of public power providers, governmental bodies, or cooperative electric companies. Allocations to governmental bodies and cooperative electric companies may be made in the manner the Secretary determines appropriate. Allocations to projects of public power providers shall be made, to the extent practicable, in such manner that the amount allocated to each such project bears the same ratio to the cost of such project as the maximum allocation limitation to projects of public power providers bears to the cost of all such projects.

New CREBs are a type of qualified tax credit bond for purposes of IRC section 54A. As such, 100 percent of the available project proceeds of New CREBs must be used within the three-year period that begins on the date of issuance. Available project proceeds are proceeds from the sale of the bond issue less issuance costs (not to exceed two percent) and any investment earnings on such sale proceeds. To the extent less than 100 percent of the available project proceeds are used to finance qualified projects during the three-year spending period, bonds will continue to qualify as

[60] IRC section 54C.

New CREBs if unspent proceeds are used within 90 days from the end of such three-year period to redeem bonds. The three-year spending period may be extended by the Secretary upon the qualified issuer's request demonstrating that the failure to satisfy the three-year requirement is due to reasonable cause and the projects will continue to proceed with due diligence.

New CREBs generally are subject to the arbitrage requirements of IRC section 148. However, available project proceeds invested during the three-year spending period are not subject to the arbitrage restrictions (i.e., yield restriction and rebate requirements). In addition, amounts invested in a reserve fund are not subject to the arbitrage restrictions to the extent: (1) such fund is funded at a rate not more rapid than equal annual installments; (2) such fund is funded in a manner reasonably expected to result in an amount not greater than an amount necessary to repay the issue; and (3) the yield on such fund is not greater than the average annual interest rate of tax-exempt obligations having a term of 10 years or more that are issued during the month the New CREBs are issued.

As with other tax credit bonds, a taxpayer holding New CREBs on a credit allowance date is entitled to a tax credit. Unlike CREBs, however, the credit rate on New CREBs is set by the Secretary at a rate that is 70 percent of the rate that would permit issuance of such bonds without discount and interest cost to the issuer. The applicable credit rate for the bond is the rate that the Secretary estimates will permit the issuance of the qualified tax credit bond with a specified maturity or redemption date without discount and without interest cost to the qualified issuer.[61] The Secretary determines credit rates for tax credit bonds based on general assumptions about credit quality of the class of potential eligible issuers and such other factors as the Secretary deems appropriate. The Secretary may determine credit rates based on general credit market yield indexes and credit ratings.[62]

The amount of the tax credit is determined by multiplying the bond's credit rate by the face amount of the holder's bond. The credit accrues quarterly, is includible in gross income (as if it were an interest payment on the bond), and can be claimed against regular income tax liability and alternative minimum tax liability. Unused credits may be carried forward to succeeding taxable years. In addition, credits may be separated from the ownership of the underlying bond similar to how interest coupons can be stripped for interest-bearing bonds.

An issuer of New CREBs is treated as meeting the "prohibition on financial conflicts of interest" requirement in IRC section 54A(d)(6) if it certifies that it satisfies (i) applicable state and local law requirements governing conflicts of interest and (ii) any additional conflict of interest rules prescribed by the Secretary with respect to any federal, state, or local government official directly involved with the issuance of New CREBs.

[61] Given the differences in credit quality and other characteristics of individual issuers, the Secretary cannot set credit rates in a manner that will allow each issuer to issue tax credit bonds at par.

[62] I.R.B. 1 (January 22, 2009).

New Federal Law (IRC section 54C)

The provision expands the New CREBs program. The proposal authorizes issuance of up to an additional $1.6 billion of New CREBs.

Effective Date

The provision applies to bonds issued after February 17, 2009.

California Law (None)

California has no comparable tax credit bonds. The federal credit is not includable in income for California income tax purposes.

Impact on California Revenue

Not applicable.

Section	Section Title
1112	Increased Limitation on Issuance of Qualified Energy Conservation Bonds

Background

Qualified energy conservation bonds may be used to finance qualified conservation purposes

The term "qualified conservation purpose" means:

1. Capital expenditures incurred for purposes of reducing energy consumption in publicly owned buildings by at least 20 percent; implementing green community programs; rural development involving the production of electricity from renewable energy resources; or any facility eligible for the production tax credit under IRC section 45 (other than Indian coal and refined coal production facilities);
2. Expenditures with respect to facilities or grants that support research in: (a) development of cellulosic ethanol or other nonfossil fuels; (b) technologies for the capture and sequestration of carbon dioxide produced through the use of fossil fuels; (c) increasing the efficiency of existing technologies for producing nonfossil fuels; (d) automobile battery technologies and other technologies to reduce fossil fuel consumption in transportation; and (e) technologies to reduce energy use in buildings;
3. Mass commuting facilities and related facilities that reduce the consumption of energy, including expenditures to reduce pollution from vehicles used for mass commuting;

4. Demonstration projects designed to promote the commercialization of: (a) green building technology; (b) conversion of agricultural waste for use in the production of fuel or otherwise; (c) advanced battery manufacturing technologies; (d) technologies to reduce peak-use of electricity; and (e) technologies for the capture and sequestration of carbon dioxide emitted from combusting fossil fuels in order to produce electricity; and
5. Public education campaigns to promote energy efficiency (other than movies, concerts, and other events held primarily for entertainment purposes).

There is a national limitation on qualified energy conservation bonds of $800 million. Allocations of qualified energy conservation bonds are made to the states with sub-allocations to large local governments. Allocations are made to the states according to their respective populations, reduced by any sub-allocations to large local governments (defined below) within the states. Sub-allocations to large local governments shall be an amount of the national qualified energy conservation bond limitation that bears the same ratio to the amount of such limitation that otherwise would be allocated to the state in which such large local government is located as the population of such large local government bears to the population of such state. The term "large local government" means: any municipality or county if such municipality or county has a population of 100,000 or more. Indian tribal governments also are treated as large local governments for these purposes (without regard to population).

Each state or large local government receiving an allocation of qualified energy conservation bonds may further allocate issuance authority to issuers within such state or large local government. However, any allocations to issuers within the state or large local government shall be made in a manner that results in not less than 70 percent of the allocation of qualified energy conservation bonds to such state or large local government being used to designate bonds that are not private activity bonds (i.e., the bond cannot meet the private business tests or the private loan test of IRC section 141).

Qualified energy conservation bonds are a type of qualified tax credit bond for purposes of IRC section 54A. As a result, 100 percent of the available project proceeds of qualified energy conservation bonds must be used for qualified conservation purposes. In the case of qualified conservation bonds issued as private activity bonds, 100 percent of the available project proceeds must be used for capital expenditures. In addition, qualified energy conservation bonds may be issued by Indian tribal governments only to the extent such bonds are issued for purposes that satisfy the present-law requirements for tax-exempt bonds issued by Indian tribal governments (i.e., essential governmental functions and certain manufacturing purposes).

Under present law, 100 percent of the available project proceeds of qualified energy conservation bonds must be used within the three-year period that begins on the date of issuance. Available project proceeds are proceeds from the sale of the issue less issuance costs (not to exceed two percent) and any investment earnings on such sale proceeds. To the extent less than 100 percent of the available project proceeds are used to finance qualified conservation purposes during the three-year spending period, bonds will continue to qualify as qualified energy conservation bonds if unspent proceeds are used within 90 days from the end of such three-year period to redeem bonds. The three-year spending period may be extended by the Secretary upon the issuer's request demonstrating that the failure to satisfy the three-year requirement is due to reasonable cause and the projects will continue to proceed with due diligence.

Qualified energy conservation bonds generally are subject to the arbitrage requirements of IRC section 148. However, available project proceeds invested during the three-year spending period are not subject to the arbitrage restrictions (i.e., yield restriction and rebate requirements). In addition, amounts invested in a reserve fund are not subject to the arbitrage restrictions to the extent: (1) such fund is funded at a rate not more rapid than equal annual installments; (2) such fund is funded in a manner reasonably expected to result in an amount not greater than an amount necessary to repay the issue; and (3) the yield on such fund is not greater than the average annual interest rate of tax-exempt obligations having a term of 10 years or more that are issued during the month the qualified energy conservation bonds are issued.

The maturity of qualified energy conservation bonds is the term that the Secretary estimates will result in the present value of the obligation to repay the principal on such bonds being equal to 50 percent of the face amount of such bonds, using as a discount rate the average annual interest rate of tax-exempt obligations having a term of 10 years or more that are issued during the month the qualified energy conservation bonds are issued.

As with other tax credit bonds, the taxpayer holding qualified energy conservation bonds on a credit allowance date is entitled to a tax credit. The credit rate on the bonds is set by the Secretary at a rate that is 70 percent of the rate that would permit issuance of such bonds without discount and interest cost to the issuer.[63] The Secretary determines credit rates for tax credit bonds based on general assumptions about credit quality of the class of potential eligible issuers and such other factors as the Secretary deems appropriate. The Secretary may determine credit rates based on general credit market yield indexes and credit ratings. The amount of the tax credit is determined by multiplying the bond's credit rate by the face amount of the holder's bond. The credit accrues quarterly, is includible in gross income (as if it were an interest payment on the bond), and can be claimed against regular income tax liability and alternative minimum tax liability. Unused credits may be carried forward to succeeding taxable years. In addition, credits may be separated from the ownership of the underlying bond similar to how interest coupons can be stripped for interest-bearing bonds.

Issuers of qualified energy conservation bonds are required to certify that the financial disclosure requirements that applicable state and local law requirements governing conflicts of interest are satisfied with respect to such issue, as well as any other additional conflict of interest rules prescribed by the Secretary with respect to any federal, state, or local government official directly involved with the issuance of qualified energy conservation bonds.

New Federal Law (IRC section 54D)

The provision expands the present-law qualified energy conservation bond program. The provision authorizes issuance of an additional $2.4 billion of qualified energy conservation bonds. Also, the

[63] Given the differences in credit quality and other characteristics of individual issuers, the Secretary cannot set credit rates in a manner that will allow each issuer to issue tax credit bonds at par.

provision clarifies that capital expenditures to implement green community programs includes grants, loans and other repayment mechanisms to implement such programs. For example, this expansion will enable states to issue these tax credit bonds to finance retrofits of existing private buildings through loans and/or grants to individual homeowners or businesses, or through other repayment mechanisms. Other repayment mechanisms can include periodic fees assessed on a government bill or utility bill that approximates the energy savings of energy efficiency or conservation retrofits. Retrofits can include heating, cooling, lighting, water-saving, storm water-reducing, or other efficiency measures.

Finally, the provision clarifies that any bond used for the purpose of providing grants, loans or other repayment mechanisms for capital expenditures to implement green community programs is not treated as a private activity bond for purposes of determining whether the requirement that not less than 70 percent of allocations within a state or large local government be used to designate bonds that are not private activity bonds (IRC section 54D(e)(3)) has been satisfied.

Effective Date

The provision is effective for bonds issued after February 17, 2009.

California Law (None)

California has no comparable tax credit bonds, and has no statutory provision limiting the dollar amount of bonds that may be issued (except as provided in the California Constitution). The federal credit is not includable in income for California income tax purposes.

Impact on California Revenue

Not applicable.

PART III of SUBTITLE B of TITLE I – ENERGY CONSERVATION INCENTIVES

Section	Section Title
1121	Extension and Modification of Credit for Nonbusiness Energy Property

Background

IRC section 25C provides a 10-percent credit for the purchase of qualified energy efficiency improvements to existing homes. A qualified energy efficiency improvement is any energy efficiency building envelope component (1) that meets or exceeds the prescriptive criteria for such a component established by the 2000 International Energy Conservation Code as supplemented and as in effect on August 8, 2005 (or, in the case of metal roofs with appropriate pigmented coatings, meets the Energy Star program requirements); (2) that is installed in or on a dwelling located in the United States and owned and used by the taxpayer as the taxpayer's principal residence; (3) the original use of which commences with the taxpayer; and (4) that reasonably can be expected to remain in use for at least five years. The credit is nonrefundable.

Building envelope components are: (1) insulation materials or systems which are specifically and primarily designed to reduce the heat loss or gain for a dwelling; (2) exterior windows (including skylights) and doors; and (3) metal or asphalt roofs with appropriate pigmented coatings or cooling granules that are specifically and primarily designed to reduce the heat gain for a dwelling.

Additionally, IRC section 25C provides specified credits for the purchase of specific energy efficient property. The allowable credit for the purchase of certain property is (1) $50 for each advanced main air circulating fan, (2) $150 for each qualified natural gas, propane, or oil furnace or hot water boiler, and (3) $300 for each item of qualified energy efficient property.

An advanced main air circulating fan is a fan used in a natural gas, propane, or oil furnace originally placed in service by the taxpayer during the taxable year, and which has an annual electricity use of no more than two percent of the total annual energy use of the furnace (as determined in the standard Department of Energy test procedures).

A qualified natural gas, propane, or oil furnace or hot water boiler is a natural gas, propane, or oil furnace or hot water boiler with an annual fuel utilization efficiency rate of at least 95.

Qualified energy-efficient property is: (1) an electric heat pump water heater which yields energy factor of at least 2.0 in the standard Department of Energy test procedure, (2) an electric heat pump which has a heating seasonal performance factor (HSPF) of at least 9, a seasonal energy efficiency ratio (SEER) of at least 15, and an energy efficiency ratio (EER) of at least 13, (3) a central air conditioner with energy efficiency of at least the highest efficiency tier established by the Consortium for Energy Efficiency as in effect on Jan. 1, 2006,[64] (4) a natural gas, propane, or oil water heater which has an energy factor of at least 0.80 or thermal efficiency of at least 90 percent, and (5) biomass fuel property.

Biomass fuel property is a stove that burns biomass fuel to heat a dwelling unit located in the United States and used as a principal residence by the taxpayer, or to heat water for such dwelling unit, and that has a thermal efficiency rating of at least 75 percent. Biomass fuel is any plant-derived fuel available on a renewable or recurring basis, including agricultural crops and trees, wood and wood waste and residues (including wood pellets), plants (including aquatic plants, grasses, residues, and fibers).

Under IRC section 25C, the maximum credit for a taxpayer with respect to the same dwelling for all taxable years is $500, and no more than $200 of such credit may be attributable to expenditures on windows.

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[64] The highest tier in effect at this time was tier 2, requiring SEER of at least 15 and EER of at least 12.5 for split central air conditioning systems and SEER of at least 14 and EER of at least 12 for packaged central air conditioning systems.

The taxpayer's basis in the property is reduced by the amount of the credit. Special proration rules apply in the case of jointly owned property, condominiums, and tenant-stockholders in cooperative housing corporations. If less than 80 percent of the property is used for nonbusiness purposes, only that portion of expenditures that is used for nonbusiness purposes is taken into account.

For purposes of determining the amount of expenditures made by any individual with respect to any dwelling unit, there shall not be taken into account expenditures which are made from subsidized energy financing. The term ''subsidized energy financing'' means financing provided under a federal, state, or local program a principal purpose of which is to provide subsidized financing for projects designed to conserve or produce energy.

The credit applies to expenditures made after December 31, 2008 for property placed in service after December 31, 2008, and prior to January 1, 2010.

<u>New Federal Law (IRC section 25C)</u>

The provision is extended for one year, through December 31, 2010.

The 10 percent credit rate is raised to 30 percent. Additionally, all energy property otherwise eligible for the $50, $100, or $150 credits is instead eligible for a 30 percent credit on expenditures for such property.

The $500 lifetime cap (and the $200 lifetime cap with respect to windows) is eliminated and replaced with an aggregate cap of $1,500 in the case of property placed in service after December 31, 2008, and prior to January 1, 2011.

The provision updates the building insulation requirements to follow the prescriptive criteria of the 2009 International Energy Conservation Code. Additionally, qualifying exterior windows, doors, and skylights must have a U-factor at or below 0.30 and a seasonal heat gain coefficient ("SHGC") at or below 0.30.

Electric heat pumps must achieve the highest efficiency tier of Consortium for Energy Efficiency, as in effect on January 1, 2009. These standards are a SEER greater than or equal to 15, EER greater than or equal to 12.5, and HSPF greater than or equal to 8.5 for split heat pumps, and SEER greater than or equal to 14, EER greater than or equal to 12, and HSPF greater than or equal to 8.0 for packaged heat pumps.

Central air conditioners must achieve the highest efficiency tier of Consortium for Energy Efficiency, as in effect on January 1, 2009. These standards are a SEER greater than or equal to 16 and EER greater than or equal to 13 for split systems, and SEER greater than or equal to 14 and EER greater than or equal to 12 for packaged systems.

Natural gas, propane, or oil water heaters must have an energy factor greater than or equal to 0.82 or a thermal efficiency of greater than or equal to 90 percent. Natural gas, propane, or oil water boilers must achieve an annual fuel utilization efficiency rate of at least 90. Qualified oil furnaces must achieve an annual fuel utilization efficiency rate of at least 90.

The requirement that biomass fuel property have a thermal efficiency rating of at least 75 percent is modified to be a thermal efficiency rating of at least 75 percent as measured using a lower heating value.

The present-law rule related to subsidized energy financing is eliminated.

Effective Date

The provision is effective for taxable years beginning after December 31, 2008. The new efficiency standards for qualifying property, other than those for biomass fuel property, apply to property placed in service after February 17, 2009.

California Law (None)

California has no comparable credit.

Impact on California Revenue

Not applicable.

Section	Section Title
1122	Modification of Credit for Residential Energy Efficient Property

Background

IRC section 25D provides a personal tax credit for the purchase of qualified solar electric property and qualified solar water heating property that is used exclusively for purposes other than heating swimming pools and hot tubs. The credit is equal to 30 percent of qualifying expenditures, with a maximum credit of $2,000 with respect to qualified solar water heating property. There is no cap with respect to qualified solar electric property.

IRC section 25D also provides a 30 percent credit for the purchase of qualified geothermal heat pump property, qualified small wind energy property, and qualified fuel cell power plants. The credit for geothermal heat pump property is capped at $2,000, the credit for qualified small wind energy property is limited to $500 with respect to each half kilowatt of capacity, not to exceed $4,000, and the credit for any fuel cell may not exceed $500 for each 0.5 kilowatt of capacity.

The credit with respect to all qualifying property may be claimed against the alternative minimum tax.

Qualified solar electric property is property that uses solar energy to generate electricity for use in a dwelling unit. Qualifying solar water heating property is property used to heat water for use in a dwelling unit located in the United States and used as a residence if at least half of the energy used by such property for such purpose is derived from the sun.

A qualified fuel cell power plant is an integrated system comprised of a fuel cell stack assembly and associated balance of plant components that (1) converts a fuel into electricity using electrochemical means, and (2) has an electricity-only generation efficiency of greater than 30 percent. The qualified fuel cell power plant must be installed on or in connection with a dwelling unit located in the United States and used by the taxpayer as a principal residence.

Qualified small wind energy property is property that uses a wind turbine to generate electricity for use in a dwelling unit located in the U.S. and used as a residence by the taxpayer.

Qualified geothermal heat pump property means any equipment which (1) uses the ground or ground water as a thermal energy source to heat the dwelling unit or as a thermal energy sink to cool such dwelling unit, (2) meets the requirements of the Energy Star program which are in effect at the time that the expenditure for such equipment is made, and (3) is installed on or in connection with a dwelling unit located in the United States and used as a residence by the taxpayer.

The credit is nonrefundable, and the depreciable basis of the property is reduced by the amount of the credit. Expenditures for labor costs allocable to onsite preparation, assembly, or original installation of property eligible for the credit are eligible expenditures.

Special proration rules apply in the case of jointly owned property, condominiums, and tenant-stockholders in cooperative housing corporations. If less than 80 percent of the property is used for nonbusiness purposes, only that portion of expenditures that is used for nonbusiness purposes is taken into account.

For purposes of determining the amount of expenditures made by any individual with respect to any dwelling unit, there shall not be taken into account expenditures which are made from subsidized energy financing. The term “subsidized energy financing” means financing provided under a federal, state, or local program a principal purpose of which is to provide subsidized financing for projects designed to conserve or produce energy.

The credit applies to property placed in service prior to January 1, 2017.

<u>New Federal Law (IRC section 25D)</u>

The provision eliminates the credit caps for solar hot water, geothermal, and wind property and eliminates the reduction in credits for property using subsidized energy financing.

Effective Date

The provision applies to taxable years beginning after December 31, 2008.

California Law (None)

California has no comparable credit.

Impact on California Revenue

Not applicable.

Section	Section Title
1123	Temporary Increase in Credit for Alternative Fuel Vehicle Refueling Property

Background

Taxpayers may claim a 30-percent credit for the cost of installing qualified clean-fuel vehicle refueling property to be used in a trade or business of the taxpayer or installed at the principal residence of the taxpayer.[65] The credit may not exceed $30,000 per taxable year per location, in the case of qualified refueling property used in a trade or business and $1,000 per taxable year per location, in the case of qualified refueling property installed on property which is used as a principal residence.

Qualified refueling property is property (not including a building or its structural components) for the storage or dispensing of a clean-burning fuel or electricity into the fuel tank or battery of a motor vehicle propelled by such fuel or electricity, but only if the storage or dispensing of the fuel or electricity is at the point of delivery into the fuel tank or battery of the motor vehicle. The use of such property must begin with the taxpayer.

Clean-burning fuels are any fuel at least 85 percent of the volume of which consists of ethanol, natural gas, compressed natural gas, liquefied natural gas, liquefied petroleum gas, or hydrogen. In addition, any mixture of biodiesel and diesel fuel, determined without regard to any use of kerosene and containing at least 20 percent biodiesel, qualifies as a clean fuel.

Credits for qualified refueling property used in a trade or business are part of the general business credit and may be carried back for one year and forward for 20 years. Credits for residential qualified refueling property cannot exceed for any taxable year the difference between the taxpayer's regular tax (reduced by certain other credits) and the taxpayer's tentative minimum tax.

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[65] IRC section 30C.

Generally, in the case of qualified refueling property sold to a tax-exempt entity, the taxpayer selling the property may claim the credit.

A taxpayer's basis in qualified refueling property is reduced by the amount of the credit. In addition, no credit is available for property used outside the United States or for which an election to expense has been made under IRC section 179.

The credit is available for property placed in service after December 31, 2005, and (except in the case of hydrogen refueling property) before January 1, 2011. In the case of hydrogen refueling property, the property must be placed in service before January 1, 2015.

New Federal Law (IRC section 30C)

For property placed in service in 2009 or 2010, the provision increases the maximum credit available for business property to $200,000 for qualified hydrogen refueling property and to $50,000 for other qualified refueling property. For nonbusiness property, the maximum credit is increased to $2,000. In addition, the credit rate is increased from 30 percent to 50 percent, except in the case of hydrogen refueling property.

Effective Date

The provision is effective for taxable years beginning after December 31, 2008.

California Law (None)

California has no comparable credit.

Impact on California Revenue

Not applicable.

PART IV of SUBTITLE B of TITLE I – MODIFICATION OF CREDIT FOR CARBON DIOXIDE SEQUESTRATION

Section	Section Title
1131	Application of Monitoring Requirements to Carbon Dioxide Used as a Tertiary Injectant

Background

A credit of $20 per metric ton is available for qualified carbon dioxide captured by a taxpayer at a qualified facility and disposed of by such taxpayer in secure geological storage (including storage at deep saline formations and unminable coal seams under such conditions as the Secretary may determine).[66] In addition, a credit of $10 per metric ton is available for qualified carbon dioxide that is captured by the taxpayer at a qualified facility and used by such taxpayer as a tertiary injectant (including carbon dioxide augmented waterflooding and immiscible carbon dioxide displacement) in a qualified enhanced oil or natural gas recovery project. Both credit amounts are adjusted for inflation after 2009.

Qualified carbon dioxide is defined as carbon dioxide captured from an industrial source that (1) would otherwise be released into the atmosphere as an industrial emission of greenhouse gas, and (2) is measured at the source of capture and verified at the point or points of injection. Qualified carbon dioxide includes the initial deposit of captured carbon dioxide used as a tertiary injectant but does not include carbon dioxide that is recaptured, recycled, and re-injected as part of an enhanced oil or natural gas recovery project process. A qualified enhanced oil or natural gas recovery project is a project that would otherwise meet the definition of an enhanced oil recovery project under IRC section 43, if natural gas projects were included within that definition.

A qualified facility means any industrial facility (1) which is owned by the taxpayer, (2) at which carbon capture equipment is placed in service, and (3) which captures not less than 500,000 metric tons of carbon dioxide during the taxable year. The credit applies only with respect to qualified carbon dioxide captured and sequestered or injected in the United States[67] or one of its possessions.[68]

Except as provided in regulations, credits are attributable to the person that captures and physically or contractually ensures the disposal, or use as a tertiary injectant, of the qualified carbon dioxide. Credits are subject to recapture, as provided by regulation, with respect to any qualified carbon dioxide that ceases to be recaptured, disposed of, or used as a tertiary injectant in a manner consistent with the rules of the provision.

The credit is part of the general business credit. The credit sunsets at the end of the calendar year in which the Secretary, in consultation with the Administrator of the Environmental Protection Agency, certifies that 75 million metric tons of qualified carbon dioxide have been captured and disposed of or used as a tertiary injectant.

<u>New Federal Law (IRC section 45Q)</u>

The provision requires that carbon dioxide used as a tertiary injectant and otherwise eligible for a $10 per metric ton credit must be sequestered by the taxpayer in permanent geological storage in order to qualify for such credit. The provision also clarifies that the term permanent geological storage includes oil and gas reservoirs in addition to unminable coal seams and deep saline formations. In addition, the provision requires that the Secretary of the Treasury consult with the

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[66] IRC section 45Q.

[67] IRC section 638(1).

[68] IRC section 638(2).

Secretary of Energy and the Secretary of the Interior, in addition to the Administrator of the Environmental Protection Agency, in promulgating regulations relating to the permanent geological storage of carbon dioxide.

Effective Date

The provision is effective for carbon dioxide captured after February 17, 2009.

California Law (None)

California has no comparable credit.

Impact on California Revenue

Not applicable.

PART V of SUBTITLE B of TITLE I – PLUG-IN ELECTRIC DRIVE MOTOR VEHICLES

Section	Section Title
1141	Credit for New Qualified Plug-In Electric Drive Motor Vehicles

A credit is available for each new qualified fuel cell vehicle, hybrid vehicle, advanced lean burn technology vehicle, and alternative fuel vehicle placed in service by the taxpayer during the taxable year.[69] In general, the credit amount varies depending upon the type of technology used, the weight class of the vehicle, the amount by which the vehicle exceeds certain fuel economy standards, and, for some vehicles, the estimated lifetime fuel savings. The credit generally is available for vehicles purchased after 2005. The credit terminates after 2009, 2010, or 2014, depending on the type of vehicle. The alternative motor vehicle credit is not allowed against the alternative minimum tax.

Plug-in electric drive motor vehicle credit

A credit is available for each qualified plug-in electric drive motor vehicle placed in service. A qualified plug-in electric drive motor vehicle is a motor vehicle that has at least four wheels, is manufactured for use on public roads, meets certain emissions standards (except for certain heavy vehicles), draws propulsion using a traction battery with at least four kilowatt-hours of capacity, and is capable of being recharged from an external source of electricity.

The base amount of the plug-in electric drive motor vehicle credit is $2,500, plus another $417 for each kilowatt-hour of battery capacity in excess of four kilowatt-hours. The maximum credit for

[69] IRC section 30B.

qualified vehicles weighing 10,000 pounds or less is $7,500. This maximum amount increases to $10,000 for vehicles weighing more than 10,000 pounds but not more than 14,000 pounds, to $12,500 for vehicles weighing more than 14,000 pounds but not more than 26,000 pounds, and to $15,000 for vehicle weighing more than 26,000 pounds.

In general, the credit is available to the vehicle owner, including the lessor of a vehicle subject to lease. If the qualified vehicle is used by certain tax-exempt organizations, governments, or foreign persons and is not subject to a lease, the seller of the vehicle may claim the credit so long as the seller clearly discloses to the user in a document the amount that is allowable as a credit. A vehicle must be used predominantly in the United States to qualify for the credit.

Once a total of 250,000 credit-eligible vehicles have been sold for use in the United States, the credit will phase out over four calendar quarters. The phaseout period begins in the second calendar quarter following the quarter during which the vehicle cap has been reached. Taxpayers may claim one-half of the otherwise allowable credit during the first two calendar quarters of the phaseout period and twenty-five percent of the otherwise allowable credit during the next two quarters. After this, no credit is available. Regardless of the phase-out limitation, no credit is available for vehicles purchased after 2014.

The basis of any qualified vehicle is reduced by the amount of the credit. To the extent a vehicle is eligible for credit as a qualified plug-in electric drive motor vehicle, it is not eligible for credit as a qualified hybrid vehicle under IRC section 30B. The portion of the credit attributable to vehicles of a character subject to an allowance for depreciation is treated as part of the general business credit; the nonbusiness portion of the credit is allowable to the extent of the excess of the regular tax over the alternative minimum tax (reduced by certain other credits) for the taxable year.

<u>New Federal Law (IRC sections 30B, 30D, 38, 1016, and 6501)</u>

The provision modifies the plug-in electric drive motor vehicle credit by limiting the maximum credit to $7,500 regardless of vehicle weight. The provision also eliminates the credit for low speed plug-in vehicles and for plug-in vehicles weighing 14,000 pounds or more.

The provision replaces the 250,000 total plug-in vehicle limitation with a 200,000 plug-in vehicles per manufacturer limitation. The credit will phase out over four calendar quarters beginning in the second calendar quarter following the quarter in which the manufacturer limit is reached. The provision also makes other technical changes.

<u>Effective Date</u>

The changes to the plug-in electric drive motor vehicle credit are effective for vehicles acquired after December 31, 2009.

<u>California Law (None)</u>

California has no comparable credit.

Impact on California Revenue

Not applicable.

Section	Section Title
1142	Credit for Certain Plug-In Electric Vehicles

Background

Alternative motor vehicle credit

A credit is available for each new qualified fuel cell vehicle, hybrid vehicle, advanced lean burn technology vehicle, and alternative fuel vehicle placed in service by the taxpayer during the taxable year.[70] In general, the credit amount varies depending upon the type of technology used, the weight class of the vehicle, the amount by which the vehicle exceeds certain fuel economy standards, and, for some vehicles, the estimated lifetime fuel savings. The credit generally is available for vehicles purchased after 2005. The credit terminates after 2009, 2010, or 2014, depending on the type of vehicle. The alternative motor vehicle credit is not allowed against the alternative minimum tax.

Plug-in electric drive motor vehicle credit

A credit is available for each qualified plug-in electric drive motor vehicle placed in service. A qualified plug-in electric drive motor vehicle is a motor vehicle that has at least four wheels, is manufactured for use on public roads, meets certain emissions standards (except for certain heavy vehicles), draws propulsion using a traction battery with at least four kilowatt-hours of capacity, and is capable of being recharged from an external source of electricity.

The base amount of the plug-in electric drive motor vehicle credit is $2,500, plus another $417 for each kilowatt-hour of battery capacity in excess of four kilowatt-hours. The maximum credit for qualified vehicles weighing 10,000 pounds or less is $7,500. This maximum amount increases to $10,000 for vehicles weighing more than 10,000 pounds but not more than 14,000 pounds, to $12,500 for vehicles weighing more than 14,000 pounds but not more than 26,000 pounds, and to $15,000 for vehicle weighing more than 26,000 pounds.

In general, the credit is available to the vehicle owner, including the lessor of a vehicle subject to lease. If the qualified vehicle is used by certain tax-exempt organizations, governments, or foreign persons and is not subject to a lease, the seller of the vehicle may claim the credit so long as the seller clearly discloses to the user in a document the amount that is allowable as a credit. A vehicle must be used predominantly in the United States to qualify for the credit.

[70] IRC section 30B.

Once a total of 250,000 credit-eligible vehicles have been sold for use in the United States, the credit will phase out over four calendar quarters. The phaseout period begins in the second calendar quarter following the quarter during which the vehicle cap has been reached. Taxpayers may claim one-half of the otherwise allowable credit during the first two calendar quarters of the phaseout period and twenty-five percent of the otherwise allowable credit during the next two quarters. After this, no credit is available. Regardless of the phase-out limitation, no credit is available for vehicles purchased after 2014.

The basis of any qualified vehicle is reduced by the amount of the credit. To the extent a vehicle is eligible for credit as a qualified plug-in electric drive motor vehicle, it is not eligible for credit as a qualified hybrid vehicle under IRC section 30B. The portion of the credit attributable to vehicles of a character subject to an allowance for depreciation is treated as part of the general business credit; the nonbusiness portion of the credit is allowable to the extent of the excess of the regular tax over the alternative minimum tax (reduced by certain other credits) for the taxable year.

New Federal Law (IRC sections 24, 25, 25B, 26, 27, 30, 30B, 30C, 53, 55, 904, 1016, 1400C, and 6501)

The provision creates a new 10-percent credit for low-speed vehicles, motorcycles, and three-wheeled vehicles that would otherwise meet the criteria of a qualified plug-in electric drive motor vehicle but for the fact that they are low-speed vehicles or do not have at least four wheels. The maximum credit for such vehicles is $2,500. Basis reduction and other rules similar to those found in IRC section 30 apply under the provision. The new credit is part of the general business credit. The new credit is not available for vehicles sold after December 31, 2011.

Effective Date

The provision is effective for vehicles acquired after February 17, 2009.

California Law (None)

California has no comparable credit.

Impact on California Revenue

Not applicable.

Section	Section Title
1143	Conversion Kits

Background

Plug-in electric drive motor vehicle credit

A credit is available for each qualified plug-in electric drive motor vehicle placed in service. A qualified plug-in electric drive motor vehicle is a motor vehicle that has at least four wheels, is manufactured for use on public roads, meets certain emissions standards (except for certain heavy vehicles), draws propulsion using a traction battery with at least four kilowatt-hours of capacity, and is capable of being recharged from an external source of electricity.

The base amount of the plug-in electric drive motor vehicle credit is $2,500, plus another $417 for each kilowatt-hour of battery capacity in excess of four kilowatt-hours. The maximum credit for qualified vehicles weighing 10,000 pounds or less is $7,500. This maximum amount increases to $10,000 for vehicles weighing more than 10,000 pounds but not more than 14,000 pounds, to $12,500 for vehicles weighing more than 14,000 pounds but not more than 26,000 pounds, and to $15,000 for vehicle weighing more than 26,000 pounds.

In general, the credit is available to the vehicle owner, including the lessor of a vehicle subject to lease. If the qualified vehicle is used by certain tax-exempt organizations, governments, or foreign persons and is not subject to a lease, the seller of the vehicle may claim the credit so long as the seller clearly discloses to the user in a document the amount that is allowable as a credit. A vehicle must be used predominantly in the United States to qualify for the credit.

Once a total of 250,000 credit-eligible vehicles have been sold for use in the United States, the credit phases out over four calendar quarters. The phaseout period begins in the second calendar quarter following the quarter during which the vehicle cap has been reached. Taxpayers may claim one-half of the otherwise allowable credit during the first two calendar quarters of the phaseout period and twenty-five percent of the otherwise allowable credit during the next two quarters. After this, no credit is available. Regardless of the phase-out limitation, no credit is available for vehicles purchased after 2014.
The basis of any qualified vehicle is reduced by the amount of the credit. To the extent a vehicle is eligible for credit as a qualified plug-in electric drive motor vehicle, it is not eligible for credit as a qualified hybrid vehicle under IRC section 30B. The portion of the credit attributable to vehicles of a character subject to an allowance for depreciation is treated as part of the general business credit; the nonbusiness portion of the credit is allowable to the extent of the excess of the regular tax over the alternative minimum tax (reduced by certain other credits) for the taxable year.

New Federal Law (IRC section 30B)

The provision creates a new 10-percent credit, up to $4,000, for the cost of converting any motor vehicle into a qualified plug-in electric drive motor vehicle. To be eligible for the credit, a qualified plug-in traction battery module must have a capacity of at least 4 kilowatt-hours. In the case of a leased traction battery module, the credit may not be claimed by the lessor but not the lessee. The credit is not available for conversions made after December 31, 2011.

Effective Date

The provision is effective for property placed in service after February 17, 2009.

California Law (None)

California has no comparable credit.

Impact on California Revenue

Not applicable.

Section	Section Title
1144	Treatment of Alternative Motor Vehicle Credit as a Personal Credit Allowed Against AMT

Background

Alternative motor vehicle credit

A credit is available for each new qualified fuel cell vehicle, hybrid vehicle, advanced lean burn technology vehicle, and alternative fuel vehicle placed in service by the taxpayer during the taxable year.[71] In general, the credit amount varies depending upon the type of technology used, the weight class of the vehicle, the amount by which the vehicle exceeds certain fuel economy standards, and, for some vehicles, the estimated lifetime fuel savings. The credit generally is available for vehicles purchased after 2005. The credit terminates after 2009, 2010, or 2014, depending on the type of vehicle. The alternative motor vehicle credit is not allowed against the alternative minimum tax.

New Federal Law (IRC sections 24, 25, 25B, 26, 30C, 55, 904, and 1400C)

The provision provides that the alternative motor vehicle credit is a personal credit allowed against the alternative minimum tax.

Effective Date

The provision is effective for taxable years beginning after December 31, 2008.

[71] IRC section 30B.

California Law (None)

California has no comparable credit.

Impact on California Revenue

Not applicable.

PART VI of SUBTITLE B of TITLE I – PARITY FOR TRANSPORTATION FRINGE BENEFITS

Section	Section Title
1151	Increased Exclusion Amount for Commuter Transit Benefits and Transit Passes

Background

Qualified transportation fringe benefits provided by an employer are excluded from an employee's gross income for income tax purposes and from an employee's wages for payroll tax purposes.[72] Qualified transportation fringe benefits include parking, transit passes, vanpool benefits, and qualified bicycle commuting reimbursements. Up to $230 (for 2009) per month of employer-provided parking is excludable from income. Up to $120 (for 2009) per month of employer-provided transit and vanpool benefits are excludable from gross income. These amounts are indexed annually for inflation, rounded to the nearest multiple of $5. No amount is includible in the income of an employee merely because the employer offers the employee a choice between cash and qualified transportation fringe benefits. Qualified transportation fringe benefits also include a cash reimbursement by an employer to an employee. However, in the case of transit passes, a cash reimbursement is considered a qualified transportation fringe benefit only if a voucher or similar item which may be exchanged only for a transit pass is not readily available for direct distribution by the employer to the employee.

New Federal Law (IRC section 132)

The provision increases the monthly exclusion for employer-provided transit and vanpool benefits to the same level as the exclusion for employer-provided parking.

The provision does not apply to any month beginning on or after January 1, 2011.

Effective Date

The provision is effective for months beginning on or after February 17, 2009.

[72] IRC sections 132(f), 3121(b)(2), 3306(b)(16), and 3401(a)(19).

California Law (R&TC sections 17131 and 17149)

Under PITL, California conforms by reference to Part III of Subchapter B of Chapter 1 of Subtitle A of the Internal Revenue Code as of the "specified date" of January 1, 2005, relating to items specifically excluded from gross income, with modifications.

However, current California law additionally provides an exclusion from gross income for any compensation or the fair market value of any other benefit, except salary or wages, received by an employee from an employer for participation in any ridesharing arrangement in California. This enhanced exclusion is not subject to any limitation.

Thus, California law already excludes from gross income any compensation or the fair market value of any other benefit, except salary or wages, received by an employee from an employer for participation in any ridesharing arrangement in California.

Impact on California Revenue

Baseline. Although California currently allows an exclusion of income for qualified commuter reimbursements for employees, it is likely that taxpayers will follow the new federal exclusion.

PART I of SUBTITLE C of TITLE I – TEMPORARY INVESTMENT INCENTIVES

Section	Section Title
1201	Special Allowance for Certain Property Acquired During 2009

Background

An additional first-year depreciation deduction is allowed equal to 50 percent of the adjusted basis of qualified property placed in service during 2008 (and 2009 for certain longer-lived and transportation property).[73] The additional first-year depreciation deduction is allowed for both regular tax and alternative minimum tax purposes for the taxable year in which the property is placed in service.[74] The basis of the property and the depreciation allowances in the year of purchase and later years are appropriately adjusted to reflect the additional first-year depreciation deduction. In addition, there are no adjustments to the allowable amount of depreciation for purposes of computing a taxpayer's alternative minimum taxable income with respect to property to which the provision applies. The amount of the additional first-year depreciation deduction is not affected by a short taxable year. The taxpayer may elect out of additional first-year depreciation for any class of property for any taxable year.

[73] IRC section 168(k). The additional first-year depreciation deduction is subject to the general rules regarding whether an item is deductible under IRC section 162 or instead is subject to capitalization under IRC section 263 or IRC section 263A.

[74] However, the additional first-year depreciation deduction is not allowed for purposes of computing earnings and profits.

The interaction of the additional first-year depreciation allowance with the otherwise applicable depreciation allowance may be illustrated as follows. Assume that in 2008, a taxpayer purchases new depreciable property and places it in service.[75] The property's cost is $1,000, and it is five-year property subject to the half-year convention. The amount of additional first-year depreciation allowed is $500. The remaining $500 of the cost of the property is deductible under the rules applicable to 5-year property. Thus, 20 percent, or $100, is also allowed as a depreciation deduction in 2008. The total depreciation deduction with respect to the property for 2008 is $600. The remaining $400 cost of the property is recovered under otherwise applicable rules for computing depreciation.

In order for property to qualify for the additional first-year depreciation deduction it must meet all of the following requirements. First, the property must be (1) property to which MACRS applies with an applicable recovery period of 20 years or less, (2) water utility property (as defined in IRC section 168(e)(5)), (3) computer software other than computer software covered by IRC section 197, or (4) qualified leasehold improvement property (as defined in IRC section 168(k)(3)).[76] Second, the original use[77] of the property must commence with the taxpayer after December 31, 2007.[78] Third, the taxpayer must purchase the property within the applicable time period. Finally, the property must be placed in service after December 31, 2007, and before January 1, 2009. An extension of the placed in service date of one year (i.e., to January 1, 2010) is provided for certain property with a recovery period of ten years or longer and certain transportation property.[79] Transportation property is defined as tangible personal property used in the trade or business of transporting persons or property.

The applicable time period for acquired property is (1) after December 31, 2007, and before January 1, 2009, but only if no binding written contract for the acquisition is in effect before January 1, 2008, or (2) pursuant to a binding written contract which was entered into after

[75] Assume that the cost of the property is not eligible for expensing under IRC section 179.

[76] A special rule precludes the additional first-year depreciation deduction for any property that is required to be depreciated under the alternative depreciation system of MACRS.

[77] The term "original use" means the first use to which the property is put, whether or not such use corresponds to the use of such property by the taxpayer. If in the normal course of its business a taxpayer sells fractional interests in property to unrelated third parties, then the original use of such property begins with the first user of each fractional interest (i.e., each fractional owner is considered the original user of its proportionate share of the property).

[78] A special rule applies in the case of certain leased property. In the case of any property that is originally placed in service by a person and that is sold to the taxpayer and leased back to such person by the taxpayer within three months after the date that the property was placed in service, the property would be treated as originally placed in service by the taxpayer not earlier than the date that the property is used under the leaseback. If property is originally placed in service by a lessor (including by operation of IRC section 168(k)(2)(D)(i)), such property is sold within three months after the date that the property was placed in service, and the user of such property does not change, then the property is treated as originally placed in service by the taxpayer not earlier than the date of such sale.

[79] In order for property to qualify for the extended placed in service date, the property is required to have an estimated production period exceeding one year and a cost exceeding $1 million.

December 31, 2007, and before January 1, 2009.[80] With respect to property that is manufactured, constructed, or produced by the taxpayer for use by the taxpayer, the taxpayer must begin the manufacture, construction, or production of the property after December 31, 2007, and before January 1, 2009. Property that is manufactured, constructed, or produced for the taxpayer by another person under a contract that is entered into prior to the manufacture, construction, or production of the property is considered to be manufactured, constructed, or produced by the taxpayer. For property eligible for the extended placed in service date, a special rule limits the amount of costs eligible for the additional first-year depreciation. With respect to such property, only the portion of the basis that is properly attributable to the costs incurred before January 1, 2009 ("progress expenditures") is eligible for the additional first-year depreciation.[81]

Property does not qualify for the additional first-year depreciation deduction when the user of such property (or a related party) would not have been eligible for the additional first-year depreciation deduction if the user (or a related party) were treated as the owner. For example, if a taxpayer sells to a related party property that was under construction prior to January 1, 2008, the property does not qualify for the additional first-year depreciation deduction. Similarly, if a taxpayer sells to a related party property that was subject to a binding written contract prior to January 1, 2008, the property does not qualify for the additional first-year depreciation deduction. As a further example, if a taxpayer (the lessee) sells property in a sale-leaseback arrangement, and the property otherwise would not have qualified for the additional first-year depreciation deduction if it were owned by the taxpayer-lessee, then the lessor is not entitled to the additional first-year depreciation deduction.

The limitation on the amount of depreciation deductions allowed with respect to certain passenger automobiles (IRC section 280F) is increased in the first year by $8,000 for automobiles that qualify (and do not elect out of the increased first-year deduction). The $8,000 increase is not indexed for inflation.

Corporations otherwise eligible for additional first year depreciation under IRC section 168(k) may elect to claim additional research or minimum tax credits in lieu of claiming depreciation under IRC section 168(k) for "eligible qualified property" placed in service after March 31, 2008 and before December 31, 2008.[82] A corporation making the election forgoes the depreciation deductions allowable under IRC section 168(k) and instead increases the limitation under IRC section 38(c) on the use of research credits or IRC section 53(c) on the use of minimum tax credits.[83] The increases in the allowable credits are treated as refundable for purposes of this

[80] Property does not fail to qualify for the additional first-year depreciation merely because a binding written contract to acquire a component of the property is in effect prior to January 1, 2008.

[81] For purposes of determining the amount of eligible progress expenditures, it is intended that rules similar to IRC section 46(d)(3) as in effect prior to the Tax Reform Act of 1986 shall apply.

[82] IRC section 168(k)(4). In the case of an electing corporation that is a partner in a partnership, the corporate partner's distributive share of partnership items is determined as if IRC section 168(k) does not apply to any eligible qualified property and the straight line method is used to calculate depreciation of such property.

[83] Special rules apply to an applicable partnership.

provision. The depreciation for qualified property is calculated for both regular tax and AMT purposes using the straight-line method in place of the method that would otherwise be used absent the election under this provision.

The research credit or minimum tax credit limitation is increased by the bonus depreciation amount, which is equal to 20 percent of bonus depreciation[84] for certain eligible qualified property that could be claimed absent an election under this provision. Generally, eligible qualified property included in the calculation is bonus depreciation property that meets the following requirements: (1) the original use of the property must commence with the taxpayer after March 31, 2008; (2) the taxpayer must purchase the property either (a) after March 31, 2008, and before January 1, 2009, but only if no binding written contract for the acquisition is in effect before April 1, 2008,[85] or (b) pursuant to a binding written contract which was entered into after March 31, 2008, and before January 1, 2009;[86] and (3) the property must be placed in service after March 31, 2008, and before January 1, 2009 (January 1, 2010 for certain longer-lived and transportation property).

The bonus depreciation amount is limited to the lesser of: (1) $30 million, or (2) six percent of the sum of research credit carryforwards from taxable years beginning before January 1, 2006 and minimum tax credits allocable to the adjusted minimum tax imposed for taxable years beginning before January 1, 2006. All corporations treated as a single employer under IRC section 52(a) are treated as one taxpayer for purposes of the limitation, as well as for electing the application of this provision.

<u>New Federal Law (IRC sections 168, 1400N, and 6211)</u>

The provision extends the additional first-year depreciation deduction for one year, generally through 2009 (through 2010 for certain longer-lived and transportation property).

The provision generally permits corporations to increase the research credit or minimum tax credit limitation by the bonus depreciation amount with respect to certain property placed in service in 2009 (2010 in the case of certain longer-lived and transportation property). The provision applies with respect to extension property, which is defined as property that is eligible qualified property solely because it meets the requirements under the extension of the special allowance for certain property acquired during 2009.

Under the provision, a taxpayer that has made an election to increase the research credit or minimum tax credit limitation for eligible qualified property for its first taxable year ending after March 31, 2008, may choose not to make this election for extension property. Further, the

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[84] For this purpose, bonus depreciation is the difference between (i) the aggregate amount of depreciation for all eligible qualified property determined if IRC section 168(k)(1) applied using the most accelerated depreciation method (determined without regard to this provision), and shortest life allowable for each property, and (ii) the amount of depreciation that would be determined if IRC section 168(k)(1) did not apply using the same method and life for each property.

[85] In the case of passenger aircraft, the written binding contract limitation does not apply.

[86] Special rules apply to property manufactured, constructed, or produced by the taxpayer for use by the taxpayer.

provision allows a taxpayer that has not made an election for eligible qualified property for its first taxable year ending after March 31, 2008, to make the election for extension property for its first taxable year ending after December 31, 2008, and for each subsequent year. In the case of a taxpayer electing to increase the research or minimum tax credit for both eligible qualified property and extension property, a separate bonus depreciation amount, maximum amount, and maximum increase amount is computed and applied to each group of property.[87]

Effective Date

The extension of the additional first-year depreciation deduction is generally effective for property placed in service after December 31, 2008.

The extension of the election to accelerate AMT and research credits in lieu of bonus depreciation is effective for taxable years ending after December 31, 2008.

California Law (R&TC sections 17201, 17250, and 24349)

Personal Income Tax Law (PITL)

Under PITL, California law, as it relates to MACRS, in general conforms to the federal rules as of the “specified date” of January 1, 2005, with certain modifications. California specifically does not conform to IRC section 168(k), which allows 30 percent and 50 percent bonus depreciation for certain property. Therefore, this provision is not applicable.

Corporate Tax Law (CTL)

Under CTL, California law does not conform to MACRS; thus, this provision is not applicable.

Impact on California Revenue

Not applicable.

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[87] In computing the maximum amount, the maximum increase amount for extension property is reduced by bonus depreciation amounts for preceding taxable years only with respect to extension property.

Section	Section Title
1202	Temporary Increase in Limitations on Expensing of Certain Depreciable Business Assets

Background

In lieu of depreciation, a taxpayer with a sufficiently small amount of annual investment may elect to deduct (or "expense") such costs under IRC section 179. Present law provides that the maximum amount a taxpayer may expense for taxable years beginning in 2008 is $250,000 of the cost of qualifying property placed in service for the taxable year.[88] For taxable years beginning in 2009 and 2010, the limitation is $125,000. In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business. Off-the-shelf computer software placed in service in taxable years beginning before 2011 is treated as qualifying property. For taxable years beginning in 2008, the $250,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $800,000. For taxable years beginning in 2009 and 2010, the $125,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $500,000. The $125,000 and $500,000 amounts are indexed for inflation in taxable years beginning in 2009 and 2010.

The amount eligible to be expensed for a taxable year may not exceed the taxable income for a taxable year that is derived from the active conduct of a trade or business (determined without regard to this provision). Any amount that is not allowed as a deduction because of the taxable income limitation may be carried forward to succeeding taxable years (subject to similar limitations). No general business credit under IRC section 38 is allowed with respect to any amount for which a deduction is allowed under IRC section 179. An expensing election is made under rules prescribed by the Secretary.[89]

For taxable years beginning in 2011 and thereafter (or before 2003), the following rules apply. A taxpayer with a sufficiently small amount of annual investment may elect to deduct up to $25,000 of the cost of qualifying property placed in service for the taxable year. The $25,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $200,000. The $25,000 and $200,000 amounts are not indexed for inflation. In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business (not including off-

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[88] Additional IRC section 179 incentives are provided with respect to qualified property meeting applicable requirements that is used by a business in an empowerment zone (IRC section 1397A) or a renewal community (IRC section 1400J), qualified IRC section 179 Gulf Opportunity Zone property (IRC section 1400N(e)), qualified Recovery Assistance property placed in service in the Kansas disaster area (Public Law 110-234, IRC section 15345 (2008)), and qualified disaster assistance property (IRC section 179(e)).

[89] IRC section 179(c)(1). Under Treas. Reg. section 1.179-5, applicable to property placed in service in taxable years beginning after 2002 and before 2008, a taxpayer is permitted to make or revoke an election under IRC section 179 without the consent of the Commissioner on an amended federal tax return for that taxable year. This amended return must be filed within the time prescribed by law for filing an amended return for the taxable year. T.D. 9209, July 12, 2005.

the-shelf computer software). An expensing election may be revoked only with consent of the Commissioner.[90]

New Federal Law (IRC section 179)

The provision extends the $250,000 and $800,000 amounts to taxable years beginning in 2009.

Effective Date

The provision is effective for taxable years beginning after December 31, 2008.

California Law (R&TC sections 17255 and 24356)

California law, as it relates to the IRC section 179 deduction, conforms to federal law as of the "specified date" of January 1, 2005, with significant exceptions.

California specifically does not conform to the increased "small business expensing" enacted in the Jobs and Growth Tax Relief Reconciliation Act (JGTRRA) of 2003 and extended and modified in various federal acts. Thus, under California law, both corporate and non-corporate taxpayers with a sufficiently small amount of annual investment in qualified depreciable property may elect to deduct up to $25,000 of the cost of qualifying property placed in service for the taxable year. The $25,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $200,000. In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business. The amount eligible to be expensed for a taxable year may not exceed the taxable income for a taxable year that is derived from the active conduct of a trade or business (determined without regard to this provision). Any amount that is not allowed as a deduction because of the taxable income limitation may be carried forward to succeeding taxable years (subject to similar limitations).

Impact on California Revenue

Not applicable.

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[90] IRC section 179(c)(2).

PART II of SUBTITLE C of TITLE I – SMALL BUSINESS PROVISIONS

Section	Section Title
1211	5-Year Carryback of Operating Losses of Small Business

Background

Under present law, a net operating loss ("NOL") generally means the amount by which a taxpayer's business deductions exceed its gross income. In general, an NOL may be carried back two years and carried over 20 years to offset taxable income in such years.[91] NOLs offset taxable income in the order of the taxable years to which the NOL may be carried.[92]

The alternative minimum tax rules provide that a taxpayer's NOL deduction cannot reduce the taxpayer's alternative minimum taxable income ("AMTI") by more than 90 percent of the AMTI.

Different rules apply with respect to NOLs arising in certain circumstances. A three-year carryback applies with respect to NOLs (1) arising from casualty or theft losses of individuals, or (2) attributable to Presidentially-declared disasters for taxpayers engaged in a farming business or a small business. A five-year carryback applies to NOLs (1) arising from a farming loss (regardless of whether the loss was incurred in a Presidentially-declared disaster area), (2) certain amounts related to Hurricane Katrina, Gulf Opportunity Zone, and Midwestern Disaster Area, or (3) qualified disaster losses.[93] Special rules also apply to real estate investment trusts (no carryback), specified liability losses (10-year carryback), and excess interest losses (no carryback to any year preceding a corporate equity reduction transaction). Additionally, a special rule applies to certain electric utility companies.

In the case of a life insurance company, present law allows a deduction for the operations loss carryovers and carrybacks to the taxable year, in lieu of the deduction for net operation losses allowed to other corporations.[94] A life insurance company is permitted to treat a loss from operations (as defined under IRC section 810(c)) for any taxable year as an operations loss carryback to each of the three taxable years preceding the loss year and an operations loss carryover to each of the 15 taxable years following the loss year.[95] Special rules apply to new life insurance companies.

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[91] IRC section 172(b)(1)(A).

[92] IRC section 172(b)(2).

[93] IRC section 172(b)(l)(J).

[94] IRC sections 810, 805(a)(5).

[95] IRC section 810(b)(1).

New Federal Law (IRC section 172)

The provision provides an eligible small business with an election[96] to increase the present-law carryback period for an applicable 2008 NOL from two years to any whole number of years elected by the taxpayer that is more than two and less than six. An eligible small business is a taxpayer meeting a $15,000,000 gross receipts test.[97] An applicable NOL is the taxpayer's NOL for any taxable year ending in 2008, or if elected by the taxpayer, the NOL for any taxable year beginning in 2008. However, any election under this provision may be made only with respect to one taxable year.

Effective Date

The provision is effective for net operating losses arising in taxable years ending after December 31, 2007.

For an NOL for a taxable year ending before the enactment of the provision, the provision includes the following transition rules: (1) any election to waive the carryback period under either IRC section 172(b)(3) with respect to such loss may be revoked before the applicable date; (2) any election to increase the carryback period under this provision is treated as timely made if made before the applicable date; and (3) any application for a tentative carryback adjustment under IRC section 6411(a) with respect to such loss is treated as timely filed if filed before the applicable date. For purposes of the transition rules, the applicable date is the date which is 60 days after February 17, 2009.

California Law (RT&C sections 17201, 17276-17276.10, and 24416-24416.10)

In general

A California taxpayer generally calculates its NOL in accordance with federal rules, as California conforms by reference under the PITL and the CTL to IRC section 172, relating to net operating loss deduction, with modifications.

Disaster losses

State tax law identifies specific events as disasters and excess disaster losses are allowed special carry forward treatment. That is, 100 percent of the excess disaster loss may be carried over for up to 15 taxable years. In addition, for disasters that were the subject of a Governor's proclamation, but not the subject of a Presidential disaster declaration, enactment of state law identifying a specific event as a disaster for state tax law purposes authorizes the taxpayer to elect to deduct the disaster loss on the return for the prior taxable year.

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[96] For all elections under this provision, the common parent of a group of corporations filing a consolidated return makes the election, which is binding on all such corporations.

[97] For this purpose, the gross receipt test of IRC section 448(c) is applied by substituting $15,000,000 for $5,000,000 each place it appears.

General NOLs - taxable years beginning before January 1, 2008

Depending on the type of taxpayer or amount of a taxpayer's income, the amount of NOL that is eligible to be carried forward and the number of years it can be carried forward vary. Two important differences are that California does not generally allow the carryback of NOLs and limits the carryforward period to 10 years in circumstances where federal law allows 20 years.

General NOLs - taxable years beginning on or after January 1, 2008

In 2008, the following changes were made:[98]

- NOL deductions are suspended for taxable years 2008 and 2009 for a taxpayer with net business income (PITL) or income subject to tax (CTL) of $500,000 or more. However, deductions for NOL carrybacks from taxable years beginning on or after January 1, 2011, will be allowed.
- For PITL, "net business income" means income from a trade or business, whether conducted by the taxpayer or by a pass-through entity (partnership or S corporation), income from rental activity, and income attributable to a farming business.
- For NOLs that are limited by the application of the suspension rules described above, the NOL carryover period is extended by one year for NOLs incurred in taxable year 2008, and two years for NOLs attributable to taxable years beginning before January 1, 2008.
- A 20-year NOL carryover period is allowed for NOLs attributable to taxable years beginning on or after January 1, 2008.
- California conforms to the federal NOL carryback rules for NOLs attributable to taxable years beginning on or after January 1, 2011, with the following modifications:
  - NOLs may only be carried back two years.
  - The amount of NOL carryback attributable to taxable year 2011 is limited to 50 percent of the net operating loss.
  - The amount of NOL carryback attributable to taxable year 2012 is limited to 75 percent of the net operating loss.
- California conforms to the federal carryback period for Real Estate Investment Trusts (REITS) and a corporate equity reduction interest loss, which is zero.

Impact on California Revenue

Not applicable.

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[98] Ch. 763, Laws of 2008 (A.B. 1452).

Section	Section Title
1212	Decreased Required Estimated Tax Payments in 2009 for Certain Small Business

Background

Under present law, the income tax system is designed to ensure that taxpayers pay taxes throughout the year based on their income and deductions. To the extent that tax is not collected through withholding, taxpayers are required to make quarterly estimated payments of tax, the amount of which is determined by reference to the required annual payment. The required annual payment is the lesser of 90 percent of the tax shown on the return or 100 percent of the tax shown on the return for the prior taxable year (110 percent if the adjusted gross income for the preceding year exceeded $150,000). An underpayment results if the required payment exceeds the amount (if any) of the installment paid on or before the due date of the installment. The period of the underpayment runs from the due date of the installment to the earlier of (1) the 15th day of the fourth month following the close of the taxable year or (2) the date on which each portion of the underpayment is made. If a taxpayer fails to pay the required estimated tax payments under the rules, a penalty is imposed in an amount determined by applying the underpayment interest rate to the amount of the underpayment for the period of the underpayment. The penalty for failure to pay estimated tax is the equivalent of interest, which is based on the time value of money.

Taxpayers are not liable for a penalty for the failure to pay estimated tax in certain circumstances. The statute provides exceptions for U.S. persons who did not have a tax liability the preceding year, if the tax shown on the return for the taxable year (or, if no return is filed, the tax), reduced by withholding, is less than $1,000, or the taxpayer is a recently retired or disabled person who satisfies the reasonable cause exception.

New Federal Law (IRC section 6654)

The provision provides that the required annual estimated tax payments of a qualified individual for taxable years beginning in 2009 is not greater than 90 percent of the tax liability shown on the tax return for the preceding taxable year. A qualified individual means any individual if the adjusted gross income shown on the tax return for the preceding taxable year is less than $500,000 ($250,000 if married filing separately) and the individual certifies that at least 50 percent of the gross income shown on the return for the preceding taxable year was income from a small trade or business. For purposes of this provision, a small trade or business means any trade or business that employed no more than 500 persons, on average, during the calendar year ending in or with the preceding taxable year.

Effective Date

The provision is effective on February 17, 2009.

California Law (R&TC sections 19136, 19136.1, and 19136.3)

California conforms to IRC section 6654, relating to failure by an individual to pay estimated income tax, as of the "specified date" of January 1, 2005, with modifications. In general, RT&C section 19136 requires taxpayers to make estimated tax payments equal to the lesser of 90% of the tax shown on the return for the taxable year or 100 percent of the tax from the preceding tax year (110 percent if the adjusted gross income for the preceding year exceeded $150,000).

For taxable years beginning on or after January 1, 2009, the option for individual taxpayers to make estimate payments equal to 100 percent of the tax shown on the taxpayer's return for the prior year is eliminated if the adjusted gross income of the taxpayer shown on the return for the current taxable year exceeds $1 million, or $500,000 for taxpayers with a married filing separate filing status.

Taxpayers are not liable for a penalty for the failure to pay estimated tax in certain circumstances.

- The penalty does not apply to U.S. persons who did not have a tax liability the preceding year, if the tax shown on the return for the taxable year (or, if no return is filed, the tax), reduced by withholding, is less than $500 ($250 in the case of a separate return filed by a married individual), or the taxpayer is a recently retired or disabled person who satisfies the reasonable cause exception.
- The penalty does not apply to any underpayment that is attributable to a change in law to the extent that the underpayment was created or increased by any provision of law that is enacted during and operative for the taxable year of the underpayment.

Impact on California Revenue

Not applicable.

PART III of SUBTITLE C of TITLE I – INCENTIVES FOR NEW JOBS

Section	Section Title
1221	Incentives to Hire Unemployed Veterans and Disconnected Youth

Background

In general

The work opportunity tax credit (WOTC) is available on an elective basis for employers hiring individuals from one or more of nine targeted groups. The amount of the credit available to an employer is determined by the amount of qualified wages paid by the employer. Generally, qualified wages consist of wages attributable to service rendered by a member of a targeted group during the one-year period beginning with the day the individual begins work for the employer (two years in the case of an individual in the long-term family assistance recipient category).

Targeted groups eligible for the credit

Generally an employer is eligible for the credit only for qualified wages paid to members of a targeted group.

(1) Families receiving TANF

An eligible recipient is an individual certified by a designated local employment agency (e.g., a state employment agency) as being a member of a family eligible to receive benefits under the Temporary Assistance for Needy Families Program ("TANF") for a period of at least nine months, part of which is during the 18-month period ending on the hiring date. For these purposes, members of the family are defined to include only those individuals taken into account for purposes of determining eligibility for the TANF.

(2) Qualified veteran

There are two subcategories of qualified veterans related to eligibility for; food stamps and compensation for a service-connected disability.

Food stamps

A qualified veteran is a veteran who is certified by the designated local agency as a member of a family receiving assistance under a food stamp program under the Food Stamp Act of 1977 for a period of at least three months, part of which is during the 12-month period ending on the hiring date. For these purposes, members of a family are defined to include only those individuals taken into account for purposes of determining eligibility for a food stamp program under the Food Stamp Act of 1977.

Entitled to compensation for a service-connected disability

A qualified veteran also includes an individual who is certified as entitled to compensation for a service-connected disability and: (1) having a hiring date which is not more than one year after having been discharged or released from active duty in the Armed Forces of the United States; or (2) having been unemployed for six months or more (whether or not consecutive) during the one-year period ending on the date of hiring.

Definitions

For these purposes, being entitled to compensation for a service-connected disability is defined with reference to section 101 of Title 38, U.S. Code, which means having a disability rating of 10 percent or higher for service connected injuries.

For these purposes, a veteran is an individual who has served on active duty (other than for training) in the Armed Forces for more than 180 days or who has been discharged or released from active duty in the Armed Forces for a service-connected disability. However, any individual who has served for a period of more than 90 days during which the individual was on active duty (other than for training) is not a qualified veteran if any of this active duty occurred during the 60-day period ending on the date the individual was hired by the employer. This latter rule is intended to prevent employers who hire current members of the armed services (or those departed from service within the last 60 days) from receiving the credit.

(3) Qualified ex-felon

A qualified ex-felon is an individual certified as: (1) having been convicted of a felony under any state or federal law; and (2) having a hiring date within one year of release from prison or the date of conviction.

(4) Designated community residents

A designated community resident is an individual certified as being at least age 18 but not yet age 40 on the hiring date and as having a principal place of abode within an empowerment zone, enterprise community, renewal community, or a rural renewal community. For these purposes, a rural renewal county is a county outside a metropolitan statistical area (as defined by the Office of Management and Budget) which had a net population loss during the five-year periods 1990-1994 and 1995-1999. Qualified wages do not include wages paid or incurred for services performed after the individual moves outside an empowerment zone, enterprise community, renewal community, or a rural renewal community.

(5) Vocational rehabilitation referral

A vocational rehabilitation referral is an individual who is certified by a designated local agency as an individual who has a physical or mental disability that constitutes a substantial handicap to employment and who has been referred to the employer while receiving, or after completing: (a) vocational rehabilitation services under an individualized, written plan for employment under a state plan approved under the Rehabilitation Act of 1973; (b) under a rehabilitation plan for veterans carried out under Chapter 31 of Title 38, U.S. Code; or (c) an individual work plan developed and implemented by an employment network pursuant to subsection (g) of section 1148 of the Social Security Act. Certification will be provided by the designated local employment agency upon assurances from the vocational rehabilitation agency that the employee has met the above conditions.

(6) Qualified summer youth employee

A qualified summer youth employee is an individual: (a) who performs services during any 90-day period between May 1 and September 15; (b) who is certified by the designated local agency as being 16 or 17 years of age on the hiring date; (c) who has not been an employee of that employer before; and (d) who is certified by the designated local agency as having a principal place of abode within an empowerment zone, enterprise community, or renewal community (as defined under Subchapter U of Subtitle A, Chapter 1 of the Internal Revenue Code). As with designated community residents, no credit is available on wages paid or incurred for service performed after the qualified summer youth moves outside of an empowerment zone, enterprise community, or renewal community. If, after the end of the 90-day period, the employer continues to employ a youth who was certified during the 90-day period as a member of another targeted group, the limit on qualified first year wages will take into account wages paid to the youth while a qualified summer youth employee.

(7) Qualified food stamp recipient

A qualified food stamp recipient is an individual at least age 18 but not yet age 40 certified by a designated local employment agency as being a member of a family receiving assistance under a food stamp program under the Food Stamp Act of 1977 for a period of at least six months ending on the hiring date. In the case of families that cease to be eligible for food stamps under section 6(o) of the Food Stamp Act of 1977, the six-month requirement is replaced with a requirement that the family has been receiving food stamps for at least three of the five months ending on the date of hire. For these purposes, members of the family are defined to include only those individuals taken into account for purposes of determining eligibility for a food stamp program under the Food Stamp Act of 1977.

(8) Qualified SSI recipient

A qualified SSI recipient is an individual designated by a local agency as receiving supplemental security income ("SSI") benefits under Title XVI of the Social Security Act for any month ending within the 60-day period ending on the hiring date.

(9) Long-term family assistance recipients

A qualified long-term family assistance recipient is an individual certified by a designated local agency as being: (a) a member of a family that has received family assistance for at least 18 consecutive months ending on the hiring date; (b) a member of a family that has received such family assistance for a total of at least 18 months (whether or not consecutive) after August 5, 1997 (the date of enactment of the welfare-to-work tax credit[99] if the individual is hired within two years after the date that the 18-month total is reached; or (c) a member of a family who is no longer eligible for family assistance because of either federal or state time limits, if the individual is hired within two years after the federal or state time limits made the family ineligible for family assistance.

[99] The welfare-to-work tax credit was consolidated into the work opportunity tax credit in the Tax Relief and Health Care Act of 2006, for qualified individuals who begin to work for an employer after December 31, 2006.

Qualified wages

Generally, qualified wages are defined as cash wages paid by the employer to a member of a targeted group. The employer's deduction for wages is reduced by the amount of the credit.

For purposes of the credit, generally, wages are defined by reference to the Federal Unemployment Tax Act (FUTA) definition of wages contained in IRC section 3306(b) (without regard to the dollar limitation therein contained). Special rules apply in the case of certain agricultural labor and certain railroad labor.

Calculation of the credit

The credit available to an employer for qualified wages paid to members of all targeted groups except for long-term family assistance recipients equals 40 percent (25 percent for employment of 400 hours or less) of qualified first-year wages. Generally, qualified first-year wages are qualified wages (not in excess of $6,000) attributable to service rendered by a member of a targeted group during the one-year period beginning with the day the individual began work for the employer. Therefore, the maximum credit per employee is $2,400 (40 percent of the first $6,000 of qualified first-year wages). With respect to qualified summer youth employees, the maximum credit is $1,200 (40 percent of the first $3,000 of qualified first-year wages). Except for long-term family assistance recipients, no credit is allowed for second-year wages.

In the case of long-term family assistance recipients, the credit equals 40 percent (25 percent for employment of 400 hours or less) of $10,000 for qualified first-year wages and 50 percent of the first $10,000 of qualified second-year wages. Generally, qualified second-year wages are qualified wages (not in excess of $10,000) attributable to service rendered by a member of the long-term family assistance category during the one-year period beginning on the day after the one-year period beginning with the day the individual began work for the employer. Therefore, the maximum credit per employee is $9,000 (40 percent of the first $10,000 of qualified first-year wages plus 50 percent of the first $10,000 of qualified second-year wages).

In the case of a qualified veteran who is entitled to compensation for a service connected disability, the credit equals 40 percent of $12,000 of qualified first-year wages. This expanded definition of qualified first-year wages does not apply to the veterans qualified with reference to a food stamp program, as defined under present law.

Certification rules

An individual is not treated as a member of a targeted group unless: (1) on or before the day on which an individual begins work for an employer, the employer has received a certification from a designated local agency that such individual is a member of a targeted group; or (2) on or before the day an individual is offered employment with the employer, a pre-screening notice is completed by the employer with respect to such individual, and not later than the 28th day after the individual begins work for the employer, the employer submits such notice, signed by the employer and the individual under penalties of perjury, to the designated local agency as part of a written request for certification. For these purposes, a pre-screening notice is a document (in such form as the Secretary may prescribe) which contains information provided by the individual on the basis of which the employer believes that the individual is a member of a targeted group.

Minimum employment period

No credit is allowed for qualified wages paid to employees who work less than 120 hours in the first year of employment.

Other rules

The work opportunity tax credit (WOTC) is not allowed for wages paid to a relative or dependent of the taxpayer. No credit is allowed for wages paid to an individual who is a more than fifty-percent owner of the entity. Similarly, wages paid to replacement workers during a strike or lockout are not eligible for the WOTC. Wages paid to any employee during any period for which the employer received on-the-job training program payments with respect to that employee are not eligible for the WOTC. The WOTC generally is not allowed for wages paid to individuals who had previously been employed by the employer. In addition, many other technical rules apply.

Expiration

The WOTC is not available for individuals who begin work for an employer after August 31, 2011.

<u>New Federal Law (IRC section 51)</u>

The provision creates a new targeted group for the WOTC. That new category is unemployed veterans and disconnected youth who begin work for the employer in 2009 or 2010.

An unemployed veteran is defined as an individual certified by the designated local agency as someone who: (1) has served on active duty (other than for training) in the Armed Forces for more than 180 days or who has been discharged or released from active duty in the Armed Forces for a service-connected disability; (2) has been discharged or released from active duty in the Armed Forces during the five-year period ending on the hiring date; and (3) has received unemployment compensation under state or federal law for not less than four weeks during the one-year period ending on the hiring date.

For purposes of the disconnected youths, it is intended that a low-level of formal education may satisfy the requirement that an individual is not readily employable by reason of lacking a sufficient number of skills. Further, it is intended that the Internal Revenue Service, when providing general guidance regarding the various new criteria, shall take into account the administrability of the program by the state agencies.

<u>Effective Date</u>

The provisions are effective for individuals who begin work for an employer after December 31, 2008.

California Law (R&TC sections 17053.34, 17053.46, 17053.47, 17053.74, 17053.80, 23622.7, 23622.8, 23623, 23634, and 23646)

California does not conform to IRC section 51, relating to the WOTC. However, California has stand-alone credits for employers hiring individuals from targeted groups in economic development areas, and a new jobs tax credit.

Credits for Hiring Individuals in Economic Development Areas

California law provides tax incentives for taxpayers conducting business activities within geographically targeted economic development areas (EDAs). EDAs include Enterprise Zones (EZs), Manufacturing Enhancement Areas (MEAs), Targeted Tax Areas (TTAs), and Local Agency Military Base Recovery Areas (LAMBRAs).

An employer located in an EDA is eligible for a hiring credit equal to a percentage of wages paid to individuals from targeted groups (i.e. qualified employees). To some extent, the definition of qualified employees for the EDA hiring credits is similar to the definition of qualified employees for purposes of the federal WOTC.

The amount of the EDA hiring credits is generally reduced by the amount of credit allowed under IRC section 51. However, because California conforms to IRC section 51 as of the “specified date” of January 1, 2005, there is no IRC section 51 reduction to the EDA hiring credits with respect to employees hired after December 31, 2005.

New Jobs Tax Credit

For taxable years beginning on or after January 1, 2009, California law provides a credit against tax for a qualified employer in the amount of $3,000 for each increase in a qualified full-time employee hired by a qualified employer in the taxable year, determined on an annual full-time equivalent basis. For qualified full-time employees that are employed less than a full year, the credit is reduced on a pro-rata basis by the number of hours for employees paid on an hourly basis or by the number weeks for salaried employees employed by the qualified employer in the taxable year.

Any credits not used in the taxable year may be carried forward up to eight years. The credit is not subject to the 50 percent limitation for business credits that applies to taxable years beginning on or after January 1, 2008, and ending January 1, 2010. Any deductions an employer is allowed for qualified wages are not reduced by the amount of the credit.

Taxpayers may only claim this credit on an original timely filed return received by the FTB on or before a cut-off date specified by the FTB, which is the last day of the calendar quarter within which the FTB estimates it will have received timely filed original returns claiming the credit that cumulatively total $400 million for all taxable years. The date received on a return will be determined by the FTB. Determinations made by the FTB with respect to the cut-off date, the date a return is received, and whether a return has been timely filed may not be reviewed in any administrative or judicial proceeding

Impact on California Revenue

Not applicable.

PART IV of SUBTITLE C of TITLE I – RULES RELATING TO DEBT INSTRUMENTS

Section	Section Title
1231	Deferral and Ratable Inclusion of Income Arising from Business Indebtedness Discharged by the Reacquisition of a Debt Instrument

Background

In general, gross income includes income that is realized by a debtor from the discharge of indebtedness, subject to certain exceptions for debtors in title 11 bankruptcy cases, insolvent debtors, certain student loans, certain farm indebtedness, certain real property business indebtedness, and certain qualified principal residence indebtedness.[100] In cases involving discharges of indebtedness that are excluded from gross income under the exceptions to the general rule, taxpayers generally are required to reduce certain tax attributes, including net operating losses, general business credits, minimum tax credits, capital loss carryovers, and basis in property, by the amount of the discharge of indebtedness.[101]

The amount of discharge of indebtedness excluded from income by an insolvent debtor not in a title 11 bankruptcy case cannot exceed the amount by which the debtor is insolvent. In the case of a discharge in bankruptcy or where the debtor is insolvent, any reduction in basis may not exceed the excess of the aggregate bases of properties held by the taxpayer immediately after the discharge over the aggregate of the liabilities of the taxpayer immediately after the discharge.[102]

For all taxpayers, the amount of discharge of indebtedness generally is equal to the excess of the adjusted issue price of the indebtedness being satisfied over the amount paid (or deemed paid) to satisfy such indebtedness.[103] This rule generally applies to (1) the acquisition by the debtor of its debt instrument in exchange for cash, (2) the issuance of a debt instrument by the debtor in satisfaction of its indebtedness, including a modification of indebtedness that is treated as an exchange (a debt-for-debt exchange), (3) the transfer by a debtor corporation of stock, or a debtor partnership of a capital or profits interest in such partnership, in satisfaction of its indebtedness

[100] See IRC sections 61(a)(12) and 108. But see IRC section 102 (a debt cancellation which constitutes a gift or bequest is not treated as income to the donee debtor).

[101] IRC section 108(b).

[102] IRC section 1017.

[103] Treas. Reg. section 1.61-12(c)(2)(ii). Treas. Reg. section 1.1275-1(b) defines "adjusted issue price."

(an equity-for-debt exchange), and (4) the acquisition by a debtor corporation of its indebtedness from a shareholder as a contribution to capital.

Debt-for-debt exchanges

If a debtor issues a debt instrument in satisfaction of its indebtedness, the debtor is treated as having satisfied the indebtedness with an amount of money equal to the issue price of the newly issued debt instrument.[104] The issue price of such newly issued debt instrument generally is determined under IRC sections 1273 and 1274.[105] Similarly, a "significant modification" of a debt instrument, within the meaning of Treas. Reg. section 1.1001-3, results in an exchange of the original debt instrument for a modified instrument. In such cases, where the issue price of the modified debt instrument is less than the adjusted issue price of the original debt instrument, the debtor will have income from the cancellation of indebtedness.

If any new debt instrument is issued (including as a result of a significant modification to a debt instrument), such debt instrument will have original issue discount equal to the excess (if any) of such debt instrument's stated redemption price at maturity over its issue price.[106] In general, an issuer of a debt instrument with original issue discount may deduct for any taxable year, with respect to such debt instrument, an amount of original issue discount equal to the aggregate daily portions of the original issue discount for days during such taxable year.[107]

Equity-for-debt exchanges

If a corporation transfers stock, or a partnership transfers a capital or profits interest in such partnership, to a creditor in satisfaction of its indebtedness, then such corporation or partnership is treated as having satisfied its indebtedness with an amount of money equal to the fair market value of the stock or interest.[108]

Related-party acquisitions

Indebtedness directly or indirectly acquired by a person who bears a relationship to the debtor described in IRC section 267(b) or IRC section 707(b) is treated as if it were acquired by the debtor.[109] Thus, where a debtor's indebtedness is acquired for less than its adjusted issue price by a person related to the debtor (within the meaning of IRC section 267(b) or IRC section 707(b)), the debtor recognizes income from the cancellation of indebtedness. Regulations under IRC

[104] IRC section 108(e)(10)(A).

[105] IRC section 108(e)(10)(B).

[106] IRC section 1273.

[107] IRC section 163(e).

[108] IRC section 108(e)(8).

[109] IRC section 108(e)(4).

section 108 provide that the indebtedness acquired by the related party is treated as new indebtedness issued by the debtor to the related holder on the acquisition date (the deemed issuance).[110] The new indebtedness is deemed issued with an issue price equal to the amount used under regulations to compute the amount of cancellation of indebtedness income realized by the debtor (i.e., either the holder's adjusted basis or the fair market value of the indebtedness, as the case may be).[111] The indebtedness deemed issued pursuant to the regulations has original issue discount to the extent its stated redemption price at maturity exceeds its issue price.

In the case of a deemed issuance under Treas. Reg. section 1.108-2(g), the related holder does not recognize any gain or loss, and the related holder's adjusted basis in the indebtedness remains the same as it was immediately before the deemed issuance.[112] The deemed issuance is treated as a purchase of the indebtedness by the related holder for purposes of IRC section 1272(a)(7) (pertaining to reduction of original issue discount where a subsequent holder pays acquisition premium) and IRC section 1276 (pertaining to acquisitions of debt at a market discount).[113]

Contribution of a debt instrument to capital of a corporation

Where a debtor corporation acquires its indebtedness from a shareholder as a contribution to capital, IRC section 118[114] does not apply, but the corporation is treated as satisfying such indebtedness with an amount of money equal to the shareholder's adjusted basis in the indebtedness.

New Federal Law (IRC section 108)

The provision permits a taxpayer to elect to defer cancellation of indebtedness income arising from a "reacquisition" of "an applicable debt instrument" after December 31, 2008, and before January 1, 2011. Income deferred pursuant to the election must be included in the gross income of the taxpayer ratably in the five taxable years beginning with (1) for repurchases in 2009, the fifth taxable year following the taxable year in which the repurchase occurs or (2) for repurchases in 2010, the fourth taxable year following the taxable year in which the repurchase occurs.

An "applicable debt instrument" is any debt instrument issued by (1) a C corporation or (2) any other person in connection with the conduct of a trade or business by such person. For purposes of the provision, a "debt instrument" is broadly defined to include any bond, debenture, note,

[110] Treas. Reg. section 1.108-2(g).

[111] Treas. Reg. section 1.108-2(g).

[112] Treas. Reg. section 1.108-2(g)(2).

[113] Treas. Reg. section 1.108-2(g)(2).

[114] IRC section 118 provides, in general, that in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer.

certificate or any other instrument or contractual arrangement constituting indebtedness (within the meaning of IRC section 1275(a)(1)).

A "reacquisition" is any "acquisition" of an applicable debt instrument by (1) the debtor that issued (or is otherwise the obligor under) such debt instrument or (2) any person related to the debtor within the meaning of IRC section 108(e)(4). For purposes of the provision, an "acquisition" includes, without limitation, (l) an acquisition of a debt instrument for cash, (2) the exchange of a debt instrument for another debt instrument (including an exchange resulting from a modification of a debt instrument), (3) the exchange of corporate stock or a partnership interest for a debt instrument, (4) the contribution of a debt instrument to the capital of the issuer, and (5) the complete forgiveness of a debt instrument by a holder of such instrument.

Special rules for debt-for-debt exchanges

If a taxpayer makes the election provided by the provision for a debt-for-debt exchange in which the newly issued debt instrument issued (or deemed issued, including by operation of the rules in Treas. Reg. section 1.108-2(g)) in satisfaction of an outstanding debt instrument of the debtor has original issue discount, then any otherwise allowable deduction for original issue discount with respect to such newly issued debt instrument that (1) accrues before the first year of the five-taxable-year period in which the related, deferred discharge of indebtedness income is included in the gross income of the taxpayer and (2) does not exceed such related, deferred discharge of indebtedness income, is deferred and allowed as a deduction ratably over the same five-taxable-year period in which the deferred discharge of indebtedness income is included in gross income.

This rule can apply also in certain cases when a debtor reacquires its debt for cash. If the taxpayer issues a debt instrument and the proceeds of such issuance are used directly or indirectly to reacquire a debt instrument of the taxpayer, the provision treats the newly issued debt instrument as if it were issued in satisfaction of the retired debt instrument. If the newly issued debt instrument has original issue discount, the rule described above applies. Thus, all or a portion of the interest deductions with respect to original issue discount on the newly issued debt instrument are deferred into the five-taxable-year period in which the discharge of indebtedness income is recognized. Where only a portion of the proceeds of a new issuance are used by a taxpayer to satisfy outstanding debt, then the deferral rule applies to the portion of the original issue discount on the newly issued debt instrument that is equal to the portion of the proceeds of such newly issued instrument used to retire outstanding debt of the taxpayer.

Acceleration of deferred items

Cancellation of indebtedness income and any related deduction for original issue discount that is deferred by an electing taxpayer (and has not previously been taken into account) generally is accelerated and taken into income in the taxable year in which the taxpayer: (1) dies, (2) liquidates or sells substantially all of its assets (including in a title 11 or similar case), (3) ceases to do business, or (4) or is in similar circumstances. In a case under title 11 or a similar case, any deferred items are taken into income as of the day before the petition is filed. Deferred items are accelerated in a case under title 11 where the taxpayer liquidates, sells substantially all of its assets, or ceases to do business, but not where a taxpayer reorganizes and emerges from the title

11 case. In the case of a pass-thru entity, this acceleration rule also applies to the sale, exchange, or redemption of an interest in the entity by a holder of such interest.

Special rule for partnerships

In the case of a partnership, any income deferred under the provision is allocated to the partners in the partnership immediately before the discharge of indebtedness in the manner such amounts would have been included in the distributive shares of such partners under IRC section 704 if such income were recognized at the time of the discharge. Any decrease in a partner's share of liabilities as a result of such discharge is not taken into account for purposes of IRC section 752 at the time of the discharge to the extent the deemed distribution under IRC section 752 would cause the partner to recognize gain under IRC section 731. Thus, the deemed distribution under IRC section 752 is deferred with respect to a partner to the extent it exceeds such partner's basis. Amounts so deferred are taken into account at the same time, and to the extent remaining in the same amount, as income deferred under the provision is recognized by the partner.

Coordination with IRC section 108(a) and procedures for election

Where a taxpayer makes the election provided by the provision, the exclusions provided by IRC section 108(a)(1)(A), (B), (C), and (D) shall not apply to the income from the discharge of indebtedness for the year in which the taxpayer makes the election or any subsequent year. Thus, for example, an insolvent taxpayer may elect under the provision to defer income from the discharge of indebtedness rather than excluding such income and reducing tax attributes by a corresponding amount. The election is to be made on an instrument-by-instrument basis; once made, the election is irrevocable. A taxpayer makes an election with respect to a debt instrument by including with its return for the taxable year in which the reacquisition of the debt instrument occurs a statement that (1) clearly identifies the debt instrument and (2) includes the amount of deferred income to which the provision applies and such other information as may be prescribed by the Secretary. The Secretary is authorized to require reporting of the election (and other information with respect to the reacquisition) for years subsequent to the year of the reacquisition.

Regulatory authority

The provision authorizes the Secretary of the Treasury to prescribe such regulations as may be necessary or appropriate for purposes of applying the provision, including rules extending the acceleration provisions to other circumstances where appropriate, rules requiring reporting of the election and such other information as the Secretary may require on returns of tax for subsequent taxable years, rules for the application of the provision to partnerships, S corporations, and other pass thru entities, including for the allocation of deferred deductions.

<u>Effective Date</u>

The provision is effective for discharges in taxable years ending after December 31, 2008.

California Law (R&TC sections 17131, 17134, 17144, 17144.5, and 24307)

California conforms to IRC section 108, relating to income from discharge of indebtedness, as amended by Section 2 of the Mortgage Forgiveness Debt Relief Act of 2007 (Public Law 110-142, December 20, 2007), with modifications.

Because this federal change was made after December 20, 2007, California is not conformed.

Impact on California Revenue

Estimated Revenue Impact of Deferral and Ratable Inclusion of Income Arising from Business Indebtedness Discharged by the Reacquisition of a Debt Instrument For Taxable Years Beginning On or After January 1, 2010 Enactment Assumed After June 30, 2010		
2010-11	2011-12	2012-13
-$351,000,000	-$16,000,000	$10,000,000

Estimates are based on a proration of federal projections developed for the American Recovery and Reinvestment Act of 2009 (ARRA). The estimate is based on income arising from business indebtedness discharged by reacquisition of a debt instrument after December 31, 2009, and before January 1, 2011.

Section	Section Title
1232	Modification of Rules for Original Issue Discount on Certain High-Yield Obligations

Background

In general, the issuer of a debt instrument with original issue discount may deduct the portion of such original issue discount equal to the aggregate daily portions of the original issue discount for days during the taxable year.[115] However, in the case of an applicable high-yield discount obligation (an "AHYDO") issued by a corporate issuer: (1) no deduction is allowed for the "disqualified portion" of the original issue discount on such obligation, and (2) the remainder of the original issue discount on any such obligation is not allowable as a deduction until paid by the issuer.[116]

[115] IRC section 163(e)(1). For purposes of IRC section 163(e)(1), the daily portion of the original issue discount for any day is determined under IRC section 1272(a) (without regard to paragraph (7) thereof and without regard to IRC section 1273(a)(3)).

[116] IRC section 163(e)(5).

An AHYDO is any debt instrument if (1) the maturity date on such instrument is more than five years from the date of issue; (2) the yield to maturity on such instrument exceeds the sum of (a) the applicable federal rate in effect under IRC section 1274(d) for the calendar month in which the obligation is issued and (b) five percentage points, and (3) such instrument has "significant original issue discount."[117] An instrument is treated as having "significant original issue discount" if the aggregate amount of interest that would be includible in the gross income of the holder with respect to such instrument for periods before the close of any accrual period (as defined in IRC section 1272(a)(5)) ending after the date five years after the date of issue, exceeds the sum of (1) the aggregate amount of interest to be paid under the instrument before the close of such accrual period, and (2) the product of the issue price of such instrument (as defined in IRC sections 1273(b) and 1274(a)) and its yield to maturity.[118]

The disqualified portion of the original issue discount on an AHYDO is the lesser of (1) the amount of original issue discount with respect to such obligation or (2) the portion of the "total return" on such obligation which bears the same ratio to such total return as the "disqualified yield" (i.e., the excess of the yield to maturity on the obligation over the applicable federal rate plus six percentage points) on such obligation bears to the yield to maturity on such obligation.[119] The term "total return" means the amount which would have been the original issue discount of the obligation if interest described in IRC section 1273(a)(2) were included in the stated redemption to maturity.[120] A corporate holder treats the disqualified portion of original issue discount as a stock distribution for purposes of the dividend received deduction.[121]

<u>New Federal Law (IRC section 163)</u>

The provision suspends the rules in IRC section 163(e)(5) for certain obligations issued in a debt-for-debt exchange, including an exchange resulting from a significant modification of a debt instrument, after August 31, 2008, and before January 1, 2010.

In general, the suspension does not apply to any newly issued debt instrument (including any debt instrument issued as a result of a significant modification of a debt instrument) that is issued for an AHYDO. However, any newly issued debt instrument (including any debt instrument issued as a result of a significant modification of a debt instrument) for which the AHYDO rules are suspended under the provision is not treated as an AHYDO for purposes of a subsequent application of the suspension rule. Thus, for example, if a new debt instrument that would be an AHYDO under present law is issued in exchange for a debt instrument that is not an AHYDO, and the provision suspends application of IRC section 163(e)(5), another new debt instrument, issued during the suspension period in exchange for the instrument with respect to which the rule in IRC

[117] IRC section 163(i)(1).

[118] IRC section 163(i)(2).

[119] IRC section 163(e)(5)(C).

[120] IRC section 163(e)(5)(C)(ii).

[121] IRC section 163(e)(5)(B).

section 163(e)(5) was suspended, would be eligible for the relief provided by the provision despite the fact that it is issued for an instrument that is an AHYDO under present law.

In addition, the suspension does not apply to any newly issued debt instrument (including any debt instrument issued as a result of a significant modification of a debt instrument) that is (1) described in IRC section 871(h)(4) (without regard to subparagraph (D) thereof) (i.e., certain contingent debt) or (2) issued to a person related to the issuer (within the meaning of IRC section 108(e)(4)).

The provision provides authority to the Secretary to apply the suspension rule to periods after December 31, 2009, where the Secretary determines that such application is appropriate in light of distressed conditions in the debt capital markets. In addition, the provision grants authority to the Secretary to use a rate that is higher than the applicable federal rate for purposes of applying IRC section 163(e)(5) for obligations issued after December 31, 2009, in taxable years ending after such date if the Secretary determines that such higher rate is appropriate in light of distressed conditions in the debt capital markets.

Effective Date

The temporary suspension of IRC section 163(e)(5) applies to obligations issued after August 31, 2008, in taxable years ending after such date. The additional authority granted to the Secretary to use a rate higher than the applicable federal rate for purposes of applying IRC section 163(e)(5) applies to obligations issued after December 31, 2009, in taxable years ending after such date.

California Law (R&TC sections 17201, 17224, 24344, and 24344.5)

California conforms to IRC Section 163(e), relating to original issue discount, as of the specified date of January 1, 2005, with modifications. R&TC sections 17224 and 24344.5 provide that the deductible amount of original issue discount is the same amount deductible on the federal tax return.

Impact on California Revenue

Baseline.

PART V of SUBTITLE C of TITLE I – QUALIFIED SMALL BUSINESS STOCK

Section	Section Title
1241	Special Rules Applicable to Qualified Small Business Stock for 2009 and 2010

Background

Under present law, individuals may exclude 50 percent (60 percent for certain empowerment zone businesses) of the gain from the sale of certain small business stock acquired at original issue and held for at least five years.[122] The portion of the gain includible in taxable income is taxed at a maximum rate of 28 percent under the regular tax.[123] A percentage of the excluded gain is an alternative minimum tax preference;[124] the portion of the gain includible in alternative minimum taxable income is taxed at a maximum rate of 28 percent under the alternative minimum tax.

Thus, under present law, gain from the sale of qualified small business stock is taxed at effective rates of 14 percent under the regular tax[125] and (i) 14.98 percent under the alternative minimum tax for dispositions before January 1, 2011; (ii) 19.98 percent under the alternative minimum tax for dispositions after December 31, 2010, in the case of stock acquired before January 1, 2001; and (iii) 17.92 percent under the alternative minimum tax for dispositions after December 31, 2010, in the case of stock acquired after December 31, 2000.[126]

The amount of gain eligible for the exclusion by an individual with respect to any corporation is the greater of (1) ten times the taxpayer's basis in the stock or (2) $10 million. In order to qualify as a small business, when the stock is issued, the gross assets of the corporation may not exceed $50 million. The corporation also must meet certain active trade or business requirements.

[122] IRC section 1202.

[123] IRC section 1(h).

[124] IRC section 57(a)(7). In the case of qualified small business stock, the percentage of gain excluded from gross income which is an alternative minimum tax preference is (i) seven percent in the case of stock disposed of in a taxable year beginning before 2011; (ii) 42 percent in the case of stock acquired before January 1, 2001, and disposed of in a taxable year beginning after 2010; and (iii) 28 percent in the case of stock acquired after December 31, 2000, and disposed of in a taxable year beginning after 2010.

[125] The 50 percent of gain included in taxable income is taxed at a maximum rate of 28 percent.

[126] The amount of gain included in alternative minimum tax is taxed at a maximum rate of 28 percent. The amount so included is the sum of (i) 50 percent (the percentage included in taxable income) of the total gain and (ii) the applicable preference percentage of the one-half gain that is excluded from taxable income.

New Federal Law (IRC section 1202)

Under the provision, the percentage exclusion for qualified small business stock sold by an individual is increased from 50 percent (60 percent for certain empowerment zone businesses) to 75 percent.

As a result of the increased exclusion, gain from the sale of qualified small business stock to which the provision applies is taxed at effective rates of 7 percent under the regular tax[127] and 12.88 percent under the alternative minimum tax.[128]

Effective Date

The provision is effective for stock issued after the date of enactment and before January 1, 2011.

California Law (R&TC sections 18152 and 18152.5)

California specifically does not conform to IRC section 1202, relating to partial exclusion for gain from certain small business stock. However, California has stand-alone language under RT&C section 18152.5 that allows an exclusion from gross income of 50 percent from the sale or exchange of qualified small business stock held for more than five years. The maximum amount of gain taken into account for this purpose is the lesser of $10 million reduced by gains taken into account in prior years, or ten times the eligible basis of the qualified stock.

Impact on California Revenue

Estimated Revenue Impact of Special Rules Applicable to Qualified Small Business Stock for 2009 & 2010 For Taxable Years Beginning On or After January 1, 2010 Enactment Assumed After June 30, 2010		
2010-11	2011-12	2012-13
No impact until fiscal year 2014/15	No impact until fiscal year 2014/15	No impact until fiscal year 2014/15

Conformity and baseline estimates are based on a proration of federal projections developed for the American Recovery and Reinvestment Tax Act of 2009, and adjusted to reflect California differences.

The conformity estimate reflects qualified purchases made in taxable year 2010. Because qualified small business stock must be held for five years, conforming to the increased exclusion

[127] The 25 percent of gain included in taxable income is taxed at a maximum rate of 28 percent.

[128] The 46 percent of gain included in alternative minimum tax is taxed at a maximum rate of 28 percent. Forty-six percent is the sum of 25 percent (the percentage of total gain included in taxable income) plus 21 percent (the percentage of total gain which is an alternative minimum tax preference).

would result in losses of $10 million in fiscal year 2014-15, $12 million in fiscal year 2015-16, and $5 million in fiscal year 2016-17.

Additionally, this provision is anticipated to encourage taxpayers to sell existing stock to purchase stock that qualifies for the additional exclusion. California will automatically benefit from this altered behavior, since any additional income reported at the federal level will also be reported as California income. Baseline gains are estimated to be $700,000 in fiscal year 2009/10, and $250,000 in fiscal year 2010/11.

PART VI of SUBTITLE C of TITLE I – S CORPORATIONS

Section	Section Title
1251	Temporary Reduction in Recognition Period for Built-In Gains Tax

Background

A "small business corporation" (as defined in IRC section 1361(b)) may elect to be treated as an S corporation. Unlike C corporations, S corporations generally pay no corporate-level tax. Instead, items of income and loss of an S corporation pass though to its shareholders. Each shareholder takes into account separately its share of these items on its individual income tax return.[129]

A corporate-level tax, at the highest marginal rate applicable to corporations (currently 35 percent) is imposed on an S corporation's gain that arose prior to the conversion of the C corporation to an S corporation and is recognized by the S corporation during the recognition period, i.e., the first 10 taxable years that the S election is in effect.[130]

Gains recognized in the recognition period are not built-in gains to the extent they are shown to have arisen while the S election was in effect or are offset by recognized built-in losses. The built-in gains tax also applies to gains with respect to net recognized built-in gain attributable to property received by an S corporation from a C corporation in a carryover basis transaction.[131] The amount of the built-in gains tax is treated as a loss taken into account by the shareholders in computing their individual income tax.[132]

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[129] IRC section 1366.

[130] IRC section 1374.

[131] IRC section 1374(d)(8). With respect to such assets, the recognition period runs from the day on which such assets were acquired (in lieu of the beginning of the first taxable year for which the corporation was an S corporation). IRC section 1374(d)(8)(B).

[132] IRC section 1366(f)(2).

New Federal Law (IRC section 1374)

The provision provides that, for any taxable year beginning in 2009 and 2010, no tax is imposed on an S corporation under IRC section 1374 if the seventh taxable year in the corporation's recognition period preceded such taxable year. Thus, with respect to gain that arose prior to the conversion of a C corporation to an S corporation, no tax will be imposed under IRC section 1374 after the seventh taxable year the S corporation election is in effect. In the case of built-in gain attributable to an asset received by an S corporation from a C corporation in a carryover basis transaction, no tax will be imposed under IRC section 1374 if such gain is recognized after the date that is seven years following the date on which such asset was acquired.[133]

Effective Date

The provision is effective for taxable years beginning after December 31, 2008.

California Law (R&TC sections 17087.5, 23800, and 23809)

California conforms by reference to IRC section 1374, relating to tax imposed on certain built-in gains, as of the "specified date" of January 1, 2005. Thus, California is not conformed to this federal change.

Impact on California Revenue

Estimated Revenue Impact of Temporary Reduction in Recognition Period for Built-In Gains Tax For Taxable Years Beginning On or After January 1, 2010 Enactment Assumed After June 30, 2010		
2010-11	2011-12	2012-13
-$4,700,000	-$1,000,000	-$700,000

Estimates are based on a proration of federal projections developed for the American Recovery and Reinvestment Act of 2009 (ARRA).

[133] Shareholders will continue to take into account all items of gain and loss under IRC section 1366.

PART VII of SUBTITLE C of TITLE I – RULES RELATING TO OWNERSHIP CHANGES

Section	Section Title
1261	Clarification of Regulations Related to Limitations on Certain Built-In Losses Following an Ownership Change

Background

IRC section 382 limits the extent to which a "loss corporation" that experiences an "ownership change" may offset taxable income in any post-change taxable year by pre-change net operating losses, certain built-in losses, and deductions attributable to the pre-change period.[134] In general, the amount of income in any post-change year that may be offset by such net operating losses, built-in losses and deductions is limited to an amount (referred to as the "IRC section 382 limitation") determined by multiplying the value of the loss corporation immediately before the ownership change by the long-term tax-exempt interest rate.[135]

A "loss corporation" is defined as a corporation entitled to use a net operating loss carryover or having a net operating loss carryover for the taxable year in which the ownership change occurs. Except to the extent provided in regulations, such term includes any corporation with a "net unrealized built-in loss" (or NUBIL),[136] defined as the amount by which the fair market value of the assets of the corporation immediately before an ownership change is less than the aggregate adjusted basis of such assets at such time. However, if the amount of the NUBIL does not exceed the lesser of (i) 15 percent of the fair market value of the corporation's assets or (ii) $10 million then the amount of the NUBIL is treated as zero.[137]

An ownership change is defined generally as an increase by more than 50 percentage points in the percentage of stock of a loss corporation that is owned by any one or more 5-percent (or greater) shareholders (as defined) within a three-year period.[138] Treasury regulations provide generally that this measurement is to be made as of any "testing date," which is any date on which

[134] IRC section 383 imposes similar limitations, under regulations, on the use of carryforwards of general business credits, alternative minimum tax credits, foreign tax credits, and net capital loss carryforwards. IRC section 383 generally refers to IRC section 382 for the meanings of its terms, but requires appropriate adjustments to take account of its application to credits and net capital losses.

[135] If the loss corporation had a "net unrealized built-in gain" (or NUBIG) at the time of the ownership change, then the IRC section 382 limitation for any taxable year may be increased by the amount of the "recognized built-in gains" (discussed further below) for that year. A NUBIG is defined as the amount by which the fair market value of the assets of the corporation immediately before an ownership change exceeds the aggregate adjusted basis of such assets at such time. However, if the amount of the NUBIG does not exceed the lesser of (i) 15 percent of the fair market value of the corporation's assets or (ii) $10 million, then the amount of the NUBIG is treated as zero. IRC section 382(h)(1).

[136] IRC section 382(k)(1).

[137] IRC section 382(h)(3).

[138] Determinations of the percentage of stock of any corporation held by any person are made on the basis of value. IRC section 382(k)(6)(C).

the ownership of one or more persons who were or who become 5-percent shareholders increases.[139]

IRC section 382(h) governs the treatment of certain built-in losses and built-in gains recognized with respect to assets held by the loss corporation at the time of the ownership change. In the case of a loss corporation that has a NUBIL (measured immediately before an ownership change), IRC section 382(h)(1) provides that any "recognized built-in loss" (or RBIL) for any taxable year during a "recognition period" (consisting of the five years beginning on the ownership change date) is subject to the IRC section 382 limitation in the same manner as if it were a pre-change net operating loss.[140] An RBIL is defined for this purpose as any loss recognized during the recognition period on the disposition of any asset held by the loss corporation immediately before the ownership change date, to the extent that such loss is attributable to an excess of the adjusted basis of the asset on the change date over its fair market value on that date.[141] An RBIL also includes any amount allowable as depreciation, amortization or depletion during the

[139] See Treas. Reg. section 1.382-2(a)(4) (providing that "a loss corporation is required to determine whether an ownership change has occurred immediately after any owner shift, or issuance or transfer (including an issuance or transfer described in Treas. Reg. section 1.382-4(d)(8)(i) or (ii)) of an option with respect to stock of the loss corporation that is treated as exercised under Treas. Reg. section 1.382-4(d)(2)" and defining a "testing date" as "each date on which a loss corporation is required to make a determination of whether an ownership change has occurred") and Temp. Treas. Reg. section 1.382-2T(e)(1) (defining an "owner shift" as "any change in the ownership of the stock of a loss corporation that affects the percentage of such stock owned by any 5-percent shareholder"). Treasury regulations under IRC section 382 provide that, in computing stock ownership on specified testing dates, certain unexercised options must be treated as exercised if certain ownership, control, or income tests are met. These tests are met only if "a principal purpose of the issuance, transfer, or structuring of the option (alone or in combination with other arrangements) is to avoid or ameliorate the impact of an ownership change of the loss corporation." Treas. Reg. section 1.382-4(d). Compare prior temporary regulations, Temp. Reg. section 1.382-2T(h)(4) ("Solely for the purpose of determining whether there is an ownership change on any testing date, stock of the loss corporation that is subject to an option shall be treated as acquired on any such date, pursuant to an exercise of the option by its owner on that date, if such deemed exercise would result in an ownership change."). IRS Notice 2008-76, I.R.B. 2008-39 (September 29, 2008), released September 7, 2008, provides that the Treasury Department intends to issue regulations modifying the term "testing date" under IRC section 382 to exclude any date on or after which the United States acquires stock or options to acquire stock in certain corporations with respect to which there is a "Housing Act Acquisition" pursuant to the Housing and Economic Recovery Act of 2008 (Public Law 110-289). The Notice states that the regulations will apply on and after September 7, 2008, unless and until there is additional guidance. IRS Notice 2008-84, I.R.B. 2008-41 (October 14, 2008), provides that the Treasury Department intends to issue regulations modifying the term "testing date" under IRC section 382 to exclude any date as of the close of which the United States owns, directly or indirectly, a more than 50 percent interest in a loss corporation, which regulations will apply unless and until there is additional guidance. IRS Notice 2008-100, 2008-14 I.R.B. 1081 (released October 15, 2008) provides that the Treasury Department intends to issue regulations providing, among other things, that certain instruments acquired by the Treasury Department under the Capital Purchase Program (CPP) pursuant to the Emergency Economic Stabilization Act of 2008 (Public Law 100-343)("EESA") shall not be treated as stock for certain purposes. The Notice also provides that certain capital contributions made by Treasury pursuant to the CPP shall not be considered to have been made as part of a plan the principal purpose of which was to avoid or increase any IRC section 382 limitation (for purposes of IRC section 382(1)(1)). The Notice states that taxpayers may rely on the rules described unless and until there is further guidance; and that any contrary guidance will not apply to instruments (i) held by Treasury that were acquired pursuant to the CCP prior to publication of that guidance, or (ii) issued to Treasury pursuant to the CCP under written binding contracts entered into prior to the publication of that guidance. IRS Notice 2009-14, 2009-7 I.R.B. 1 (January 30, 2009) amplifies and supersedes Notice 2008-100, and provides additional guidance regarding the application of IRC section 382 and other provisions of law to corporations whose instruments are acquired by the Treasury Department under certain programs pursuant to EESA.

[140] IRC section 382(h)(2). The total amount of the loss corporation's RBILs that are subject to the section 382 limitation cannot exceed the amount of the corporation's NUBIL.

[141] IRC section 382(h)(2)(B).

recognition period, to the extent that such amount is attributable to the excess of the adjusted basis of the asset over its fair market value on the ownership change date.[142] In addition, any amount that is allowable as a deduction during the recognition period (determined without regard to any carryover) but which is attributable to periods before the ownership change date is treated as an RBIL for the taxable year in which it is allowable as a deduction.[143]

As indicated above, IRC section 382(h)(1) provides in the case of a loss corporation that has a NUBIG that the IRC section 382 limitation may be increased for any taxable year during the recognition period by the amount of recognized built-in gains (or RBIGs) for such taxable year.[144] An RBIG is defined for this purpose as any gain recognized during the recognition period on the disposition of any asset held by the loss corporation immediately before the ownership change date, to the extent that such gain is attributable to an excess of the fair market value of the asset on the change date over its adjusted basis on that date.[145] In addition, any item of income that is properly taken into account during the recognition period but which is attributable to periods before the ownership change date is treated as an RBIG for the taxable year in which it is properly taken into account.[146]

Internal Revenue Service Notice 2003-65[147] provides two alternative safe harbor approaches for the identification of built-in items for purposes of IRC section 382(h): the "1374 approach" and the "338 approach."

Under the 1374 approach,[148] NUBIG or NUBIL is the net amount of gain or loss that would be recognized in a hypothetical sale of the assets of the loss corporation immediately before the ownership change.[149] The amount of gain or loss recognized during the recognition period on the sale or exchange of an asset held at the time of the ownership change is RBIG or RBIL, respectively, to the extent it is attributable to a difference between the adjusted basis and the fair market value of the asset on the change date, as described above. However, the 1374 approach

[142] IRC section 382(h)(2)(B).

[143] IRC section 382(h)(6)(B).

[144] The total amount of such increases cannot exceed the amount of the corporation's NUBIG.

[145] IRC section 382(h)(2)(A).

[146] IRC section 382(h)(6)(A).

[147] 2003-2 C.B. 747.

[148] The 1374 approach generally incorporates rules similar to those of IRC section 1374(d) and the Treasury regulations thereunder in calculating NUBIG and NUBIL and identifying RBIG and RBIL.

[149] More specifically, NUBIG or NUBIL is calculated by determining the amount that would be realized if immediately before the ownership change the loss corporation had sold all of its assets, including goodwill, at fair market value to a third party that assumed all of its liabilities, decreased by the sum of any deductible liabilities of the loss corporation that would be included in the amount realized on the hypothetical sale and the loss corporation's aggregate adjusted basis in all of its assets, increased or decreased by the corporation's IRC section 481 adjustments that would be taken into account on a hypothetical sale, and increased by any RBIL that would not be allowed as a deduction under IRC section 382, 383 or 384 on the hypothetical sale.

generally relies on the accrual method of accounting to identify items of income or deduction as RBIG or RBIL, respectively. Generally, items of income or deduction properly included in income or allowed as a deduction during the recognition period are considered attributable to period before the change date (and thus are treated as RBIG or RBIL, respectively), if a taxpayer using an accrual method of accounting would have included the item in income or been allowed a deduction for the item before the change date. However, the 1374 approach includes a number of exceptions to this general rule, including a special rule dealing with bad debt deductions under IRC section 166. Under this special rule, any deduction item properly taken into account during the first 12 months of the recognition period as a bad debt deduction under IRC section 166 is treated as RBIL if the item arises from a debt owed to the loss corporation at the beginning of the recognition period (and deductions for such items properly taken into account after the first 12 months of the recognition period are not RBILs).[150]

The 338 approach identifies items of RBIG and RBIL generally by comparing the loss corporation's actual items of income, gain, deduction and loss with those that would have resulted if an IRC section 338 election had been made with respect to a hypothetical purchase of all of the outstanding stock of the loss corporation on the change date. Under the 338 approach, NUBIG or NUBIL is calculated in the same manner as it is under the 1374 approach.[151] The 338 approach identifies RBIG or RBIL by comparing the loss corporation's actual items of income, gain, deduction and loss with the items of income, gain, deduction and loss that would result if an IRC section 338 election had been made for the hypothetical purchase. The loss corporation is treated for this purpose as using those accounting methods that the loss corporation actually uses. The 338 approach does not include any special rule with regard to bad debt deductions under IRC section 166.

IRC section 166 generally allows a deduction in respect of any debt that becomes worthless, in whole or in part, during the taxable year.[152] The determination of whether a debt is worthless, in whole or in part, is a question of fact. However, in the case of a bank or other corporation that is subject to supervision by federal authorities, or by state authorities maintaining substantially equivalent standards, the Treasury regulations under IRC section 166 provide a presumption of worthlessness to the extent that a debt is charged off during the taxable year pursuant to a specific order of such an authority or in accordance with established policies of such an authority (and in the latter case, the authority confirms in writing upon the first subsequent audit of the bank or other corporation that the charge-off would have been required if the audit had been made at the time of the charge-off). The presumption does not apply if the taxpayer does not claim the amount so charged off as a deduction for the taxable year in which the charge-off takes

[150] IRS Notice 2003-65, section III.B.2.b.

[151] Accordingly, unlike the case in which an IRC section 338 election is actually made, contingent consideration (including a contingent liability) is taken into account in the initial calculation of NUBIG or NUBIL, and no further adjustments are made to reflect subsequent changes in deemed consideration.

[152] IRC section 166 does not apply, however, to a debt which is evidenced by a security, defined for this purpose (by cross-reference to IRC section 165(g)(2)(C)) as a bond, debenture, note or certificate or other evidence of indebtedness issued by a corporation or by a government or political subdivision thereof, with interest coupons or in registered form. IRC section 166(e).

place. In that case, the charge-off is treated as having been involuntary; however, in order to claim the IRC section 166 deduction in a later taxable year, the taxpayer must produce sufficient evidence to show that the debt became partially worthless in the later year or became recoverable only in part subsequent to the taxable year of the charge-off, as the case may be, and to the extent that the deduction claimed in the later year for a partially worthless debt was not involuntarily charged off in prior taxable years, it was charged off in the later taxable year.[153]

The Treasury regulations also permit a bank (generally as defined for purposes of IRC section 581, with certain modifications) that is subject to supervision by federal authorities, or state authorities maintaining substantially equivalent standards, to make a "conformity election" under which debts charged off for regulatory purposes during a taxable year are conclusively presumed to be worthless for tax purposes to the same extent, provided that the charge-off results from a specific order of the regulatory authority or corresponds to the institution's classification of the debt as a "loss asset" pursuant to loan loss classification standards that are consistent with those of certain specified bank regulatory authorities. The conformity election is treated as the adoption of a method of accounting.[154]

Internal Revenue Service Notice 2008-83,[155] released on October 1, 2008, provides that "[f]or purposes of IRC section 382(h), any deduction properly allowed after an ownership change (as defined in IRC section 382(g)) to a bank with respect to losses on loans or bad debts (including any deduction for a reasonable addition to a reserve for bad debts) shall not be treated as a built-in loss or a deduction that is attributable to periods before the change date."[156] The Notice further states that the Internal Revenue Service and the Treasury Department are studying the proper treatment under IRC section 382(h) of certain items of deduction or loss allowed after an ownership change to a corporation that is a bank (as defined in IRC section 581) both immediately before and after the change date, and that any such corporation may rely on the treatment set forth in Notice 2008-83 unless and until there is additional guidance.

<u>New Federal Law (Act Section 1261 affecting IRC section 382)</u>

The provision provides that Congress finds as follows: (1) The delegation of authority to the Secretary of the Treasury, or his delegate, under IRC section 382(m) does not authorize the Secretary to provide exemptions or special rules that are restricted to particular industries or classes of taxpayers; (2) Internal Revenue Service Notice 2008-83 is inconsistent with the congressional intent in enacting such IRC section 382(m); (3) the legal authority to prescribe Notice 2008-83 is doubtful; (4) however, as taxpayers should generally be able to rely on guidance issued by the Secretary of the Treasury, legislation is necessary to clarify the force and

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[153] See Treas. Reg. section 1.166-2(d)(1) and (2).

[154] See Treas. Reg. section 1.166-2(d)(3); of. Priv. Let. Rul. 9248048 (July 7, 1992); Tech. Ad. Mem. 9122001 (Feb. 8, 1991).

[155] 2008-42 I.R.B. 2008-42 (Oct. 20, 2008).

[156] IRS Notice 2008-83, section 2.

effect of Notice 2008-83 and restore the proper application under the IRC of the limitation on built-in losses following an ownership change of a bank.

Under the provision, Treasury Notice 2008-83 shall be deemed to have the force and effect of law with respect to any ownership change (as defined in IRC section 382(g)) occurring on or before January 16, 2009, and with respect to any ownership change (as so defined) which occurs after January 16, 2009, if such change (1) is pursuant to a written binding contract entered in to on or before such date or (2) is pursuant to a written agreement entered into on or before such date and such agreement was described on or before such date in a public announcement or in a filing with the Securities and Exchange Commission required by reason of such ownership change, but shall otherwise have no force or effect with respect to any ownership change after such date.

Effective Date

The provision is effective on February 17, 2009.

California Law (R&TC sections 17024.5, 17321, 23051.5, 24451, 24458, and 24472)

California conforms to IRC section 382, relating to limitation on net operating loss carryforwards and certain built-in losses following ownership change, as of the "specified date" of January 1, 2005, with modifications. California law[157] specifically provides that IRS Notice 2008-83, 2008-42 I.R.B. 905, issued October 20, 2008, shall not be applicable for CTL purposes with respect to any ownership change occurring at any time.

Impact on California Revenue

Not applicable.

Section	Section Title
1262	Treatment of Certain Ownership Changes for Purposes of Limitations on Net Operating Loss Carryforwards and Certain Built-In Losses

Background

IRC section 382 limits the extent to which a "loss corporation" that experiences an "ownership change" may offset taxable income in any post-change taxable year by pre-change net operating losses, certain built-in losses, and deductions attributable to the pre-change period.[158] In general,

[157] R&TC section 24458.

[158] IRC section 383 imposes similar limitations, under regulations, on the use of carryforwards of general business credits, alternative minimum tax credits, foreign tax credits, and net capital loss carryforwards. IRC section 383 generally refers to IRC section 382 for the meanings of its terms, but requires appropriate adjustments to take account of its application to credits and net capital losses.

the amount of income in any post-change year that may be offset by such net operating losses, built-in losses and deductions is limited to an amount (referred to as the "IRC section 382 limitation") determined by multiplying the value of the loss corporation immediately before the ownership change by the long-term tax-exempt interest rate.[159]

A "loss corporation" is defined as a corporation entitled to use a net operating loss carryover or having a net operating loss carryover for the taxable year in which the ownership change occurs. Except to the extent provided in regulations, such term includes any corporation with a "net unrealized built-in loss" (or NUBIL),[160] defined as the amount by which the fair market value of the assets of the corporation immediately before an ownership change is less than the aggregate adjusted basis of such assets at such time. However, if the amount of the NUBIL does not exceed the lesser of (i) 15 percent of the fair market value of the corporation's assets or (ii) $10,000,000, then the amount of the NUBIL is treated as zero.[161]

An ownership change is defined generally as an increase by more than 50 percentage points in the percentage of stock of a loss corporation that is owned by any one or more 5-percent (or greater) shareholders (as defined) within a three year period.[162] Treasury regulations provide generally that this measurement is to be made as of any "testing date," which is any date on which the ownership of one or more persons who were or who become 5-percent shareholders increases.[163]

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[159] If the loss corporation had a "net unrealized built in gain" (or NUBIG) at the time of the ownership change, then the IRC section 382 limitation for any taxable year may be increased by the amount of the "recognized built-in gains" (discussed further below) for that year. A NUBIG is defined as the amount by which the fair market value of the assets of the corporation immediately before an ownership change exceeds the aggregate adjusted basis of such assets at such time. However, if the amount of the NUBIG does not exceed the lesser of (i) 15 percent of the fair market value of the corporation's assets or (ii) $10,000,000, then the amount of the NUBIG is treated as zero. IRC section 382(h)(1).

[160] IRC section 382(k)(1).

[161] IRC section 382(h)(3).

[162] Determinations of the percentage of stock of any corporation held by any person are made on the basis of value. IRC section 382(k)(6)(C).

[163] See Treas. Reg. section 1.382-2(a)(4) (providing that "a loss corporation is required to determine whether an ownership change has occurred immediately after any owner shift, or issuance or transfer (including an issuance or transfer described in Treas. Reg. section 1.382-4(d)(8)(i) or (ii)) of an option with respect to stock of the loss corporation that is treated as exercised under Treas. Reg. section 1.382-4(d)(2)" and defining a "testing date" as "each date on which a loss corporation is required to make a determination of whether an ownership change has occurred") and Temp. Treas. Reg. section 1.382-2T(e)(1) (defining an "owner shift" as "any change in the ownership of the stock of a loss corporation that affects the percentage of such stock owned by any 5-percent shareholder"). Treasury regulations under IRC section 382 provide that, in computing stock ownership on specified testing dates, certain unexercised options must be treated as exercised if certain ownership, control, or income tests are met. These tests are met only if "a principal purpose of the issuance, transfer, or structuring of the option (alone or in combination with other arrangements) is to avoid or ameliorate the impact of an ownership change of the loss corporation." Treas. Reg. section 1.382-4(d). Compare prior temporary regulations, Temp. Reg. section 1.382-2T(h)(4) ("Solely for the purpose of determining whether there is an ownership change on any testing date, stock of the loss corporation that is subject to an option shall be treated as acquired on any such date, pursuant to an exercise of the option by its owner on that date, if such deemed exercise would result in an ownership change."). IRS Notice 2008-76, I.R.B. 2008-39 (September 29, 2008), released September 7, 2008, provides that the Treasury Department intends to issue regulations modifying the term "testing date" under IRC section 382 to exclude any date on or after which the United States acquires stock or options to acquire stock in certain corporations with respect to which there is a "Housing Act Acquisition" pursuant to the Housing and Economic Recovery Act of 2008 (Public Law 110-289). The Notice states that the

New Federal Law (IRC section 382)

The provision provides an exception from the application of the IRC section 382 limitation. Under the provision, the IRC section 382 limitation that would otherwise arise as a result of an ownership change shall not apply in the case of an ownership change that occurs pursuant to a restructuring plan of a taxpayer which is required under a loan agreement or commitment for a line of credit entered into with the Department of the Treasury under the Emergency Economic Stabilization Act of 2008, and is intended to result in a rationalization of the costs, capitalization, and capacity with respect to the manufacturing workforce of, and suppliers to, the taxpayer and its subsidiaries.[164]

However, an ownership change that would otherwise be excepted from the IRC section 382 limitation under the provision will instead remain subject to the IRC section 382 limitation if, immediately after such ownership change, any person (other than a voluntary employees' beneficiary association within the meaning of IRC section 501(c)(9)) owns stock of the new loss corporation possessing 50 percent or more of the total combined voting power of all classes of stock entitled to vote or of the total value of the stock of such corporation. For purposes of this rule, persons who bear a relationship to one another described in IRC section 267(b) or 707(b)(1), or who are members of a group of persons acting in concert, are treated as a single person.

The exception from the application of the IRC section 382 limitation under the provision does not change the fact that an ownership change has occurred for other purposes of IRC section 382.[165]

Effective Date

The provision applies to ownership changes after February 17, 2009.

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regulations will apply on and after September 7, 2008, unless and until there is additional guidance. IRS Notice 2008-84, I.R.B. 2008-41 (October 14, 2008), provides that the Treasury Department intends to issue regulations modifying the term "testing date" under IRC section 382 to exclude any date as of the close of which the United States owns, directly or indirectly, a more than 50 percent interest in a loss corporation, which regulations will apply unless and until there is additional guidance. IRS Notice 2008-100, 2008-14 I.R.B. 1081 (released October 15, 2008) provides that the Treasury Department intends to issue regulations providing, among other things, that certain instruments acquired by the Treasury Department under the Capital Purchase Program (CPP) pursuant to the Emergency Economic Stabilization Act of 2008 (Public Law 100-343)("EESA") shall not be treated as stock for certain purposes. The Notice also provides that certain capital contributions made by Treasury pursuant to the CPP shall not be considered to have been made as part of a plan the principal purpose of which was to avoid or increase any IRC section 382 limitation (for purposes of IRC section 382(1)(1)). The Notice states that taxpayers may rely on the rules described unless and until there is further guidance; and that any contrary guidance will not apply to instruments (i) held by Treasury that were acquired pursuant to the CCP prior to publication of that guidance, or (ii) issued to Treasury pursuant to the CCP under written binding contracts entered into prior to the publication of that guidance. IRS Notice 2009-14, 2009-7 I.R.B. 1 (January 30, 2009) amplifies and supersedes Notice 2008-100, and provides additional guidance regarding the application of IRC section 382 and other provisions of law to corporations whose instruments are acquired by the Treasury Department under certain programs pursuant to EESA.

[164] This exception shall not apply in the case of any subsequent ownership change unless such subsequent ownership change also meets the requirements of the exception.

[165] For example, an ownership change has occurred for purposes of determining the testing period under IRC section 382(i)(2).

California Law (R&TC sections 17321, 24451, 24458, and 24472)

California conforms to IRC section 382, relating to limitation on net operating loss carryforwards and certain built-in losses following ownership change, as of the "specified date" of January 1, 2005, with modifications. California law[166] specifically provides that IRS Notice 2008-83, 2008-42 I.R.B. 905, issued October 20, 2008, shall not be applicable for CTL purposes with respect to any ownership change occurring at any time.

Because this federal change was made after January 1, 2005, California is not conformed.

Impact on California Revenue

Estimated Revenue Impact of Treatment of Certain Ownership Changes for Purposes of Limitations on Net Operating Loss Carryforwards and Certain Built-in Losses For Taxable Years Beginning On or After January 1, 2010 Enactment Assumed After June 30, 2010		
2010-11	2011-12	2012-13
-$400,000	-$1,100,000	-$3,400,000

Estimates are based on a proration of federal projections developed for the American Recovery and Reinvestment Act of 2009 (ARRA).

SUBTITLE D of TITLE I – MANUFACTURING RECOVERY PROVISIONS

Section	Section Title
1301	Temporary Expansion of Availability of Industrial Development Bonds to Facilities Manufacturing Intangible Property

Background

Qualified small issue bonds (commonly referred to as "industrial development bonds" or "small issue IDBs") are tax-exempt bonds issued by state and local governments to finance private business manufacturing facilities (including certain directly related and ancillary facilities) or the acquisition of land and equipment by certain farmers. In both instances, these bonds are subject to limits on the amount of financing that may be provided, both for a single borrowing and in the aggregate. In general, no more than $1 million of small-issue bond financing may be outstanding at any time for property of a business (including related parties) located in the same municipality or county. Generally, this $1 million limit may be increased to $10 million if, in addition to outstanding bonds, all other capital expenditures of the business (including related parties) in the

[166] R&TC section 24458.

same municipality or county are counted toward the limit over a six-year period that begins three years before the issue date of the bonds and ends three years after such date. Outstanding aggregate borrowing is limited to $40 million per borrower (including related parties) regardless of where the property is located.

The IRC permits up to $10 million of capital expenditures to be disregarded, in effect increasing from $10 million to $20 million the maximum allowable amount of total capital expenditures by an eligible business in the same municipality or county. However, no more than $10 million of bond financing may be outstanding at any time for property of an eligible business (including related parties) located in the same municipality or county. Other limits (e.g., the $40 million per-borrower limit) also continue to apply.

A manufacturing facility is any facility which is used in the manufacturing or production of tangible personal property (including the processing resulting in a change in the condition of such property). Manufacturing facilities include facilities that are directly related and ancillary to a manufacturing facility (as described in the previous sentence) if (1) such facilities are located on the same site as the manufacturing facility and (2) not more than 25 percent of the net proceeds of the issue are used to provide such facilities.[167]

New Federal Law (IRC section 144)

In general

For bonds issued after the date of enactment and before January 1, 2011, the provision expands the definition of manufacturing facilities to mean any facility that is used in the manufacturing, creation, or production of tangible property or intangible property (within the meaning of IRC section 197(d)(1)(C)(iii)). For this purpose, intangible property means any patent, copyright, formula, process, design, knowhow, format, or other similar item. It is intended to include among other items, the creation of computer software, and intellectual property associated bio-tech and pharmaceuticals.

In lieu of the directly related and ancillary test of present law, the provision provides a special rule for bonds issued after February 17, 2009 and before January 1, 2011. For these bonds, the provision provides that facilities that are functionally related and subordinate to the manufacturing facility are treated as a manufacturing facility and the 25 percent of net proceeds restriction does not apply to such facilities.[168] Functionally related and subordinate facilities must be located on the same site as the manufacturing facility.

[167] The 25 percent restriction was enacted by the Technical and Miscellaneous Tax Act of 1988 because of concern over the scope of the definition of manufacturing facility. See H.R. Rpt. No. 100-795 (1988). The amendment was intended to clarify that while the manufacturing facility definition does not preclude the financing of ancillary activities, the 25 percent restriction was intended to limit the use of bond proceeds to finance facilities other than for "core manufacturing." The conference agreement (HR 111-16) followed the House bill, which the conference report described as follows: "The House bill clarifies that up to 25 percent of the proceeds of a qualified small issue may be used to finance ancillary activities which are carried out at the manufacturing site. All such ancillary activities must be subordinate and integral to the manufacturing process."

[168] The provision is based in part on a similar rule applicable to exempt facility bonds. Treas. Reg. section 1.103-8(a)(3) provides: "(3) Functionally related and subordinate. An exempt facility includes any land, building, or other property

Effective Date

The provision is effective for bonds issued after February 17, 2009.

California Law (R&TC section 17143)

California specifically does not conform to IRC section 144, relating to qualified small issue bond; qualified student loan bond; and qualified redevelopment bond.

Impact on California Revenue

Not applicable.

Section	Section Title
1302	Credit for Investment in Advanced Energy Facilities

Background

An income tax credit is allowed for the production of electricity from qualified energy resources at qualified facilities.[169] Qualified energy resources comprise wind, closed-loop biomass, open-loop biomass, geothermal energy, solar energy, small irrigation power, municipal solid waste, qualified hydropower production, and marine and hydrokinetic renewable energy. Qualified facilities are, generally, facilities that generate electricity using qualified energy resources.

An income tax credit is also allowed for certain energy property placed in service. Qualifying property includes certain fuel cell property, solar property, geothermal power production property, small wind energy property, combined heat and power system property, and geothermal heat pump property.[170]

In addition to these, numerous other credits are available to taxpayers to encourage renewable energy production and energy conservation, including, among others, credits for certain biofuels, plug-in electric vehicles, and energy efficient appliances, and for improvements to heating, air conditioning, and insulation.

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functionally related and subordinate to such facility. Property is not functionally related and subordinate to a facility if it is not of a character and size commensurate with the character and size of such facility."

[169] IRC section 45. In addition to the electricity production credit, IRC section 45 also provides income tax credits for the production of Indian coal and refined coal at qualified facilities.

[170] IRC section 48.

No credit is specifically designed under present law to encourage the development of a domestic manufacturing base to support the industries described above.

New Federal Law (IRC sections 46, 48C, and 49)

The provision establishes a 30 percent credit for investment in qualified property used in a qualified advanced energy manufacturing project. A qualified advanced energy project is a project that re-equips, expands, or establishes a manufacturing facility for the production of: (1) property designed to be used to produce energy from the sun, wind, or geothermal deposits (within the meaning of IRC section 613(e)(2)), or other renewable resources; (2) fuel cells, microturbines, or an energy storage system for use with electric or hybrid-electric motor vehicles; (3) electric grids to support the transmission of intermittent sources of renewable energy, including storage of such energy; (4) property designed to capture and sequester carbon dioxide; (5) property designed to refine or blend renewable fuels (but not fossil fuels) or to produce energy conservation technologies (including energy-conserving lighting technologies and smart grid technologies; (6) other advanced energy property designed to reduce greenhouse gas emissions as may be determined by the Secretary; or (7) property designed to manufacture any new qualified plug-in electric drive motor vehicle (as defined in IRC section 30D(c)), any specified vehicle (as defined by IRC section 30D(f)(2)), or any component which is designed specifically for use with such vehicles, including any electric motor, generator, or power control unit.

Qualified property must be tangible personal property and other tangible property (not including a building or its structural components) used in a qualified advanced energy project. Qualified property does not include property designed to manufacture equipment for use in the refining or blending of any transportation fuel other than renewable fuels. The basis of qualified property must be reduced by the amount of credit received.

Credits are available only for projects certified by the Secretary of Treasury, in consultation with the Secretary of Energy. The Secretary of Treasury must establish a certification program no later than 180 days after the date of enactment, and may allocate up to $2.3 billion in credits.

In selecting projects, the Secretary may consider only those projects where there is a reasonable expectation of commercial viability. In addition, the Secretary must consider other selection criteria, including which projects (1) will provide the greatest domestic job creation; (2) will provide the greatest net impact in avoiding or reducing air pollutants or anthropogenic emissions of greenhouse gases; (3) projects that have the greatest potential for technological innovation and commercial deployment; (4) have the lowest levelized cost of generated or stored energy, or of measured reduction in energy consumption or greenhouse gas emission; and (5) have the shortest project time from certification to completion.

Each project application must be submitted during the two-year period beginning on the date such certification program is established. An applicant for certification has one year from the date the Secretary accepts the application to provide the Secretary with evidence that the requirements for certification have been met. Upon certification, the applicant has three years from the date of issuance of the certification to place the project in service. Not later than four years after the date of enactment of the credit, the Secretary is required to review the credit allocations and redistribute any credits that were not used either because of a revoked certification or because of an insufficient quantity of credit applications.

Effective Date

The provision is effective for periods after February 17, 2009, under rules similar to the rules of IRC section 48(m) (as in effect on the last day before the date of the enactment of the Revenue Reconciliation Act of 1990).

California Law (None)

California has no comparable credit.

Impact on California Revenue

Not applicable.

SUBTITLE E of TITLE I – ECONOMIC RECOVERY TOOLS

Section	Section Title
1401	Recovery Zone Bonds

Background

Under present law, gross income does not include interest on state or local bonds. State and local bonds are classified generally as either governmental bonds or private activity bonds. Governmental bonds are bonds the proceeds of which are primarily used to finance governmental functions or which are repaid with governmental funds. Private activity bonds are bonds in which the state or local government serves as a conduit providing financing to nongovernmental persons (e.g., private businesses or individuals). The exclusion from income for state and local bonds does not apply to private activity bonds unless the bonds are issued for certain permitted purposes ("qualified private activity bonds") and other IRC requirements are met.

Private activity bonds

The IRC defines a private activity bond as any bond that satisfies (1) the private business use test and the private security or payment test ("the private business test"); or (2) "the private loan financing test."[171]

[171] IRC section 141.

Private business test

Under the private business test, a bond is a private activity bond if it is part of an issue in which:

1. More than 10 percent of the proceeds of the issue (including use of the bond-financed property) are to be used in the trade or business of any person other than a governmental unit ("private business use"); and
2. More than 10 percent of the payment of principal or interest on the issue is, directly or indirectly, secured by (a) property used or to be used for a private business use or (b) to be derived from payments in respect of property, or borrowed money, used or to be used for a private business use ("private payment test").[172]

A bond is not a private activity bond unless both parts of the private business test (i.e., the private business use test and the private payment test) are met. Thus, a facility that is 100 percent privately used does not cause the bonds financing such facility to be private activity bonds if the bonds are not secured by or paid with private payments. For example, land improvements that benefit a privately-owned factory may be financed with governmental bonds if the debt service on such bonds is not paid by the factory owner or other private parties and such bonds are not secured by the property.

Private loan financing test

A bond issue satisfies the private loan financing test if proceeds exceeding the lesser of $5 million or five percent of such proceeds are used directly or indirectly to finance loans to one or more nongovernmental persons. Private loans include both business and other (e.g., personal) uses and payments to private persons; however, in the case of business uses and payments, all private loans also constitute private business uses and payments subject to the private business test.

Arbitrage restrictions

The exclusion from income for interest on state and local bonds does not apply to any arbitrage bond.[173] An arbitrage bond is defined as any bond that is part of an issue if any proceeds of the issue are reasonably expected to be used (or intentionally are used) to acquire higher yielding investments or to replace funds that are used to acquire higher yielding investments.[174] In general, arbitrage profits may be earned only during specified periods (e.g., defined "temporary periods") before funds are needed for the purpose of the borrowing or on specified types of investments (e.g., "reasonably required reserve or replacement funds"). Subject to limited exceptions, investment profits that are earned during these periods or on such investments must be rebated to the federal government.

[172] The 10 percent private business test is reduced to five percent in the case of private business uses (and payments with respect to such uses) that are unrelated to any governmental use being financed by the issue.

[173] IRC sections 103(a) and (b)(2).

[174] IRC section 148.

Qualified private activity bonds

Qualified private activity bonds permit states or local governments to act as conduits providing tax-exempt financing for certain private activities. The definition of qualified private activity bonds includes an exempt facility bond, or qualified mortgage, veterans' mortgage, small issue, redevelopment, 501(c)(3), or student loan bond (IRC section 141(e)).

The definition of an exempt facility bond includes bonds issued to finance certain transportation facilities (airports, ports, mass commuting, and high-speed intercity rail facilities); qualified residential rental projects; privately owned and/or operated utility facilities (sewage, water, solid waste disposal, and local district heating and cooling facilities, certain private electric and gas facilities, and hydroelectric dam enhancements); public/private educational facilities; qualified green building and sustainable design projects; and qualified highway or surface freight transfer facilities (IRC section 142(a)).

In most cases, the aggregate volume of qualified private activity bonds is restricted by annual aggregate volume limits imposed on bonds issued by issuers within each state ("state volume cap"). For calendar year 2007, the state volume cap, which is indexed for inflation, equals $85 per resident of the state, or $256.24 million, if greater. Exceptions to the state volume cap are provided for bonds for certain governmentally owned facilities (e.g., airports, ports, high-speed intercity rail, and solid waste disposal) and bonds which are subject to separate local, state, or national volume limits (e.g., public/private educational facility bonds, enterprise zone facility bonds, qualified green building bonds, and qualified highway or surface freight transfer facility bonds).

Qualified private activity bonds generally are subject to restrictions on the use of proceeds for the acquisition of land and existing property. In addition, qualified private activity bonds generally are subject to restrictions on the use of proceeds to finance certain specified facilities (e.g., airplanes, skyboxes, other luxury boxes, health club facilities, gambling facilities, and liquor stores), and use of proceeds to pay costs of issuance (e.g., bond counsel and underwriter fees). Small issue and redevelopment bonds also are subject to additional restrictions on the use of proceeds for certain facilities (e.g., golf courses and massage parlors).

Moreover, the term of qualified private activity bonds generally may not exceed 120 percent of the economic life of the property being financed and certain public approval requirements (similar to requirements that typically apply under state law to issuance of governmental debt) apply under federal law to issuance of private activity bonds.

Qualified tax credit bonds

In lieu of interest, holders of qualified tax credit bonds receive a tax credit that accrues quarterly. The following bonds are qualified tax credit bonds: qualified forestry conservation bonds, new clean renewable energy bonds, qualified energy conservation bonds, and qualified zone academy bonds.[175]

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[175] See IRC sections 54B, 54C, 54D, and 54E.

IRC section 54A sets forth general rules applicable to qualified tax credit bonds. These rules include requirements regarding the expenditure of available project proceeds, reporting, arbitrage, maturity limitations, and financial conflicts of interest, among other special rules.

A taxpayer who holds a qualified tax credit bond on one or more credit allowance dates of the bond during the taxable year shall be allowed a credit against the taxpayer's income tax for the taxable year. In general, the credit amount for any credit allowance date is 25 percent of the annual credit determined with respect to the bond. The annual credit is determined by multiplying the applicable credit rate by the outstanding face amount of the bond. The applicable credit rate for the bond is the rate that the Secretary estimates will permit the issuance of the qualified tax credit bond with a specified maturity or redemption date without discount and without interest cost to the qualified issuer.[176] The Secretary determines credit rates for tax credit bonds based on general assumptions about credit quality of the class of potential eligible issuers and such other factors as the Secretary deems appropriate. The Secretary may determine credit rates based on general credit market yield indexes and credit ratings. The credit is included in gross income and, under regulations prescribed by the Secretary, may be stripped.

IRC section 54A requires that 100 percent of the available project proceeds of qualified tax credit bonds must be used within the three-year period that begins on the date of issuance. Available project proceeds are proceeds from the sale of the bond issue less issuance costs (not to exceed two percent) and any investment earnings on such sale proceeds. To the extent less than 100 percent of the available project proceeds are used to finance qualified projects during the three-year spending period, bonds will continue to qualify as qualified tax credit bonds if unspent proceeds are used within 90 days from the end of such three-year period to redeem bonds. The three-year spending period may be extended by the Secretary upon the issuer's request demonstrating that the failure to satisfy the three-year requirement is due to reasonable cause and the projects will continue to proceed with due diligence.

Qualified tax credit bonds generally are subject to the arbitrage requirements of IRC section 148. However, available project proceeds invested during the three-year spending period are not subject to the arbitrage restrictions (i.e., yield restriction and rebate requirements). In addition, amounts invested in a reserve fund are not subject to the arbitrage restrictions to the extent: (1) such fund is funded at a rate not more rapid than equal annual installments; (2) such fund is funded in a manner reasonably expected to result in an amount not greater than an amount necessary to repay the issue; and (3) the yield on such fund is not greater than the average annual interest rate of tax-exempt obligations having a term of 10 years or more that are issued during the month the qualified tax credit bonds are issued.

The maturity of qualified tax credit bonds is the term that the Secretary estimates will result in the present value of the obligation to repay the principal on such bonds being equal to 50 percent of the face amount of such bonds, using as a discount rate the average annual interest rate of tax-

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[176] Given the differences in credit quality and other characteristics of individual issuers, the Secretary cannot set credit rates in a manner that will allow each issuer to issue tax credit bonds at par.

exempt obligations having a term of 10 years or more that are issued during the month the qualified tax credit bonds are issued.

New Federal Law (Act Section 1401 affecting IRC sections 1400L and 1400U)

In general

The provision permits an issuer to designate one or more areas as "recovery zones." The area must have significant poverty, unemployment, general distress, or home foreclosures, be any area for which a designation as an empowerment zone or renewal community is in effect, or be any area designated by the issuer as economically distressed by reason of the closure or realignment of a military installation pursuant to the Defense Base Closure and Realignment Act of 1990. Issuers may issue recovery zone economic development bonds and recovery zone facility bonds with respect to these zones.

There is a national recovery zone economic development bond limitation of $10 billion. In addition, there is a separate national recovery zone facility bond limitation of $15 billion. The Secretary is to separately allocate the bond limitations among the states in the proportion that each state's employment decline bears to the national decline in employment (the aggregate 2008 state employment declines for all states). The Secretary is to adjust each state's allocation for a calendar year such that no state receives less than 0.9 percent of the national recovery zone economic development bond limitation and no less than 0.9 percent of the national recovery zone facility bond limitation. In turn, each state is to reallocate its allocation among the counties (parishes) and large municipalities in such state in the proportion that each such county or municipality's 2008 employment decline bears to the aggregate employment declines for all counties and municipalities in such state. The provision also permits a county or large municipality to waive all or part of its allocation of the state bond limitations to allow further allocation within that State. In calculating the local employment decline with respect to a county, the portion of such decline attributable to a large municipality is disregarded for purposes of determining the county's portion of the state employment decline and is attributable to the large municipality only.

For purposes of the provision "2008 state employment decline" means, with respect to any state, the excess (if any) of (i) the number of individuals employed in such state as determined for December 2007, over (ii) the number of individuals employed in such state as determined for December 2008. The term "large municipality" means a municipality with a population of more than 100,000.

Recovery zone economic development bonds

New IRC section 54AA(h) creates a special rule for qualified bonds (a type of taxable governmental bond) issued before January 1, 2011, that entitles the issuer of such bonds to receive an advance tax credit equal to 35 percent of the interest payable on an interest payment date. For taxable governmental bonds that are designated recovery zone economic development bonds, the applicable percentage is 45 percent.

A recovery zone economic development bond is a taxable governmental bond issued as part of an issue if 100 percent of the available project proceeds of such issue are to be used for one or more qualified economic development purposes and the issuer designates such bond for purposes of this section. A qualified economic development purpose means expenditures for purposes of promoting development or other economic activity in a recovery zone, including (1) capital expenditures paid or incurred with respect to property located in such zone, (2) expenditures for public infrastructure and construction of public facilities located in a recovery zone.

The provision allows a reasonably required reserve fund to be funded from the proceeds of a recovery zone economic development bond.

The aggregate face amount of bonds which may be designated by any issuer cannot exceed the amount of the recovery zone economic development bond limitation allocated to such issuer.

Recovery zone facility bonds

The provision creates a new category of exempt facility bonds, "recovery zone facility bonds." A recovery zone facility bond means any bond issued as part of an issue if: (1) 95 percent or more of the net proceeds of such issue are to be used for recovery zone property and (2) such bond is issued before January 1, 2011, and (3) the issuer designates such bond as a recovery zone facility bond. The aggregate face amount of bonds which may be designated by any issuer cannot exceed the amount of the recovery zone facility bond limitation allocated to such issuer.

Under the provision, the term "recovery zone property" means any property subject to depreciation to which IRC section 168 applies (or would apply but for IRC section 179) if (1) such property was constructed, reconstructed, renovated, or acquired by purchase by the taxpayer after the date on which the designation of the recovery zone took effect; (2) the original use of such property in the recovery zone commences with the taxpayer; and (3) substantially all of the use of such property is in the recovery zone and is in the active conduct of a qualified business by the taxpayer in such zone. The term "qualified business" means any trade or business except that the rental to others of real property located in a recovery zone shall be treated as a qualified business only if the property is not residential rental property (as defined in IRC section 168(e)(2)) and does not include any trade or business consisting of the operation of any facility described in IRC section 144(c)(6)(B) (i.e., any private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other facility used for gambling, or any store the principal purpose of which is the sale of alcoholic beverages for consumption off premises).

Subject to the following exceptions and modifications, issuance of recovery zone facility bonds is subject to the general rules applicable to issuance of qualified private activity bonds:

1. Issuance of the bonds is not subject to the aggregate annual state private activity bond volume limits (IRC section 146); and
2. The restriction on acquisition of existing property does not apply (IRC section 147(d)).

Effective Date

The provision is effective for obligations issued after February 17, 2009.

California Law (None)

California has no comparable tax credit bonds, nor does California conform to IRC sections 103 and 141 through 150, relating to the federal rules exempting the interest earned on state or municipal bonds and the arbitrage rebate rules. In addition, the federal "private-activity-bond" rules have not been adopted by California. The federal credit on qualified tax credit bonds is not includable in income for California income tax purposes.

Impact on California Revenue

Not applicable.

Section	Section Title
1402	Tribal Economic Development Bonds

Background

Under present law, gross income does not include interest on state or local bonds.[177] State and local bonds are classified generally as either governmental bonds or private activity bonds. Governmental bonds are bonds the proceeds of which are primarily used to finance governmental facilities or the debt is repaid with governmental funds. Private activity bonds are bonds in which the state or local government serves as a conduit providing financing to nongovernmental persons. For these purposes, the term "nongovernmental person" includes the federal government and all other individuals and entities other than states or local governments.[178] Interest on private activity bonds is taxable, unless the bonds are issued for certain purposes permitted by the IRC and other requirements are met.[179]

Although not states or subdivisions of states, Indian tribal governments are provided with a tax status similar to state and local governments for specified purposes under the IRC.[180] Among the purposes for which a tribal government is treated as a state is the issuance of tax-exempt bonds.

[177] IRC section 103.

[178] IRC section 141(b)(6); Treas. Reg. section 1.141-1(b).

[179] IRC sections 103(b)(1) and 141.

[180] IRC section 7871.

Under IRC section 7871(c), tribal governments are authorized to issue tax-exempt bonds only if substantially all of the proceeds are used for essential governmental functions.[181]

The term essential governmental function does not include any function that is not customarily performed by state and local governments with general taxing powers. IRC section 7871(c) further prohibits Indian tribal governments from issuing tax-exempt private activity bonds (as defined in IRC section 141(a)) with the exception of certain bonds for manufacturing facilities.

New Federal Law (IRC section 7871)

Tribal economic development bonds

The provision allows Indian tribal governments to issue "tribal economic development bonds." There is a national bond limitation of $2 billion, to be allocated as the Secretary determines appropriate, in consultation with the Secretary of the Interior. Tribal economic development bonds issued by an Indian tribal government are treated as if such bond were issued by a state except that IRC section 146 (relating to state volume limitations) does not apply. The provision also clarifies that for purposes of IRC section 141, use of bond proceeds by an Indian tribe, or instrumentality thereof, is treated as use by a state.

A tribal economic development bond is any bond issued by an Indian tribal government (1) the interest on which would be tax-exempt if issued by a state or local government, and (2) that is designated by the Indian tribal government as a tribal economic development bond. The aggregate face amount of bonds that may be designated by any Indian tribal government cannot exceed the amount of national tribal economic development bond limitation allocated to such government.

Tribal economic development bonds cannot be used to finance any portion of a building in which class II or class III gaming (as defined in section 4 of the Indian Gaming Regulatory Act) is conducted, or housed, or any other property used in the conduct of such gaming. Nor can tribal economic development bonds be used to finance any facility located outside of the Indian reservation.

Treasury study

The provision requires that the Treasury Department study the effects of tribal economic development bonds. One year after February 17, 2009, a report is to be submitted to Congress providing the results of such study along with any recommendations, including whether the restrictions of IRC section 7871(c) should be eliminated or otherwise modified.

Effective Date

The provision applies to obligations issued after February 17, 2009.

[181] IRC section 7871(c).

California Law (R&TC sections 17143 and 24272)

California specifically does not conform to IRC sections 103 and 141 through 150, relating to the federal rules exempting the interest earned on state or municipal bonds and the arbitrage rebate rules. In addition, the federal "private-activity-bond" rules have not been adopted by California. Also, California has never conformed to IRC section 7871, relating to Indian tribal governments treated as states for certain purposes.

California state and municipal bonds

The general rule in California is that for income tax purposes all interest received or accrued is fully taxable, except for interest on federal obligations (such as Treasury bills, notes, and bonds, as more fully described below) and tax-exempt bonds issued by this state or a local government in this state.

Unlike federal law, the interest earned on bonds issued by other states and municipalities in other states is fully taxable to a resident of California. The California exemption from income taxation of interest on bonds of the state and its political subdivisions is contained in the California Constitution (subdivision (b) of section 26 of Article XIII). The Revenue and Taxation Code further provides, by statute, that the federal "private-activity-bond" analysis shall not be made in determining whether interest on bonds issued by the state or a political subdivision thereof shall be exempt from California income tax. Thus, in California, if the use of the bond proceeds of a state or local California issue is for private business use or is secured by property used for a private business use, the interest on that bond is still treated for California income tax purposes as tax exempt, even though the interest on the bond may well be taxable for federal income tax purposes.

California conduit revenue bonds

Conduit revenue bonds are issued by a governmental (state or municipal) entity for various purposes, including economic development, educational and health facilities construction, and multi-family housing. The funds obtained from the financing are loaned to a nongovernmental borrower who builds and operates the project. The use by a private firm (via expenditure of the bond proceeds) of a governmental agency's authority to issue tax-exempt debt is premised on the fact that the project will provide public benefit. A conduit revenue bond is payable solely from the loan payments received from the non-governmental party (unless the bond is insured by a third party who guarantees payment in the event of a default by the private firm who has pledged the revenue source). The governmental issuer typically has no liability for debt service on the bonds, except for the administration of the bond. Although the issuer has no actual liability on the bonds, their reputation and standing with respect to future debt financing may be negatively affected in the event of a default on the bonds. More importantly, should the bonds go into default, the governmental entity will likely be drawn into the settlement process. Most conduit revenue bonds are sold at negotiated sales with the interest rate and other terms of the bonds negotiated between the issuer, the non-governmental borrower, and an underwriter. The security for some of these transactions is sufficient to allow the underwriter to act as a pass-through for the bonds and in so doing act as a placement agent rather than an underwriter. Because the public agency's credit is not on the line, many issuers do not participate in any substantive fashion in the sale of the bonds. Rather, they may limit their role to reviewing the bond purchase contract and other legal and disclosure documents to ensure that they are adequately indemnified against liabilities and to accurately describe their role to investors as issuers and not as borrowers or guarantors of the debt.

Because the conduit revenue bonds issued in California are issued by this state or a local government in this state, the interest paid on such bonds is exempt from state income taxation under the California Constitution.

California treatment of federal bond interest

Interest earned on federal bonds is also tax-exempt for California income tax purposes. This results from federal law (31 U.S.C. section 3124(a)) that prohibits all states from imposing an income tax on interest income from direct obligations of the U. S. government. Examples of bonds that are exempt for California income tax purposes include those issued by federal land banks, the Federal Home Loan Bank, and Banks for Cooperatives. Not all federal bonds are direct obligations of the U.S. government, and interest on those bonds is taxable.

Examples of federal bonds not exempt are those issued by the Federal National Mortgage Association (Fannie Maes), Government National Mortgage Association (Ginnie Maes), and Federal Loan Home Mortgage Corporation (Freddie Macs).

California franchise tax treatment

Interest received from federal, state, municipal, or other bonds is includable in the gross income of corporations taxable under the franchise tax. The franchise tax is a nondiscriminatory privilege tax for the right to exercise the corporate franchise and is not a tax on the income received, but instead merely uses that income of the year as the measure of the tax for the privilege of exercising the corporate franchise.

Impact on California Revenue

Not applicable.

Section	Section Title
1403	Increase in New Markets Tax Credit

Background

IRC section 45D provides a new markets tax credit for qualified equity investments made to acquire stock in a corporation, or a capital interest in a partnership, that is a qualified community development entity ("CDE").[182] The amount of the credit allowable to the investor (either the original purchaser or a subsequent holder) is (1) a five-percent credit for the year in which the equity interest is purchased from the CDE and for each of the following two years, and (2) a six-percent credit for each of the following four years. The credit is determined by applying the applicable percentage (five or six percent) to the amount paid to the CDE for the investment at its original issue, and is available for a taxable year to the taxpayer who holds the qualified equity investment on the date of the initial investment or on the respective anniversary date that occurs during the taxable year. The credit is recaptured if, at any time during the seven-year period that begins on the date of the original issue of the qualified equity investment, the issuing entity ceases to be a qualified CDE, the proceeds of the investment cease to be used as required, or the equity investment is redeemed.

A qualified CDE is any domestic corporation or partnership: (1) whose primary mission is serving or providing investment capital for low-income communities or low-income persons; (2) that maintains accountability to residents of low-income communities by providing them with representation on any governing board of or any advisory board to the CDE; and (3) that is certified by the Secretary as being a qualified CDE. A qualified equity investment means stock (other than nonqualified preferred stock) in a corporation or a capital interest in a partnership that is acquired directly from a CDE for cash, and includes an investment of a subsequent purchaser if such investment was a qualified equity investment in the hands of the prior holder. Substantially all of the investment proceeds must be used by the CDE to make qualified low-income community investments. For this purpose, qualified low-income community investments include: (1) capital or equity investments in, or loans to, qualified active low-income community businesses; (2) certain financial counseling and other services to businesses and residents in low-income communities; (3) the purchase from another CDE of any loan made by such entity that is a qualified low-income community investment; or (4) an equity investment in, or loan to, another CDE.

A "low-income community" is a population census tract with either (1) a poverty rate of at least 20 percent or (2) median family income which does not exceed 80 percent of the greater of metropolitan area median family income or statewide median family income (for a non-metropolitan census tract, does not exceed 80 percent of statewide median family income). In the case of a population census tract located within a high migration rural county, low-income is defined by reference to 85 percent (rather than 80 percent) of statewide median family income. For this purpose, a high migration rural county is any county that, during the 20-year period ending with the year in which the most recent census was conducted, has a net out-migration of inhabitants from the county of at least 10 percent of the population of the county at the beginning of such period.

The Secretary has the authority to designate "targeted populations" as low-income communities for purposes of the new markets tax credit. For this purpose, a "targeted population" is defined by reference to section 103(20) of the Riegle Community Development and Regulatory Improvement Act of 1994 (12 U.S.C. 4702(20)) to mean individuals, or an identifiable group of individuals, including an Indian tribe, who (A) are low-income persons; or (B) otherwise lack adequate access to loans or equity investments. Under such Act, "low-income" means (1) for a targeted population

[182] IRC section 45D was added by section 121(a) of the Community Renewal Tax Relief Act of 2000, Public Law 106-554.

within a metropolitan area, less than 80 percent of the area median family income; and (2) for a targeted population within a non-metropolitan area, less than the greater of 80 percent of the area median family income or 80 percent of the statewide non-metropolitan area median family income.[183] Under such Act, a targeted population is not required to be within any census tract. In addition, a population census tract with a population of less than 2,000 is treated as a low-income community for purposes of the credit if such tract is within an empowerment zone, the designation of which is in effect under IRC section 1391, and is contiguous to one or more low-income communities.

A qualified active low-income community business is defined as a business that satisfies, with respect to a taxable year, the following requirements: (1) at least 50 percent of the total gross income of the business is derived from the active conduct of trade or business activities in any low-income community; (2) a substantial portion of the tangible property of such business is used in a low-income community; (3) a substantial portion of the services performed for such business by its employees is performed in a low-income community; and (4) less than five percent of the average of the aggregate unadjusted bases of the property of such business is attributable to certain financial property or to certain collectibles.

The maximum annual amount of qualified equity investments is capped at $3.5 billion per year for calendar years 2006 through 2009. Lower caps applied for calendar years 2001 through 2005.

New Federal Law (IRC section 45D)

For calendar years 2008 and 2009, the provision increases the maximum amount of qualified equity investments by $1.5 billion (to $5 billion for each year). The provision requires that the additional amount for 2008 be allocated to qualified CDEs that submitted an allocation application with respect to calendar year 2008 and either (1) did not receive an allocation for such calendar year, or (2) received an allocation for such calendar year in an amount less than the amount requested in the allocation application.

Effective Date

The provision is effective on February 17, 2009.

California Law (None)

California has no comparable credit.

Impact on California Revenue

Not applicable.

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[183] 12 U.S.C. sec. 4702(17) (defines "low-income" for purposes of 12 U.S.C. sec. 4702(20)).

Section	Section Title
1404	Coordination of Low-Income Housing Credit and Low-Income Housing Grants

The summary of this provision is combined with Act section 1602, Grants to States for Low-Income Housing Projects in Lieu of Low Income Housing Credit Allocations for 2009.

PART I of SUBTITLE F of TITLE I – IMPROVED MARKETABILITY FOR TAX-EXEMPT BONDS

Section	Section Title
1501 –1502	De Minimis Safe Harbor Exception for Tax-Exempt Interest of Financial Institutions and Modification of Small Issuer Exception to Tax-Exempt Interest Expense Allocation Rules for Financial Institutions

Background

Present law disallows a deduction for interest on indebtedness incurred or continued to purchase or carry obligations the interest on which is exempt from tax.[184] In general, an interest deduction is disallowed only if the taxpayer has a purpose of using borrowed funds to purchase or carry tax-exempt obligations; a determination of the taxpayer's purpose in borrowing funds is made based on all of the facts and circumstances.[185]

Two-percent rule for individuals and certain nonfinancial corporations

In the absence of direct evidence linking an individual taxpayer's indebtedness with the purchase or carrying of tax-exempt obligations, the Internal Revenue Service takes the position that it ordinarily will not infer that a taxpayer's purpose in borrowing money was to purchase or carry tax-exempt obligations if the taxpayer's investment in tax-exempt obligations is "insubstantial."[186] An individual's holdings of tax-exempt obligations are presumed to be insubstantial if during the taxable year the average adjusted basis of the individual's tax-exempt obligations is two percent or less of the average adjusted basis of the individual's portfolio investments and assets held by the individual in the active conduct of a trade or business.

Similarly, in the case of a corporation that is not a financial institution or a dealer in tax-exempt obligations, where there is no direct evidence of a purpose to purchase or carry tax-exempt obligations, the corporation's holdings of tax-exempt obligations are presumed to be insubstantial if the average adjusted basis of the corporation's tax-exempt obligations is two percent or less of

[184] IRC section 265(a).

[185] See Rev. Proc. 72-18, 1972-1 C.B. 740.

[186] See Rev. Proc. 72-18, 1972-1 C.B. 740.

the average adjusted basis of all assets held by the corporation in the active conduct of its trade or business.

Financial institutions

In the case of a financial institution, the IRC generally disallows that portion of the taxpayer's interest expense that is allocable to tax-exempt interest.[187] The amount of interest that is disallowed is an amount which bears the same ratio to such interest expense as the taxpayer's average adjusted bases of tax-exempt obligations acquired after August 7, 1986, bears to the average adjusted bases for all assets of the taxpayer.

Exception for certain obligations of qualified small issuers

The general rule in IRC section 265(b), denying financial institutions' interest expense deductions allocable to tax-exempt obligations, does not apply to "qualified tax-exempt obligations."[188] Instead, as discussed in the next section, only 20 percent of the interest expense allocable to "qualified tax-exempt obligations" is disallowed.[189] A "qualified tax-exempt obligation" is a tax-exempt obligation that (1) is issued after August 7, 1986, by a qualified small issuer, (2) is not a private activity bond, and (3) is designated by the issuer as qualifying for the exception from the general rule of IRC section 265(b).

A "qualified small issuer" is an issuer that reasonably anticipates that the amount of tax-exempt obligations that it will issue during the calendar year will be $10 million or less.[190] The IRC specifies the circumstances under which an issuer and all subordinate entities are aggregated.[191] For purposes of the $10 million limitation, an issuer and all entities that issue obligations on behalf of such issuer are treated as one issuer. All obligations issued by a subordinate entity are treated as being issued by the entity to which it is subordinate. An entity formed (or availed of) to avoid the $10 million limitation and all entities benefiting from the device are treated as one issuer.

Composite issues (i.e., combined issues of bonds for different entities) qualify for the "qualified tax-exempt obligation" exception only if the requirements of the exception are met with respect to (1) the composite issue as a whole (determined by treating the composite issue as a single issue) and (2) each separate lot of obligations that is part of the issue (determined by treating each

[187] IRC section 265(b)(1). A "financial institution" is any person that (1) accepts deposits from the public in the ordinary course of such person's trade or business and is subject to federal or state supervision as a financial institution or (2) is a corporation described in IRC section 585(a)(2). IRC section 265(b)(5).

[188] IRC section 265(b)(3).

[189] IRC sections 265(b)(3)(A), 291(a)(3) and 291(e)(1).

[190] IRC section 265(b)(3)(C).

[191] IRC section 265(b)(3)(E).

separate lot of obligations as a separate issue).[192] Thus a composite issue may qualify for the exception only if the composite issue itself does not exceed $10 million, and if each issuer benefitting from the composite issue reasonably anticipates that it will not issue more than $10 million of tax-exempt obligations during the calendar year, including through the composite arrangement.

Treatment of financial institution preference items

IRC section 291(a)(3) reduces by 20 percent the amount allowable as a deduction with respect to any financial institution preference item. Financial institution preference items include interest on debt to carry tax-exempt obligations acquired after December 31, 1982, and before August 8, 1986.[193] IRC section 265(b)(3) treats qualified tax-exempt obligations as if they were acquired on August 7, 1986. As a result, the amount allowable as a deduction by a financial institution with respect to interest incurred to carry a qualified tax-exempt obligation is reduced by 20 percent.

<u>New Federal Law (IRC sections 265 and 291)</u>

Two-percent safe harbor for financial institutions

The provision provides that tax-exempt obligations issued during 2009 or 2010 and held by a financial institution, in an amount not to exceed two percent of the adjusted basis of the financial institution's assets, are not taken into account for the purpose of determining the portion of the financial institution's interest expense subject to the pro-rata interest disallowance rule of IRC section 265(b). For purposes of this rule, a refunding bond (whether a current or advance refunding) is treated as issued on the date of the issuance of the refunded bond (or in the case of a series of refundings, the original bond).

The provision also amends IRC section 291(e) to provide that tax-exempt obligations issued during 2009 and 2010, and not taken into account for purposes of the calculation of a financial institution's interest expense subject to the pro-rata interest disallowance rule, are treated as having been acquired on August 7, 1986. As a result, such obligations are financial institution preference items, and the amount allowable as a deduction by a financial institution with respect to interest incurred to carry such obligations is reduced by 20 percent.

Modifications to qualified small issuer exception

With respect to tax-exempt obligations issued during 2009 and 2010, the provision increases from $10 million to $30 million the annual limit for qualified small issuers.

In addition, in the case of "qualified financing issue" issued in 2009 or 2010, the provision applies the $30 million annual volume limitation at the borrower level (rather than at the level of the pooled financing issuer). Thus, for the purpose of applying the requirements of the IRC section

[192] IRC section 265(b)(3)(F).

[193] IRC section 291(e)(1).

265(b)(3) qualified small issuer exception, the portion of the proceeds of a qualified financing issue that are loaned to a "qualified borrower" that participates in the issue are treated as a separate issue with respect to which the qualified borrower is deemed to be the issuer.

A "qualified financing issue" is any composite, pooled or other conduit financing issue the proceeds of which are used directly or indirectly to make or finance loans to one or more ultimate borrowers all of whom are qualified borrowers. A "qualified borrower" means (1) a state or political subdivision of a state or (2) an organization described in IRC section 501(c)(3) and exempt from tax under IRC section 501(a). Thus, for example, a $100 million pooled financing issue that was issued in 2009 could qualify for the IRC section 265(b)(3) exception if the proceeds of such issue were used to make four equal loans of $25 million to four qualified borrowers. However, if (1) more than $30 million were loaned to any qualified borrower, (2) any borrower were not a qualified borrower, or (3) any borrower would, if it were the issuer of a separate issue in an amount equal to the amount loaned to such borrower, fail to meet any of the other requirements of IRC section 265(b)(3), the entire $100 million pooled financing issue would fail to qualify for the exception.

For purposes of determining whether an issuer meets the requirements of the small issuer exception, qualified IRC section 501(c)(3) bonds issued in 2009 or 2010 are treated as if they were issued by the IRC section 501(c)(3) organization for whose benefit they were issued (and not by the actual issuer of such bonds). In addition, in the case of an organization described in section 501(c)(3) and exempt from taxation under IRC section 501(a), requirements for "qualified financing issues" shall be applied as if the IRC section 501(c)(3) organization were the issuer. Thus, in any event, an organization described in IRC section 501(c)(3) and exempt from taxation under IRC section 501(a) shall be limited to the $30 million per issuer cap for qualified tax exempt obligations described in IRC section 265(b)(3).

Effective Date

The provisions are effective for obligations issued after December 31, 2008.

California Law (R&TC sections 17280, 24272, and 24449)

California law specifically does not conform to IRC section 265, relating to expenses and interest relating to tax-exempt income. Instead, California law provides that no deduction is allowed for any of the following: (1) any amount allocable to one or more classes of income other than interest wholly exempt from tax, (2) interest on indebtedness incurred or continued to purchase or carry obligations the interest on which is wholly exempt from tax; or (3) interest on indebtedness incurred or continued to purchase or carry shares of stock of a management company or series thereof which during the taxable year of the holder thereof distributes exempt-interest dividends. In the case of corporate franchise taxpayers, R&TC section 24272 requires those corporations to include interest income from federal, state, municipal, or other bonds on their California franchise tax return, so that they have no “exempt interest” for state tax purposes.

California conforms to IRC section 291, relating to special rules relating to corporate preference items, as of the “specified date” of January 1, 2005. Therefore, California is not conformed to the

20 percent reduction to the preference item interest deduction. However, because R&TC section 24272 requires corporations to include interest income from federal, state, municipal, or other bonds on the California franchise tax return, these items are not preference items for franchise tax purposes.

Impact on California Revenue

Not applicable.

Section	Section Title
1503	Temporary Modification of Alternative Minimum Tax Limitations on Tax-Exempt Bonds

Background

Present law imposes an alternative minimum tax ("AMT") on individuals and corporations. AMT is the amount by which the tentative minimum tax exceeds the regular income tax. The tentative minimum tax is computed based upon a taxpayer's alternative minimum taxable income ("AMTI"). AMTI is the taxpayer's taxable income modified to take into account certain preferences and adjustments. One of the preference items is tax-exempt interest on certain tax-exempt bonds issued for private activities (IRC section 57(a)(5)). Also, in the case of a corporation, an adjustment based on current earnings is determined, in part, by taking into account 75 percent of items, including tax-exempt interest, that are excluded from taxable income but included in the corporation's earnings and profits (IRC section 56(g)(4)(B)).

New Federal Law (IRC sections 56 and 57)

The provision provides that tax-exempt interest on private activity bonds issued in 2009 and 2010 is not an item of tax preference for purposes of the alternative minimum tax and interest on tax exempt bonds issued in 2009 and 2010 is not included in the corporate adjustment based on current earnings. For these purposes, a refunding bond is treated as issued on the date of the issuance of the refunded bond (or in the case of a series of refundings, the original bond).

The provision also provides that tax-exempt interest on private activity bonds issued in 2009 and 2010 to currently refund a private activity bond issued after December 31, 2003, and before January 1, 2009, is not an item of tax preference for purposes of the alternative minimum tax. Also tax-exempt interest on bonds issued in 2009 and 2010 to currently refund a bond issued after December 31, 2003, and before January 1, 2009, is not included in the corporate adjustment based on current earnings.

Effective Date

The provision applies to interest on bonds issued after December 31, 2008.

California Law (R&TC sections 17062, 17143, 23457, and 24272)

California law specifically does not conform to the federal private-activity bond rules.

Impact on California Revenue

Not applicable.

Section	Section Title
1504	Modification to High Speed Intercity Rail Facility Bond

Background

In general

Under present law, gross income does not include interest on state or local bonds. State and local bonds are classified generally as either governmental bonds or private activity bonds. Governmental bonds are bonds the proceeds of which are primarily used to finance governmental functions or which are repaid with governmental funds. Private activity bonds are bonds in which the state or local government serves as a conduit providing financing to nongovernmental persons (e.g., private businesses or individuals). The exclusion from income for state and local bonds does not apply to private activity bonds unless the bonds are issued for certain permitted purposes ("qualified private activity bonds") and other IRC requirements are met.

High-speed rail

An exempt facility bond is a type of qualified private activity bond. Exempt facility bonds can be issued for high-speed intercity rail facilities. A facility qualifies as a high-speed intercity rail facility if it is a facility (other than rolling stock) for fixed guideway rail transportation of passengers and their baggage between metropolitan statistical areas. The facilities must use vehicles that are reasonably expected to operate at speeds in excess of 150 miles per hour between scheduled stops and the facilities must be made available to members of the general public as passengers. If the bonds are to be issued for a nongovernmental owner of the facility, such owner must irrevocably elect not to claim depreciation or credits with respect to the property financed by the net proceeds of the issue.

The IRC imposes a special redemption requirement for these types of bonds. Any proceeds not used within three years of the date of issuance of the bonds must be used within the following six months to redeem such bonds.

Seventy-five percent of the principal amount of the bonds issued for high-speed rail facilities is exempt from the volume limit. If all the property to be financed by the net proceeds of the issue is to be owned by a governmental unit, then such bonds are completely exempt from the volume limit.

New Federal Law (IRC section 142)

The provision modifies the requirement that high-speed intercity rail transportation facilities use vehicles that are reasonably expected to operate at speeds in excess of 150 miles per hour. Instead, under the provision such facilities must use vehicles capable of attaining a maximum speed in excess of 150 miles per hour.

Effective Date

The provision is effective for obligations issued after February 17, 2009.

California Law (R&TC sections 17143 and 24272)

California specifically does not conform to IRC sections 103 and 141 through 150, relating to the federal rules exempting the interest earned on state or municipal bonds and the arbitrage rebate rules. In addition, the federal "private-activity-bond" rules have not been adopted by California.

California state and municipal bonds

The general rule in California is that for income tax purposes all interest received or accrued is fully taxable, except for interest on federal obligations (such as Treasury bills, notes, and bonds, as more fully described below) and tax-exempt bonds issued by this state or a local government in this state.

Unlike federal law, the interest earned on bonds issued by other states and municipalities in other states is fully taxable to a resident of California. The California exemption from income taxation of interest on bonds of the state and its political subdivisions is contained in the California Constitution (subdivision (b) of section 26 of Article XIII). The Revenue and Taxation Code further provides, by statute, that the federal "private-activity-bond" analysis shall not be made in determining whether interest on bonds issued by the state or a political subdivision thereof shall be exempt from California income tax. Thus, in California, if the use of the bond proceeds of a state or local California issue is for private business use or is secured by property used for a private business use, the interest on that bond is still treated for California income tax purposes as tax exempt, even though the interest on the bond may well be taxable for federal income tax purposes.

California conduit revenue bonds

Conduit revenue bonds are issued by a governmental (state or municipal) entity for various purposes, including economic development, educational and health facilities construction, and multi-family housing. The funds obtained from the financing are loaned to a nongovernmental borrower who builds and operates the project. The use by a private firm (via expenditure of the bond proceeds) of a governmental agency's authority to issue tax-exempt debt is premised on the fact that the project will provide public benefit. A conduit revenue bond is payable solely from the loan payments received from the non-governmental party (unless the bond is insured by a third party who guarantees payment in the event of a default by the private firm who has pledged the revenue source). The governmental issuer typically has no liability for debt service on the bonds, except for the administration of the bond. Although the issuer has no actual liability on the bonds, their reputation and standing with respect to future debt financing may be negatively affected in the event of a default on the bonds. More importantly, should the bonds go into default, the governmental entity will likely be drawn into the settlement process. Most conduit revenue bonds are sold at negotiated sales with the interest rate and other terms of the bonds negotiated between the issuer, the non-governmental borrower, and an underwriter. The security for some of these transactions is sufficient to allow the underwriter to act as a pass-through for the bonds and in so doing act as a placement agent rather than an underwriter. Because the public agency's credit is not on the line, many issuers do not participate in any substantive fashion in the sale of the bonds. Rather, they may limit their role to reviewing the bond purchase contract and other legal and disclosure documents to ensure that they are adequately indemnified against liabilities and to accurately describe their role to investors as issuers and not as borrowers or guarantors of the debt.

Because the conduit revenue bonds issued in California are issued by this state or a local government in this state, the interest paid on such bonds is exempt from state income taxation under the California Constitution.

California treatment of federal bond interest

Interest earned on federal bonds is also tax-exempt for California income tax purposes. This results from federal law (31 U.S.C. § 3124(a)) that prohibits all states from imposing an income tax on interest income from direct obligations of the U. S. government. Examples of bonds that are exempt for California income tax purposes include those issued by federal land banks, the Federal Home Loan Bank, and Banks for Cooperatives.

Not all federal bonds are direct obligations of the U.S. government, and interest on those bonds is taxable. Examples of federal bonds not exempt are those issued by the Federal National Mortgage Association (Fannie Maes), Government National Mortgage Association (Ginnie Maes), and Federal Loan Home Mortgage Corporation (Freddie Macs).

California franchise tax treatment

Interest received from federal, state, municipal, or other bonds is includable in the gross income of corporations taxable under the franchise tax. The franchise tax is a nondiscriminatory privilege tax for the right to exercise the corporate franchise and is not a tax on the income received, but instead merely uses that income of the year as the measure of the tax for the privilege of exercising the corporate franchise.

Impact on California Revenue

Not applicable.

PART II of SUBTITLE F of TITLE I – DELAY IN APPLICATION OF WITHHOLDING ON GOVERNMENT CONTRACTORS

Section	Section Title
1511	Delay in Application of Withholding Tax on Government Contractors

Background

For payments made after December 31, 2010, the IRC imposes a withholding requirement at a three-percent rate on certain payments to persons providing property or services made by the Government of the United States, every state, every political subdivision thereof, and every instrumentality of the foregoing (including multi-state agencies). The withholding requirement applies regardless of whether the government entity making such payment is the recipient of the property or services. Political subdivisions of states (or any instrumentality thereof) with less than $100 million of annual expenditures for property or services that would otherwise be subject to withholding are exempt from the withholding requirement.

Payments subject to the three-percent withholding requirement include any payment made in connection with a government voucher or certificate program which functions as a payment for property or services. For example, payments to a commodity producer under a government commodity support program are subject to the withholding requirement. Present law also imposes information reporting requirements on the payments that are subject to withholding requirement.

The three-percent withholding requirement does not apply to any payments made through a federal, state, or local government public assistance or public welfare program for which eligibility is determined by a needs or income test. The three-percent withholding requirement also does not apply to payments of wages or to any other payment with respect to which mandatory (e.g., U.S.-source income of foreign taxpayers) or voluntary (e.g., unemployment benefits) withholding applies under present law. Although the withholding requirement applies to payments that are potentially subject to backup withholding under IRC section 3406, it does not apply to those payments from which amounts are actually being withheld under backup withholding rules.

The three-percent withholding requirement also does not apply to the following: payments of interest; payments for real property; payments to tax-exempt entities or foreign governments; intra-governmental payments; payments made pursuant to a classified or confidential contract (as defined in IRC section 6050M(e)(3)), and payments to government employees that are not otherwise excludable from the new withholding proposal with respect to the employees' services as employees.

New Federal Law (IRC section 3402)

The provision delays the implementation of the three percent withholding requirement by one year to apply to payments after December 31, 2011.

Effective Date

The provision is effective on February 17, 2009.

California Law (R&TC sections 18551, 18661-18663, and 18667-18668)

California does not conform by reference to IRC section 3402, relating to income tax collected at source, but instead has stand-alone rules relating to withholding.

Wage withholding

The Employment Development Department (EDD) administers California's wage withholding program. Unless specifically excluded, employers are required to withhold personal income tax from wages paid to employees. Employers are required to make periodic tax deposits of amounts withheld based on their federal deposit schedule, which can range from the next banking day after payment to quarterly, depending on the amount of withholding. When employers fail to withhold or under withhold from wages paid to their employees, they become liable and may be assessed for the amounts that should have been withheld.

Employers are required to file quarterly reports that detail, by employee, the personal income tax withheld and the employee's wages subject to withholding. Employers are also required to file an annual reconciliation statement that is used to reconcile total payroll taxes due to total payroll tax deposits.

Withholding on certain payments by government entities

Non-wage payments made to persons (whether individuals, corporations, or partnerships) providing property or services made by the Government of the United States, the State of California, every political subdivision thereof, and every instrumentality of the foregoing (including multi-state agencies), are not subject to mandatory withholding.

Independent contractors

California resident contractors

California does not impose mandatory withholding on payments to resident independent contractors.

California nonresident contractors

The FTB currently administers the withhold-at-source program on payments to nonresidents for services performed by independent contractors, rents, royalties, estate distributions, trust distributions, and partnership distributions and allocations of income.

Withholding is required on payments to nonresident independent contractors when the payer expects total payments for the year to the independent contractor to exceed $1,500. Independent contractors include individuals who are not employees and any other type of entity including corporations and partnerships with no permanent place of business in California. Withholding is required regardless of whether the payments to the independent contractor are subject to a Form 1099-MISC reporting requirement. The withholding rate is 7 percent. Reduced rates may be granted to prevent over withholding, but are rarely requested, except by entertainers. However, full waivers are frequently granted when the payee has a consistent history of filing tax returns with FTB. Withholding agents (i.e., the payers) are required to remit payments monthly if accumulated withholding on all payees exceeds $2,500.

<u>Impact on California Revenue</u>

Estimated Revenue Impact of Delay in Application of Withholding Tax on Government Contractors Enactment Assumed After June 30, 2010		
2010-11	2011-12	2012-13
N/A	$28,000,000	$300,000

Estimates are based on a modified proration of federal projections developed for the American Recovery and Reinvestment Act of 2009 (ARRA). To determine the revenue impact of conforming, it is assumed that California would impose one percent withholding on contract payments made by the state, as well as local and other political subdivisions of this state. This estimate also takes into account recent law changes to California's estimate payment schedule. Fiscal year 2011-12 was adjusted to take into account taxable year 2012, which is the first year withholding would be required.

Because the new federal withholding program would also increase compliance, a portion of this income would also be reported by California taxpayers. Based on the federal estimate, there is an estimated baseline revenue gain of $3 million annually.

PART III of SUBTITLE F of TITLE I – TAX CREDIT BONDS FOR SCHOOLS

Section	Section Title
1521	Qualified School Construction Bonds

Background

Tax-exempt bonds

Interest on state and local governmental bonds generally is excluded from gross income for federal income tax purposes if the proceeds of the bonds are used to finance direct activities of these governmental units or if the bonds are repaid with revenues of the governmental units. These can include tax-exempt bonds which finance public schools.[194] An issuer must file with the Internal Revenue Service certain information about the bonds issued in order for that bond issue to be tax-exempt.[195] Generally, this information return is required to be filed no later than the 15th day of the second month after the close of the calendar quarter in which the bonds were issued.

The tax exemption for state and local bonds does not apply to any arbitrage bond.[196] An arbitrage bond is defined as any bond that is part of an issue if any proceeds of the issue are reasonably expected to be used (or intentionally are used) to acquire higher yielding investments or to replace funds that are used to acquire higher yielding investments.[197] In general, arbitrage profits may be earned only during specified periods (e.g., defined "temporary periods") before funds are needed for the purpose of the borrowing or on specified types of investments (e.g., "reasonably required reserve or replacement funds"). Subject to limited exceptions, investment profits that are earned during these periods or on such investments must be rebated to the federal government.

Qualified zone academy bonds

As an alternative to traditional tax-exempt bonds, states and local governments were given the authority to issue "qualified zone academy bonds."[198] A total of $400 million of qualified zone academy bonds is authorized to be issued annually in calendar years 1998 through 2009. The $400 million aggregate bond cap is allocated each year to the states according to their respective populations of individuals below the poverty line. Each state, in turn, allocates the credit authority to qualified zone academies within such state.

[194] IRC section 103.

[195] IRC section 149(e).

[196] IRC section 103(a) and (b)(2).

[197] IRC section 148.

[198] IRC section 1397E.

A taxpayer holding a qualified zone academy bond on the credit allowance date is entitled to a credit. The credit is includible in gross income (as if it were a taxable interest payment on the bond), and may be claimed against regular income tax and alternative minimum tax liability.

The Treasury Department sets the credit rate at a rate estimated to allow issuance of qualified zone academy bonds without discount and without interest cost to the issuer.[199] The Secretary determines credit rates for tax credit bonds based on general assumptions about credit quality of the class of potential eligible issuers and such other factors as the Secretary deems appropriate. The Secretary may determine credit rates based on general credit market yield indexes and credit ratings. The maximum term of the bond is determined by the Treasury Department, so that the present value of the obligation to repay the principal on the bond is 50 percent of the face value of the bond.

"Qualified zone academy bonds" are defined as any bond issued by a state or local government, provided that (1) at least 95 percent of the proceeds are used for the purpose of renovating, providing equipment to, developing course materials for use at, or training teachers and other school personnel in a "qualified zone academy" and (2) private entities have promised to contribute to the qualified zone academy certain equipment, technical assistance or training, employee services, or other property or services with a value equal to at least 10 percent of the bond proceeds.

A school is a "qualified zone academy" if (1) the school is a public school that provides education and training below the college level, (2) the school operates a special academic program in cooperation with businesses to enhance the academic curriculum and increase graduation and employment rates, and (3) either (a) the school is located in an empowerment zone or enterprise community designated under the IRC, or (b) it is reasonably expected that at least 35 percent of the students at the school will be eligible for free or reduced-cost lunches under the school lunch program established under the National School Lunch Act.

The arbitrage requirements which generally apply to interest-bearing tax-exempt bonds also generally apply to qualified zone academy bonds. In addition, an issuer of qualified zone academy bonds must reasonably expect to and actually spend 100 percent of the proceeds of such bonds on qualified zone academy property within the three years period that begins on the date of issuance. To the extent less than 100 percent of the proceeds are used to finance qualified zone academy property during the three years spending period, bonds will continue to qualify as qualified zone academy bonds if unspent proceeds are used within 90 days from the end of such three years period to redeem any nonqualified bonds. The three years spending period may be extended by the Secretary if the issuer establishes that the failure to meet the spending requirement is due to reasonable cause and the related purposes for issuing the bonds will continue to proceed with due diligence.

Two special arbitrage rules apply to qualified zone academy bonds. First, available project proceeds invested during the three-year period beginning on the date of issue are not subject to

[199] Given the differences in credit quality and other characteristics of individual issuers, the Secretary cannot set credit rates in a manner that will allow each issuer to issue tax credit bonds at par.

the arbitrage restrictions (i.e., yield restriction and rebate requirements). Available project proceeds are proceeds from the sale of an issue of qualified zone academy bonds, less issuance costs (not to exceed two percent) and any investment earnings on such proceeds. Thus, available project proceeds invested during the three-year spending period may be invested at unrestricted yields, but the earnings on such investments must be spent on qualified zone academy property. Second, amounts invested in a reserve fund are not subject to the arbitrage restrictions to the extent: (1) such fund is funded at a rate not more rapid than equal annual installments; (2) such fund is funded in a manner reasonably expected to result in an amount not greater than an amount necessary to repay the issue; and (3) the yield on such fund is not greater than the average annual interest rate of tax-exempt obligations having a term of 10 years or more that are issued during the month the qualified zone academy bonds are issued.

Issuers of qualified zone academy bonds are required to report issuance to the Internal Revenue Service in a manner similar to the information returns required for tax-exempt bonds.

<u>New Federal Law (IRC sections 54A and 54F)</u>

In general

The provision creates a new category of tax-credit bonds: qualified school construction bonds. Qualified school construction bonds must meet three requirements: (1) 100 percent of the available project proceeds of the bond issue is used for the construction, rehabilitation, or repair of a public school facility or for the acquisition of land on which such a bond-financed facility is to be constructed; (2) the bond is issued by a state or local government within which such school is located; and (3) the issuer designates such bonds as a qualified school construction bond.

National limitation

There is a national limitation on qualified school construction bonds of $11 billion for calendar years 2009 and 2010, respectively.

Allocation to the states

The national limitation is tentatively allocated among the states in proportion to respective amounts each such state is eligible to receive under section 1124 of the Elementary and Secondary Education Act of 1965 for the most recent fiscal year ending before such calendar year. The amount each state is allocated under the above formula is then reduced by the amount received by any local large educational agency within the state.

For allocation purposes, a state includes the District of Columbia and any possession of the United States. The provision provides a special allocation for possessions of the United States other than Puerto Rico under the national limitation for States. Under this special rule an allocation to a possession other than Puerto Rico is made on the basis of the respective populations of individuals below the poverty line (as defined by the Office of Management and Budget) rather than respective populations of children aged five through seventeen. This special allocation reduces the state allocation share of the national limitation otherwise available for allocation among the states. Under another special rule the Secretary of the Interior may allocate $200 million of school construction bonds for 2009 and 2010, respectively, to Indian schools. This special allocation for Indian schools is to be used for purposes of the construction, rehabilitation, and repair of schools funded by the Bureau of Indian Affairs. For purposes of such allocations Indian tribal governments are qualified issuers. The special allocation for Indian schools does not reduce the state allocation share of the national limitation otherwise available for allocation among the states.

If an amount allocated under this allocation to the states is unused for a calendar year it may be carried forward by the state to the next calendar year.

Allocation to large school districts

Forty percent of the national limitation is allocated among large local educational agencies in proportion to the respective amounts each agency received under section 1124 of the Elementary and Secondary Education Act of 1965 for the most recent fiscal year ending before such calendar year. Any unused allocation of any agency within a state may be allocated by the agency to such state. With respect to a calendar year, the term large local educational agency means any local educational agency if such agency is: (1) among the 100 local educational agencies with the largest numbers of children aged 5 through 17 from families living below the poverty level, or (2) one of not more than 25 local educational agencies (other than in 1, immediately above) that the Secretary of Education determines are in particular need of assistance, based on a low level of resources for school construction, a high level of enrollment growth, or other such factors as the Secretary of Education deems appropriate. If any amount allocated to large local educational agency is unused for a calendar year the agency may reallocate such amount to the State in which the agency is located.

Application of qualified tax credit bond rules

The provision makes qualified school construction bonds a type of qualified tax credit bond for purposes of IRC section 54A. In addition, qualified school construction bonds may be issued by Indian tribal governments only to the extent such bonds are issued for purposes that satisfy the present law requirements for tax-exempt bonds issued by Indian tribal governments (i.e., essential governmental functions and certain manufacturing purposes).

The provision requires 100 percent of the available project proceeds of qualified school construction bonds to be used within the three-year period that begins on the date of issuance. Available project proceeds are proceeds from the sale of the issue less issuance costs (not to exceed two percent) and any investment earnings on such sale proceeds. To the extent less than 100 percent of the available project proceeds are used to finance qualified purposes during the three-year spending period, bonds will continue to qualify as qualified school construction bonds if unspent proceeds are used within 90 days from the end of such three-year period to redeem bonds. The three-year spending period may be extended by the Secretary upon the issuer's request demonstrating that the failure to satisfy the three-year requirement is due to reasonable cause and the projects will continue to proceed with due diligence.

Qualified school construction bonds generally are subject to the arbitrage requirements of IRC section 148. However, available project proceeds invested during the three-year spending period are not subject to the arbitrage restrictions (i.e., yield restriction and rebate requirements). In addition, amounts invested in a reserve fund are not subject to the arbitrage restrictions to the extent: (1) such fund is funded at a rate not more rapid than equal annual installments; (2) such fund is funded in a manner reasonably expected to result in an amount not greater than an amount necessary to repay the issue; and (3) the yield on such fund is not greater than the average annual interest rate of tax-exempt obligations having a term of 10 years or more that are issued during the month the qualified school construction bonds are issued.

The maturity of qualified school construction bonds is the term that the Secretary estimates will result in the present value of the obligation to repay the principal on such bonds being equal to 50 percent of the face amount of such bonds, using as a discount rate the average annual interest rate of tax-exempt obligations having a term of 10 years or more that are issued during the month the qualified school construction bonds are issued.

As with present-law tax credit bonds, the taxpayer holding qualified school construction bonds on a credit allowance date is entitled to a tax credit. The credit rate on the bonds is set by the Secretary at a rate that is 100 percent of the rate that would permit issuance of such bonds without discount and interest cost to the issuer. The amount of the tax credit is determined by multiplying the bond's credit rate by the face amount on the holder's bond. The credit accrues quarterly, is includible in gross income (as if it were an interest payment on the bond), and can be claimed against regular income tax liability and alternative minimum tax liability. Unused credits may be carried forward to succeeding taxable years. In addition, credits may be separated from the ownership of the underlying bond in a manner similar to the manner in which interest coupons can be stripped from interest-bearing bonds.

Issuers of qualified school construction bonds are required to certify that the financial disclosure requirements and applicable state and local law requirements governing conflicts of interest are satisfied with respect to such issue, as well as any other additional conflict of interest rules prescribed by the Secretary with respect to any federal, state, or local government official directly involved with the issuance of qualified school construction bonds.

Effective Date

The provision is effective for bonds issued after February 17, 2009.

California Law (R&TC sections 17143 and 24272)

California does not conform to federal tax-credit bonds, and income from such bonds is not includable in California gross income.

California specifically does not conform to IRC sections 103 and 141 through 150, relating to the federal rules exempting the interest earned on state or municipal bonds and the arbitrage rebate rules. In addition, the federal “private-activity-bond” rules have not been adopted by California.

California state and municipal bonds

The general rule in California is that for income tax purposes all interest received or accrued is fully taxable, except for interest on federal obligations (such as Treasury bills, notes, and bonds, as more fully described below) and tax-exempt bonds issued by this state or a local government in this state.

Unlike federal law, the interest earned on bonds issued by other states and municipalities in other states is fully taxable to a resident of California. The California exemption from income taxation of interest on bonds of the state and its political subdivisions is contained in the California Constitution (subdivision (b) of section 26 of Article XIII). The Revenue and Taxation Code further provides, by statute, that the federal "private-activity-bond" analysis shall not be made in determining whether interest on bonds issued by the state or a political subdivision thereof shall be exempt from California income tax. Thus, in California, if the use of the bond proceeds of a state or local California issue is for private business use or is secured by property used for a private business use, the interest on that bond is still treated for California income tax purposes as tax exempt, even though the interest on the bond may well be taxable for federal income tax purposes.

California conduit revenue bonds

Conduit revenue bonds are issued by a governmental (state or municipal) entity for various purposes, including economic development, educational and health facilities construction, and multi-family housing. The funds obtained from the financing are loaned to a nongovernmental borrower who builds and operates the project. The use by a private firm (via expenditure of the bond proceeds) of a governmental agency's authority to issue tax-exempt debt is premised on the fact that the project will provide public benefit. A conduit revenue bond is payable solely from the loan payments received from the non-governmental party (unless the bond is insured by a third party who guarantees payment in the event of a default by the private firm who has pledged the revenue source). The governmental issuer typically has no liability for debt service on the bonds, except for the administration of the bond. Although the issuer has no actual liability on the bonds, their reputation and standing with respect to future debt financing may be negatively affected in the event of a default on the bonds. More importantly, should the bonds go into default, the governmental entity will likely be drawn into the settlement process. Most conduit revenue bonds are sold at negotiated sales with the interest rate and other terms of the bonds negotiated between the issuer, the non-governmental borrower, and an underwriter. The security for some of these transactions is sufficient to allow the underwriter to act as a pass-through for the bonds and in so doing act as a placement agent rather than an underwriter. Since the public agency's credit is not on the line, many issuers do not participate in any substantive fashion in the sale of the bonds. Rather, they may limit their role to reviewing the bond purchase contract and other legal and disclosure documents to ensure that they are adequately indemnified against liabilities and to accurately describe their role to investors as issuers and not as borrowers or guarantors of the debt.

Because the conduit revenue bonds issued in California are issued by this state or a local government in this state, the interest paid on such bonds is exempt from state income taxation under the California Constitution.

California treatment of federal bond interest

Interest earned on federal bonds is also tax-exempt for California income tax purposes. This results from federal law (31 U.S.C. § 3124(a)) that prohibits all states from imposing an income tax on interest income from direct obligations of the U. S. government. Examples of bonds that are exempt for California income tax purposes include those issued by federal land banks, the Federal Home Loan Bank, and Banks for Cooperatives. Not all federal bonds are direct obligations of the U.S. government and interest on those bonds is taxable.

Examples of federal bonds not exempt are those issued by the Federal National Mortgage Association (Fannie Maes), Government National Mortgage Association (Ginnie Maes), and Federal Loan Home Mortgage Corporation (Freddie Macs).

California franchise tax treatment

Interest received from federal, state, municipal, or other bonds is includable in the gross income of corporations taxable under the franchise tax. The franchise tax is a nondiscriminatory privilege tax for the right to exercise the corporate franchise and is not a tax on the income received, but instead merely uses that income of the year as the measure of the tax for the privilege of exercising the corporate franchise.

Impact on California Revenue

Not applicable.

Section	Section Title
1522	Extension and Expansion of Qualified Zone Academy Bonds

Background

Tax-exempt bonds

Interest on state and local governmental bonds generally is excluded from gross income for federal income tax purposes if the proceeds of the bonds are used to finance direct activities of these governmental units or if the bonds are repaid with revenues of the governmental units.

These can include tax-exempt bonds which finance public schools.[200] An issuer must file with the Internal Revenue Service certain information about the bonds issued in order for that bond issue to be tax-exempt.[201] Generally, this information return is required to be filed no later the 15th day of the second month after the close of the calendar quarter in which the bonds were issued.

The tax exemption for state and local bonds does not apply to any arbitrage bond.[202] An arbitrage bond is defined as any bond that is part of an issue if any proceeds of the issue are reasonably expected to be used (or intentionally are used) to acquire higher yielding investments or to replace funds that are used to acquire higher yielding investments.[203] In general, arbitrage profits may be earned only during specified periods (e.g., defined "temporary periods") before funds are needed for the purpose of the borrowing or on specified types of investments (e.g., "reasonably required reserve or replacement funds"). Subject to limited exceptions, investment profits that are earned during these periods or on such investments must be rebated to the federal government.

Qualified zone academy bonds

As an alternative to traditional tax-exempt bonds, states and local governments were given the authority to issue "qualified zone academy bonds."[204] A total of $400 million of qualified zone academy bonds is authorized to be issued annually in calendar years 1998 through 2009. The $400 million aggregate bond cap is allocated each year to the states according to their respective populations of individuals below the poverty line. Each state, in turn, allocates the credit authority to qualified zone academies within such state.

A taxpayer holding a qualified zone academy bond on the credit allowance date is entitled to a credit. The credit is includible in gross income (as if it were a taxable interest payment on the bond), and may be claimed against regular income tax and alternative minimum tax liability. The Treasury Department sets the credit rate at a rate estimated to allow issuance of qualified zone academy bonds without discount and without interest cost to the issuer.[205] The Secretary determines credit rates for tax credit bonds based on general assumptions about credit quality of the class of potential eligible issuers and such other factors as the Secretary deems appropriate. The Secretary may determine credit rates based on general credit market yield indexes and credit ratings. The maximum term of the bond is determined by the Treasury Department, so that the present value of the obligation to repay the principal on the bond is 50 percent of the face value of the bond.

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[200] IRC section 103.

[201] IRC section 149(e).

[202] IRC sections 103(a) and (b)(2).

[203] IRC section 148.

[204] See IRC sections 54E and 1397E.

[205] Given the differences in credit quality and other characteristics of individual issuers, the Secretary cannot set credit rates in a manner that will allow each issuer to issue tax credit bonds at par.

"Qualified zone academy bonds" are defined as any bond issued by a state or local government, provided that (1) at least 95 percent of the proceeds are used for the purpose of renovating, providing equipment to, developing course materials for use at, or training teachers and other school personnel in a "qualified zone academy" and (2) private entities have promised to contribute to the qualified zone academy certain equipment, technical assistance or training, employee services, or other property or services with a value equal to at least 10 percent of the bond proceeds.

A school is a "qualified zone academy" if (1) the school is a public school that provides education and training below the college level, (2) the school operates a special academic program in cooperation with businesses to enhance the academic curriculum and increase graduation and employment rates, and (3) either (a) the school is located in an empowerment zone or enterprise community designated under the IRC, or (b) it is reasonably expected that at least 35 percent of the students at the school will be eligible for free or reduced-cost lunches under the school lunch program established under the National School Lunch Act.

The arbitrage requirements which generally apply to interest-bearing tax-exempt bonds also generally apply to qualified zone academy bonds. In addition, an issuer of qualified zone academy bonds must reasonably expect to and actually spend 100 percent or more of the proceeds of such bonds on qualified zone academy property within the three-year period that begins on the date of issuance. To the extent less than 100 percent of the proceeds are used to finance qualified zone academy property during the three-year spending period, bonds will continue to qualify as qualified zone academy bonds if unspent proceeds are used within 90 days from the end of such three-year period to redeem any nonqualified bonds. The three-year spending period may be extended by the Secretary if the issuer establishes that the failure to meet the spending requirement is due to reasonable cause and the related purposes for issuing the bonds will continue to proceed with due diligence.

Two special arbitrage rules apply to qualified zone academy bonds. First, available project proceeds invested during the three-year period beginning on the date of issue are not subject to the arbitrage restrictions (i.e., yield restriction and rebate requirements). Available project proceeds are proceeds from the sale of an issue of qualified zone academy bonds, less issuance costs (not to exceed two percent) and any investment earnings on such proceeds. Thus, available project proceeds invested during the three-year spending period may be invested at unrestricted yields, but the earnings on such investments must be spent on qualified zone academy property. Second, amounts invested in a reserve fund are not subject to the arbitrage restrictions to the extent: (1) such fund is funded at a rate not more rapid than equal annual installments; (2) such fund is funded in a manner reasonably expected to result in an amount not greater than an amount necessary to repay the issue; and (3) the yield on such fund is not greater than the average annual interest rate of tax-exempt obligations having a term of 10 years or more that are issued during the month the qualified zone academy bonds are issued.

Issuers of qualified zone academy bonds are required to report issuance to the Internal Revenue Service in a manner similar to the information returns required for tax-exempt bonds.

New Federal Law (IRC section 54E)

The provision extends and expands the present-law qualified zone academy bond program. The provision authorizes issuance of up to $1.4 billion of qualified zone academy bonds annually for 2009 and 2010, respectively.

Effective Date

The provision applies to obligations issued after December 31, 2008.

California Law (R&TC sections 17143 and 24272)

California does not conform to federal tax-credit bonds, and income from such bonds is not includable in California gross income.

California specifically does not conform to IRC sections 103 and 141 through 150, relating to the federal rules exempting the interest earned on state or municipal bonds and the arbitrage rebate rules. In addition, the federal "private-activity-bond" rules have not been adopted by California.

California state and municipal bonds

The general rule in California is that for income tax purposes all interest received or accrued is fully taxable, except for interest on federal obligations (such as Treasury bills, notes, and bonds, as more fully described below) and tax-exempt bonds issued by this state or a local government in this state.

Unlike federal law, the interest earned on bonds issued by other states and municipalities in other states is fully taxable to a resident of California. The California exemption from income taxation of interest on bonds of the state and its political subdivisions is contained in the California Constitution (Art. XIII, § 26. subd. (b)). The Revenue and Taxation Code further provides, by statute, that the federal "private-activity-bond" analysis shall not be made in determining whether interest on bonds issued by the state or a political subdivision thereof shall be exempt from California income tax. Thus, in California, if the use of the bond proceeds of a state or local California issue is for private business use or is secured by property used for a private business use, the interest on that bond is still treated for California income tax purposes as tax exempt, even though the interest on the bond may well be taxable for federal income tax purposes.

California conduit revenue bonds

Conduit revenue bonds are issued by a governmental (state or municipal) entity for various purposes, including economic development, educational and health facilities construction, and multi-family housing. The funds obtained from the financing are loaned to a nongovernmental borrower who builds and operates the project. The use by a private firm (via expenditure of the bond proceeds) of a governmental agency's authority to issue tax-exempt debt is premised on the fact that the project will provide public benefit. A conduit revenue bond is payable solely from the loan payments received from the non-governmental party (unless the bond is insured by a third party who guarantees payment in the event of a default by the private firm who has pledged the revenue source). The governmental issuer typically has no liability for debt service on the bonds, except for the administration of the bond. Although the issuer has no actual liability on the bonds, their reputation and standing with respect to future debt financing may be negatively affected in the event of a default on the bonds. More importantly, should the bonds go into default, the governmental entity will likely be drawn into the settlement process. Most conduit revenue bonds are sold at negotiated sales with the interest rate and other terms of the bonds negotiated between the issuer, the non-governmental borrower, and an underwriter. The security for some of these transactions is sufficient to allow the underwriter to act as a pass-through for the bonds and in so doing act as a placement agent rather than an underwriter. Since the public agency's credit is not on the line, many issuers do not participate in any substantive fashion in the sale of the bonds. Rather, they may limit their role to reviewing the bond purchase contract and other legal and disclosure documents to ensure that they are adequately indemnified against liabilities and to accurately describe their role to investors as issuers and not as borrowers or guarantors of the debt.

Because the conduit revenue bonds issued in California are issued by this state or a local government in this state, the interest paid on such bonds is exempt from state income taxation under the California Constitution.

California treatment of federal bond interest

Interest earned on federal bonds is also tax-exempt for California income tax purposes. This results from federal law (31 U.S.C. § 3124(a)) that prohibits all states from imposing an income tax on interest income from direct obligations of the U. S. government. Examples of bonds that are exempt for California income tax purposes include those issued by federal land banks, the Federal Home Loan Bank, and Banks for Cooperatives. Not all federal bonds are direct obligations of the U.S. government and interest on those bonds is taxable.

Examples of federal bonds not exempt are those issued by the Federal National Mortgage Association (Fannie Maes), Government National Mortgage Association (Ginnie Maes), and Federal Loan Home Mortgage Corporation (Freddie Macs).

California franchise tax treatment

Interest received from federal, state, municipal, or other bonds is includable in the gross income of corporations taxable under the franchise tax. The franchise tax is a nondiscriminatory privilege tax for the right to exercise the corporate franchise and is not a tax on the income received, but instead merely uses that income of the year as the measure of the tax for the privilege of exercising the corporate franchise.

Impact on California Revenue

Not applicable.

PART IV of SUBTITLE F of TITLE I – BUILD AMERICA BONDS

Section	Section Title
1531	Build America Bonds

Background

In general

Under present law, gross income does not include interest on state or local bonds. State and local bonds are classified generally as either governmental bonds or private activity bonds. Governmental bonds are bonds the proceeds of which are primarily used to finance governmental functions or which are repaid with governmental funds. Private activity bonds are bonds in which the state or local government serves as a conduit providing financing to nongovernmental persons (e.g., private businesses or individuals). The exclusion from income for state and local bonds does not apply to private activity bonds, unless the bonds are issued for certain permitted purposes ("qualified private activity bonds") and other IRC requirements are met.

Private activity bonds

The IRC defines a private activity bond as any bond that satisfies (1) the private business use test and the private security or payment test ("the private business test"); or (2) "the private loan financing test."[206]

Private business test

Under the private business test, a bond is a private activity bond if it is part of an issue in which:

1. More than 10 percent of the proceeds of the issue (including use of the bond-financed property) are to be used in the trade or business of any person other than a governmental unit ("private business use"); and
2. More than 10 percent of the payment of principal or interest on the issue is, directly or indirectly, secured by (a) property used or to be used for a private business use or (b) to be derived from payments in respect of property, or borrowed money, used or to be used for a private business use ("private payment test").[207]

A bond is not a private activity bond unless both parts of the private business test (i.e., the private business use test and the private payment test) are met. Thus, a facility that is 100 percent privately used does not cause the bonds financing such facility to be private activity bonds if the bonds are not secured by or paid with private payments. For example, land improvements that

[206] IRC section 141.

[207] The 10 percent private business test is reduced to five percent in the case of private business uses (and payments with respect to such uses) that are unrelated to any governmental use being financed by the issue.

benefit a privately-owned factory may be financed with governmental bonds if the debt service on such bonds is not paid by the factory owner or other private parties.

Private loan financing test

A bond issue satisfies the private loan financing test if proceeds exceeding the lesser of $5 million or five percent of such proceeds are used directly or indirectly to finance loans to one or more nongovernmental persons. Private loans include both business and other (e.g., personal) uses and payments by private persons; however, in the case of business uses and payments, all private loans also constitute private business uses and payments subject to the private business test.

Arbitrage restrictions

The exclusion from income for interest on state and local bonds does not apply to any arbitrage bond.[208] An arbitrage bond is defined as any bond that is part of an issue if any proceeds of the issue are reasonably expected to be used (or intentionally are used) to acquire higher yielding investments or to replace funds that are used to acquire higher yielding investments.[209] In general, arbitrage profits may be earned only during specified periods (e.g., defined "temporary periods") before funds are needed for the purpose of the borrowing or on specified types of investments (e.g., "reasonably required reserve or replacement funds"). Subject to limited exceptions, investment profits that are earned during these periods or on such investments must be rebated to the federal government.

Qualified tax credit bonds

In lieu of interest, holders of qualified tax credit bonds receive a tax credit that accrues quarterly. The following bonds are qualified tax credit bonds: qualified forestry conservation bonds, new clean renewable energy bonds, qualified energy conservation bonds, and qualified zone academy bonds.[210]

IRC section 54A sets forth general rules applicable to qualified tax credit bonds. These rules include requirements regarding credit allowance dates, the expenditure of available project proceeds, reporting, arbitrage, maturity limitations, and financial conflicts of interest, among other special rules.

A taxpayer who holds a qualified tax credit bond on one or more credit allowance dates of the bond during the taxable year shall be allowed a credit against the taxpayer's income tax for the taxable year. In general, the credit amount for any credit allowance date is 25 percent of the annual credit determined with respect to the bond. The annual credit is determined by multiplying the applicable credit rate by the outstanding face amount of the bond. The applicable credit rate

[208] IRC section 103(a) and (b)(2).

[209] IRC section 148.

[210] See IRC sections 54B, 54C, 54D, and 54E.

for the bond is the rate that the Secretary estimates will permit the issuance of the qualified tax credit bond with a specified maturity or redemption date without discount and without interest cost to the qualified issuer.[211] The Secretary determines credit rates for tax credit bonds based on general assumptions about credit quality of the class of potential eligible issuers and such other factors as the Secretary deems appropriate. The Secretary may determine credit rates based on general credit market yield indexes and credit ratings.

The credit is included in gross income and, under regulations prescribed by the Secretary, may be stripped (a separation (including at issuance) of the ownership of a qualified tax credit bond and the entitlement to the credit with respect to such bond).

IRC section 54A requires that 100 percent of the available project proceeds of qualified tax credit bonds must be used within the three-year period that begins on the date of issuance. Available project proceeds are proceeds from the sale of the bond issue less issuance costs (not to exceed two percent) and any investment earnings on such sale proceeds. To the extent less than 100 percent of the available project proceeds are used to finance qualified projects during the three-year spending period, bonds will continue to qualify as qualified tax credit bonds if unspent proceeds are used within 90 days from the end of such three-year period to redeem bonds. The three-year spending period may be extended by the Secretary upon the issuer's request demonstrating that the failure to satisfy the three-year requirement is due to reasonable cause and the projects will continue to proceed with due diligence.

Qualified tax credit bonds generally are subject to the arbitrage requirements of IRC section 148. However, available project proceeds invested during the three-year spending period are not subject to the arbitrage restrictions (i.e., yield restriction and rebate requirements). In addition, amounts invested in a reserve fund are not subject to the arbitrage restrictions to the extent: (1) such fund is funded at a rate not more rapid than equal annual installments; (2) such fund is funded in a manner reasonably expected to result in an amount not greater than an amount necessary to repay the issue; and (3) the yield on such fund is not greater than the average annual interest rate of tax-exempt obligations having a term of 10 years or more that are issued during the month the qualified tax credit bonds are issued.

The maturity of qualified tax credit bonds is the term that the Secretary estimates will result in the present value of the obligation to repay the principal on such bonds being equal to 50 percent of the face amount of such bonds, using as a discount rate the average annual interest rate of tax-exempt obligations having a term of 10 years or more that are issued during the month the qualified tax credit bonds are issued.

[211] Given the differences in credit quality and other characteristics of individual issuers, the Secretary cannot set credit rates in a manner that will allow each issuer to issue tax credit bonds at par.

New Federal Law (IRC sections 21, 54, 54A, 54AA, 1397E, 1400N, 6211, 6401, and 6411)

In general

The provision permits an issuer to elect to have an otherwise tax-exempt bond treated as a "Build America Bond." A "Build America Bond" is any obligation (other than a private activity bond) if the interest on such obligation would be (but for this provision) excludable from gross income under IRC section 103 and the issuer makes an irrevocable election to have the provision apply. In determining if an obligation would be tax-exempt under IRC section 103, the credit (or the payment discussed below for qualified bonds) is not treated as a federal guarantee. Further, the yield on a Build America Bond is determined without regard to the credit. A Build America Bond does not include any bond if the issue price has more than a de minimis amount of premium over the stated principal amount of the bond.

The holder of a Build America Bond will accrue a tax credit in the amount of 35 percent of the interest paid on the interest payment dates of the bond during the calendar year.[212] The interest payment date is any date on which the holder of record of the Build America Bond is entitled to a payment of interest under such bond. The sum of the accrued credits is allowed against regular and alternative minimum tax. Unused credit may be carried forward to succeeding taxable years. The credit, as well as the interest paid by the issuer, is included in gross income and the credit may be stripped under rules similar to those provided in IRC section 54A regarding qualified tax credit bonds. Rules similar to those that apply for S corporations, partnerships and regulated investment companies with respect to qualified tax credit bonds also apply to the credit.

Unlike the tax credit for bonds issued under IRC section 54A, the credit rate would not be calculated by the Secretary, but rather would be set by law at 35 percent. The actual credit that a taxpayer may claim is determined by multiplying the interest payment that the taxpayer receives from the issuer (i.e., the bond coupon payment) by 35 percent. Because the credit that the taxpayer claims is also included in income, the Committee anticipates that state and local issuers will issue bonds paying interest at rates approximately equal to 74.1 percent of comparable taxable bonds. It is anticipated that if an issuer issues a taxable governmental bond with coupons at 74.1 percent of a comparable taxable bond's coupon that the issuer's bond should sell at par. For example, if a taxable bond of comparable risk pays a $1,000 coupon and sells at par, then if a state or local issuer issues an equal-sized bond with coupon of $741.00, such a bond should also sell at par. The taxpayer who acquires the latter bond will receive an interest payment of $741 and may claim a credit of $259 (35 percent of $741). The credit and the interest payment are both included in the taxpayer's income. Thus, the taxpayer's taxable income from this instrument would be $1,000. This is the same taxable income that the taxpayer would recognize from holding the comparable taxable bond. Consequently, the issuer's bond should sell at the same price as would the taxable bond.

[212] Original issue discount (OID) is not treated as a payment of interest for purposes of determining the credit under the provision. OID is the excess of an obligation's stated redemption price at maturity over the obligation's issue price (IRC section 1273(a)).

Special rule for qualified bonds issued during 2009 and 2010

A "qualified bond" is any Build America Bond issued as part of an issue if 100 percent of the available project proceeds of such issue are to be used for capital expenditures.[213] The bond must be issued after February 17, 2009, and before January 1, 2011. The issuer must make an irrevocable election to have the special rule for qualified bonds apply.

Under the special rule for qualified bonds, in lieu of the tax credit to the holder, the issuer is allowed a credit equal to 35 percent of each interest payment made under such bond.[214] If in 2009 or 2010, the issuer elects to receive the credit, in the example above, for the state or local issuer's bond to sell at par, the issuer would have to issue the bond with a $1,000 interest coupon. The taxpayer who holds such a bond would include $1,000 on interest in his or her income. From the taxpayer's perspective the bond is the same the taxable bond in the example above and the taxpayer would be willing to pay par for the bond. However, under the provision the state or local issuer would receive a payment of $350 for each $1,000 coupon paid to bondholders. (The net interest cost to the issuer would be $650.)

The payment by the Secretary is to be made contemporaneously with the interest payment made by the issuer, and may be made either in advance or as reimbursement. In lieu of payment to the issuer, the payment may be made to a person making interest payments on behalf of the issuer. For purposes of the arbitrage rules, the yield on a qualified bond is reduced by the amount of the credit/payment.

The provision allows for a reasonably required reserve fund to be funded from bond proceeds.[215]

Transitional coordination with state law

As noted above, interest on a Build America Bond and the related credit are includible in gross income to the holder for federal tax purposes. The provision provides that until a state provides otherwise, the interest on any taxable governmental bond and the amount of any credit determined with respect to such bond shall be treated as being exempt from federal income tax for purposes of state income tax laws.

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[213] Under Treas. Reg. section 150-1(b), capital expenditure means any cost of a type that is properly chargeable to capital account (or would be so chargeable with a proper election or with the application of the definition of placed in service under Treas. Reg. sec. 1.150-2(c)) under general federal income tax principles. For purposes of applying the "general federal income tax principles" standard, an issuer should generally be treated as if it were a corporation subject to taxation under subchapter C of chapter 1 of the IRC. An example of a capital expenditure would include expenditures made for the purchase of fiber-optic cable to provide municipal broadband service.

[214] Original issue discount (OID) is not treated as a payment of interest for purposes of calculating the refundable credit under the provision.

[215] Under IRC section 148(d)(2), a bond is an arbitrage bond if the amount of the proceeds from the sale of such issue that is part or any reserve or replacement fund exceeds 10 percent of the proceeds. As such the interest on such bond would not be tax-exempt under IRC section 103 and thus would not be a qualified bond for purposes of the provision.

Effective Date

The provision is effective for obligations issued after February 17, 2009.

California Law (R&TC sections 17143 and 24272)

California does not conform to federal tax-credit bonds, and income from such bonds is not includable in California gross income.

California specifically does not conform to IRC sections 103 and 141 through 150, relating to the federal rules exempting the interest earned on state or municipal bonds and the arbitrage rebate rules. In addition, the federal "private-activity-bond" rules have not been adopted by California.

California state and municipal bonds

The general rule in California is that for income tax purposes all interest received or accrued is fully taxable, except for interest on federal obligations (such as Treasury bills, notes, and bonds, as more fully described below) and tax-exempt bonds issued by this state or a local government in this state.

Unlike federal law, the interest earned on bonds issued by other states and municipalities in other states is fully taxable to a resident of California. The California exemption from income taxation of interest on bonds of the state and its political subdivisions is contained in the California Constitution (subdivision (b) of section 26 of Article XIII). The Revenue and Taxation Code further provides, by statute, that the federal "private-activity-bond" analysis shall not be made in determining whether interest on bonds issued by the state or a political subdivision thereof shall be exempt from California income tax. Thus, in California, if the use of the bond proceeds of a state or local California issue is for private business use or is secured by property used for a private business use, the interest on that bond is still treated for California income tax purposes as tax exempt, even though the interest on the bond may well be taxable for federal income tax purposes.

California conduit revenue bonds

Conduit revenue bonds are issued by a governmental (state or municipal) entity for various purposes, including economic development, educational and health facilities construction, and multi-family housing. The funds obtained from the financing are loaned to a nongovernmental borrower who builds and operates the project. The use by a private firm (via expenditure of the bond proceeds) of a governmental agency's authority to issue tax-exempt debt is premised on the fact that the project will provide public benefit. A conduit revenue bond is payable solely from the loan payments received from the non-governmental party (unless the bond is insured by a third party who guarantees payment in the event of a default by the private firm who has pledged the revenue source). The governmental issuer typically has no liability for debt service on the bonds, except for the administration of the bond. Although the issuer has no actual liability on the bonds, their reputation and standing with respect to future debt financing may be negatively affected in the event of a default on the bonds. More importantly, should the bonds go into default, the governmental entity will likely be drawn into the settlement process. Most conduit revenue bonds are sold at negotiated sales with the interest rate and other terms of the bonds negotiated between the issuer, the non-governmental borrower, and an underwriter. The security for some of these transactions is sufficient to allow the underwriter to act as a pass-through for the bonds and in so doing act as a placement agent rather than an underwriter. Since the public agency's credit is not on the line, many issuers do not participate in any substantive fashion in the sale of the bonds. Rather, they may limit their role to reviewing the bond purchase contract and other legal and disclosure documents to ensure that they are adequately indemnified against liabilities and to accurately describe their role to investors as issuers and not as borrowers or guarantors of the debt.

Because the conduit revenue bonds issued in California are issued by this state or a local government in this state, the interest paid on such bonds is exempt from state income taxation under the California Constitution.

California treatment of federal bond interest

Interest earned on federal bonds is also tax-exempt for California income tax purposes. This results from federal law (31 U.S.C. § 3124(a)) that prohibits all states from imposing an income tax on interest income from direct obligations of the U. S. government. Examples of bonds that are exempt for California income tax purposes include those issued by federal land banks, the Federal Home Loan Bank, and Banks for Cooperatives. Not all federal bonds are direct obligations of the U.S. government and interest on those bonds is taxable.

Examples of federal bonds not exempt are those issued by the Federal National Mortgage Association (Fannie Maes), Government National Mortgage Association (Ginnie Maes), and Federal Loan Home Mortgage Corporation (Freddie Macs).

California franchise tax treatment

Interest received from federal, state, municipal, or other bonds is includable in the gross income of corporations taxable under the franchise tax. The franchise tax is a nondiscriminatory privilege tax for the right to exercise the corporate franchise and is not a tax on the income received, but instead merely uses that income as the measure of the tax for the privilege of exercising the corporate franchise.

Impact on California Revenue

Not applicable.

PART V of SUBTITLE F of TITLE I – REGULATED INVESTMENT COMPANIES ALLOWED TO PASS-THRU TAX CREDIT BOND CREDITS

Section	Section Title
1541	Regulated Investment Companies Allowed to Pass Thru Tax Credit Bond Credits

Background

In lieu of interest, holders of qualified tax credit bonds receive a tax credit that accrues quarterly. The credit is treated as interest that is includible in gross income. The following bonds are qualified tax credit bonds: qualified forestry conservation bonds, new clean renewable energy bonds, qualified energy conservation bonds, and qualified zone academy bonds.[216] The IRC provides that in the case of a qualified tax credit bond held by a regulated investment company, the credit is allowed to shareholders of such company (and any gross income included with respect to such credit shall be treated as distributed to such shareholders) under procedures prescribed by the Secretary.[217] The Secretary has not prescribed procedures for the pass through of the credit to regulated investment company shareholders.

New Federal Law (IRC sections 54, 54A, 851, and 853A)

The provision provides procedures for passing though credits on "tax credit bonds" to the shareholders of an electing regulated investment company. In general, an electing regulated investment company is not allowed any credits with respect to any tax credit bonds it holds during any year for which an election is in effect. The company is treated as having an amount of interest included in its gross income in an amount equal that which would have been included if no election were in effect, and a dividends paid deduction in the same amount is allowed to the company. Each shareholder of the electing regulated investment company is (1) required to include in gross income an amount equal to the shareholder's proportional share of the interest attributable to its credits and (2) allowed such proportional share as a credit against such shareholder's federal income tax. In order to pass through tax credits to a shareholder, a regulated investment company is required to mail a written notice to such shareholder not later than 60 days after the close of the regulated investment company's taxable year, designating the shareholder's proportionate share of passed-through credits and the shareholder's gross income in respect of such credits.

A tax credit bond means a qualified tax credit bond as defined in IRC section 54A(d), a Build America Bond (as defined in IRC section 54AA(d)), and any other bond for which a credit is allowable under subpart H of part IV of subchapter A of the IRC.

The provision gives the Secretary authority to prescribe the time and manner in which a regulated investment company makes the election to pass through credits on tax credit bonds. In addition, the provision requires the Secretary to prescribe such guidance as may be necessary to carry out

[216] See IRC sections 54B, 54C, 54D, and 54E.

[217] See IRC section 54A(h), which also covers real estate investment trusts.

the provision, including prescribing methods for determining a shareholder's proportionate share of tax credits.

Effective Date

The provision is applicable to taxable years ending after February 17, 2009.

California Law (None)

California has no comparable credit.

Impact on California Revenue

Not applicable.

SUBTITLE G of TITLE I – OTHER PROVISIONS

Section	Section Title
1601	Application of Certain Labor Standards to Projects Financed with Certain Tax-Favored Bonds

Background

The United States Code (Subchapter IV of Chapter 31 of Title 40) applies a prevailing wage requirement to certain contracts to which the federal government is a party.

New Federal Law (Act section 1601 affecting IRC section 54C)

The provision provides that Subchapter IV of Chapter 31 of Title 40 of the U.S. Code shall apply to projects financed with the proceeds of:

1. Any qualified new clean renewable energy bond (as defined in IRC section 54C) issued after the date of enactment;
2. Any qualified energy conservation bond (as defined in sec. 54D of the Code) issued after the date of enactment;
3. Any qualified zone academy bond (as defined in IRC section 54E) issued after the date of enactment;
4. Any qualified school construction bond (as defined in IRC section 54F); and
5. Any recovery zone economic development bond (as defined in IRC section 1400U-2).

Effective Date

The provision is effective on February 17, 2009.

California Law

The Franchise Tax Board does not administer the application of prevailing wages to be paid. Defer to the Employment Development Department (EDD).

Impact on California Revenue

Defer to the EDD.

Section	Section Title
1602	Grants to States for Low-Income Housing Projects in Lieu of Low Income Housing Credit (LIHC) Allocations for 2009
& 1404	Coordination of Low-Income Housing Credit and Low-Income Housing Grants

Background

In general

The low-income housing credit may be claimed over a 10-year period by owners of certain residential rental property for the cost of rental housing occupied by tenants having incomes below specified levels.[218] The amount of the credit for any taxable year in the credit period is the applicable percentage of the qualified basis of each qualified low-income building. The qualified basis of any qualified low-income building for any taxable year equals the applicable fraction of the eligible basis of the building.

Volume limits

A low-income housing credit is allowable only if the owner of a qualified building receives a housing credit allocation from the state or local housing credit agency. Generally, the aggregate credit authority provided annually to each state for calendar year 2009 is $2.30 per resident, with a minimum annual cap of $2,665,000 for certain small population states.[219] These amounts are indexed for inflation. Projects that also receive financing with proceeds of tax-exempt bonds issued subject to the private activity bond volume limit do not require an allocation of the low-income housing credit.

Basic rule for federal grants

The basis of a qualified building must be reduced by the amount of any federal grant with respect to such building.

[218] IRC section 42.

[219] Rev. Proc. 2008-66.

New Federal Law (Act section 1602 affecting IRC section 42)

Low-income housing grant election amount

The Secretary of the Treasury shall make a grant to the state housing credit agency of each state in an amount equal to the low-income housing grant election amount.

The low-income housing grant election amount for a state is an amount elected by the state subject to certain limits. The maximum low-income housing grant election amount for a state may not exceed 85 percent of the product of ten and the sum of the state's: (1) unused housing credit ceiling for 2008; (2) any returns to the state during 2009 of credit allocations previously made by the state; (3) 40 percent of the state's 2009 credit allocation; and (4) 40 percent of the state's share of the national pool allocated in 2009, if any).

Grants under this provision are not taxable income to recipients.

Subawards to low-income housing credit buildings

A state receiving a grant under this provision is to use these monies to make subawards to finance the construction, or acquisition and rehabilitation of qualified low-income buildings as defined under the low-income housing credit. A subaward may be made to finance a qualified low-income building regardless of whether the building has an allocation of low-income housing credit. However, in the case of qualified low-income buildings without allocations of the low-income housing credit, the state housing credit agency must make a determination that the subaward with respect to such building will increase the total funds available to the state to build and rehabilitate affordable housing. In conjunction with this determination the state housing credit agency must establish a process in which applicants for the subawards must demonstrate good faith efforts to obtain investment commitments before the agency makes such subawards.

Any building receiving grant money from a subaward is required to satisfy the low-income housing credit rules. The state housing credit agency shall perform asset management functions to ensure compliance with the low-income housing credit rules and the long-term viability of buildings financed with these subawards.[220] Failure to satisfy the low-income housing credit rules will result in recapture enforced by means of liens or other methods that the Secretary of the Treasury (or delegate) deems appropriate. Any such recapture will be payable to the Secretary of the Treasury for deposit in the general fund of the Treasury.

Any grant funds not used to make subawards before January 1, 2011, and any grant monies from subawards returned on or after January 1, 2011 must be returned to the Secretary of the Treasury.

[220] The state housing credit agency may collect reasonable fees from subaward recipients to cover the expenses of the agency's asset management duties. Alternatively, the state housing credit agency may retain a third party to perform these asset management duties.

Appropriations

The provision appropriates to the Secretary of the Treasury such sums as may be necessary to carry out this provision.

<u>New Federal Law (Act section 1404 affecting IRC section 42)</u>

Basic rule for federal grants

The grants received under this provision do not reduce tax basis of a qualified low-income building.

Reduction in low-income housing credit volume limit for 2009

The otherwise applicable low-income housing credit volume limit for any state for 2009 is reduced by the amount taken into account in determining the low-income housing grant election amount.

<u>Effective Date</u>

The provision is effective on February 17, 2009.

<u>California Law (R&TC sections 17057.5, 17058, 23610.4, and 23610.5)</u>

In general

California conforms by reference to IRC section 42, relating to the low-income housing credit, as of the "specified date" of January 1, 2005, with modifications. In order to qualify for the California low-income housing credit, the low-income housing project must be located in California. Additional modifications include the following:

California Tax Credit Allocation Committee

The California Tax Credit Allocation Committee is required to allocate this credit based on the project's need for economic feasibility. Thus, the amount of the California tax credit allocated to a project cannot exceed the amount that, in addition to the federal credit allocated to that project, is necessary for the financial feasibility of the project and its viability throughout the extended use period.

Credit amount and credit period

Generally, the percentage of costs for which the credit may be taken in the first three years is the highest percentage allowed under federal law in the month the building is placed in service. For the fourth year, the percentage is the difference between 30 percent and the sum of the credit percentage for the first three years.

For new buildings that are federally subsidized and existing buildings that are at risk of conversion to market rental rates, the percentage of creditable costs in the first three years is the same as the federal percentage applicable to the subsidized new buildings. For the fourth year, the percentage is the difference between 13 percent and the sum of the credit percentages for the first three years.

Compliance period

California uses a 30-year compliance period instead of the federal 15-year period California does not conform to the federal credit recapture rules.

Basis adjustments

California modifies the federal rule for the increase in qualified basis after the first year of the credit period.[221] When the basis of a building that has been granted a low-income housing tax credit is increased and exceeds the basis at the end of the first year of the four-year credit period, the taxpayer is eligible for a credit on the excess basis. This additional credit is also taken over a four-year period beginning with the taxable year in which the increase in qualified basis occurs.

Partnership allocations

For partnership allocations of low-income housing credits occurring on or after January 1, 2009, and before January 1, 2016, the credit must be allocated to the partners of a partnership owning the project based on the partnership agreement, regardless how the federal credit is allocated and regardless of whether the allocation of the credit under the partnership agreement has "substantial economic effect" within the meaning of IRC section 704(b). To the extent the allocation of the credit to a partner lacks substantial economic effect, any loss or deduction attributable to the sale, transfer, exchange, abandonment, or any other disposition of a partnership interest prior to the federal credit's expiration is deferred and treated as if it occurred in the first taxable year immediately following the taxable year in which the federal credit period expires.[222]

Low-income housing grant election amount

The grant election amount is not includible in the California taxable income of recipients.

Basic rule for federal grants

The grants received under this provision do not reduce the California tax basis of a qualified low-income building.

<u>Impact on California Revenue</u>

Not applicable.

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[221] IRC section 42(f)(3).

[222] R&TC section 23610.5(b)(1)(C).

Section	Section Title
1603	Grants for Specified Energy Property in Lieu of Tax Credits

Background

Renewable electricity production credit

An income tax credit is allowed for the production of electricity from qualified energy resources at qualified facilities (the ''renewable electricity production credit'').[223] Qualified energy resources comprise wind, closed-loop biomass, open-loop biomass, geothermal energy, solar energy, small irrigation power, municipal solid waste, qualified hydropower production, and marine and hydrokinetic renewable energy. Qualified facilities are, generally, facilities that generate electricity using qualified energy resources. To be eligible for the credit, electricity produced from qualified energy resources at qualified facilities must be sold by the taxpayer to an unrelated person.

Energy credit

An income tax credit is also allowed for certain energy property placed in service. Qualifying property includes certain fuel cell property, solar property, geothermal power production property, small wind energy property, combined heat and power system property, and geothermal heat pump property.[224]

New Federal Law (Act Section 1603 affecting IRC Section 48)

The provision authorizes the Secretary of the Treasury to provide a grant to each person who places in service during 2009 or 2010 energy property that is either (1) an electricity production facility otherwise eligible for the renewable electricity production credit or (2) qualifying property otherwise eligible for the energy credit. In general, the grant amount is 30 percent of the basis of the property that would (1) be eligible for the energy credit under IRC section 48 or (2) comprise an electricity production (IRC section 45) credit-eligible facility. For qualified microturbine, combined heat and power system, and geothermal heat pump property, the amount is 10 percent of the basis of the property.

Qualifying property must be depreciable or amortizable to be eligible for the grant.

The provision also permits taxpayers to claim the credit with respect to otherwise eligible property that is not placed in service in 2009 and 2010 so long as construction begins in either of those years and is completed prior to 2013 (in the case of wind facility property), 2014 (in the case of other renewable power facility property eligible for credit under IRC section 45), or 2017 (in the case of any specified energy property described in IRC section 48).

[223] IRC section 45. In addition to the renewable electricity production credit, IRC section 45 also provides income tax credits for the production of Indian coal and refined coal at qualified facilities.

[224] IRC section 48.

Nonbusiness property and property that would not otherwise be eligible for credit under IRC section 48 or part of a facility that would be eligible for credit under IRC section 45 is not eligible for a grant under the provision. The grant may be paid to whichever party would have been entitled to a credit under IRC section 48 or IRC section 45, as the case may be.

In addition, no grant may be awarded to any federal, state, or local government (or any political subdivision, agency, or instrumentality thereof) or any IRC section 501(c) tax-exempt entity.

No grant may be made unless the application for the grant has been received before October 1, 2011.

The grant program shall be administered by the Secretary of the Treasury.

Effective Date

The provision is effective February 17, 2009.

California Law (None)

California has no comparable credit or grant provisions.

Impact on California Revenue

Not applicable.

PART VI of SUBTITLE I of TITLE I – HEALTH COVERAGE IMPROVEMENT

Section	Section Title
1899A-1899I	Health Coverage Improvements

Background

In general

Under the Trade Act of 2002,[225] in the case of taxpayers who are eligible individuals, a refundable tax credit is provided for 65 percent of the taxpayer's premiums for qualified health insurance of the taxpayer and qualifying family members for each eligible coverage month beginning in the taxable year. The credit is commonly referred to as the health coverage tax credit ("HCTC"). The

[225] Public Law 107-210 (2002).

credit is available only with respect to amounts paid by the taxpayer. The credit is available on an advance basis.[226]

Qualifying family members are the taxpayer's spouse and any dependent of the taxpayer with respect to whom the taxpayer is entitled to claim a dependency exemption. Any individual who has other specified coverage is not a qualifying family member.

Persons eligible for the credit

Eligibility for the credit is determined on a monthly basis. In general, an eligible coverage month is any month if, as of the first day of the month, the taxpayer (1) is an eligible individual, (2) is covered by qualified health insurance, (3) does not have other specified coverage, and (4) is not imprisoned under federal, state, or local authority.[227] In the case of a joint return, the eligibility requirements are met if at least one spouse satisfies the requirements.

An eligible individual is an individual who is (1) an eligible TAA recipient, (2) an eligible alternative Trade Adjustment Assistance ("TAA") recipient, or (3) an eligible Pension Benefit Guaranty Corporation ("PBGC") pension recipient.

An individual is an eligible TAA recipient during any month if the individual (1) is receiving for any day of such month a trade readjustment allowance[228] or who would be eligible to receive such an allowance but for the requirement that the individual exhaust unemployment benefits before being eligible to receive an allowance and (2) with respect to such allowance, is covered under a certification issued under subchapter A or D of chapter 2 of title II of the Trade Act of 1974. An individual is treated as an eligible TAA recipient during the first month that such individual would otherwise cease to be an eligible TAA recipient.

An individual is an eligible alternative TAA recipient during any month if the individual (1) is a worker described in section 246(a)(3)(B) of the Trade Act of 1974 who is participating in the program established under section 246(a)(1) of such Act, and (2) is receiving a benefit for such month under section 246(a)(2) of such Act. An individual is treated as an eligible alternative TAA recipient during the first month that such individual would otherwise cease to be an eligible TAA recipient.

An individual is a PBGC pension recipient for any month if he or she (1) is age 55 or over as of the first day of the month, and (2) is receiving a benefit any portion of which is paid by the PBGC. The IRS has interpreted the definition of PBGC pension recipient to also include certain alternative

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[226] An individual is eligible for the advance payment of the credit once a qualified health insurance costs credit eligibility certificate is in effect. IRC section 7527.

[227] An eligible month must begin after November 4, 2002. This date is 90 days after the date of enactment of the Trade Act of 2002, which was August 6, 2002.

[228] The eligibility rules and conditions for such an allowance are specified in chapter 2 of title II of the Trade Act of 1974. Among other requirements, payment of a trade readjustment allowance is conditioned upon the individual enrolling in certain training programs or receiving a waiver of training requirements.

recipients and recipients who have received certain lump-sum payments on or after August 6, 2002. A person is not an eligible individual if he or she may be claimed as a dependent on another person's tax return.

An otherwise eligible taxpayer is not eligible for the credit for a month if, as of the first day of the month, the individual has other specified coverage. Other specified coverage is (1) coverage under any insurance which constitutes medical care (except for insurance substantially all of the coverage of which is for excepted benefits)[229] maintained by an employer (or former employer) if at least 50 percent of the cost of the coverage is paid by an employer[230] (or former employer) of the individual or his or her spouse or (2) coverage under certain governmental health programs. Specifically, an individual is not eligible for the credit if, as of the first day of the month, the individual is (1) entitled to benefits under Medicare Part A, enrolled in Medicare Part B, or enrolled in Medicaid or SCHIP, (2) enrolled in a health benefits plan under the Federal Employees Health Benefit Plan, or (3) entitled to receive benefits under chapter 55 of title 10 of the United States Code (relating to military personnel). An individual is not considered to be enrolled in Medicaid solely by reason of receiving immunizations.

A special rule applies with respect to alternative TAA recipients. For eligible alternative TAA recipients, an individual has other specified coverage if the individual is (1) eligible for coverage under any qualified health insurance (other than coverage under a COBRA continuation provision, state-based continuation coverage, or coverage through certain state arrangements) under which at least 50 percent of the cost of coverage is paid or incurred by an employer of the taxpayer or the taxpayer's spouse or (2) covered under any such qualified health insurance under which any portion of the cost of coverage is paid or incurred by an employer of the taxpayer or the taxpayer's spouse.

Qualified health insurance

Qualified health insurance eligible for the credit is: (1) COBRA continuation[231]coverage; (2) state-based continuation coverage provided by the state under a state law that requires such coverage; (3) coverage offered through a qualified state high risk pool; (4) coverage under a health insurance program offered to state employees or a comparable program; (5) coverage through an

[229] Excepted benefits are: (1) coverage only for accident or disability income or any combination thereof; (2) coverage issued as a supplement to liability insurance; (3) liability insurance, including general liability insurance and automobile liability insurance; (4) worker's compensation or similar insurance; (5) automobile medical payment insurance; (6) credit-only insurance; (7) coverage for on-site medical clinics; (8) other insurance coverage similar to the coverages in (1)-(7) specified in regulations under which benefits for medical care are secondary or incidental to other insurance benefits; (9) limited scope dental or vision benefits; (10) benefits for long-term care, nursing home care, home health care, community-based care, or any combination thereof; and (11) other benefits similar to those in (9) and (10) as specified in regulations; (12) coverage only for a specified disease or illness; (13) hospital indemnity or other fixed indemnity insurance; and (14) Medicare supplemental insurance.

[230] An amount is considered paid by the employer if it is excludable from income. Thus, for example, amounts paid for health coverage on a salary reduction basis under an employer plan are considered paid by the employer. A rule aggregating plans of the same employer applies in determining whether the employer pays at least 50 percent of the cost of coverage.

[231] COBRA continuation is defined in IRC section 9832(d)(1).

arrangement entered into by a state and a group health plan, an issuer of health insurance coverage, an administrator, or an employer; (6) coverage offered through a state arrangement with a private sector health care coverage purchasing pool; (7) coverage under a state-operated health plan that does not receive any federal financial participation; (8) coverage under a group health plan that is available through the employment of the eligible individual's spouse; and (9) coverage under individual health insurance if the eligible individual was covered under individual health insurance during the entire 30-day period that ends on the date the individual became separated from the employment which qualified the individual for the TAA allowance, the benefit for an eligible alternative TAA recipient, or a pension benefit from the PBGC, whichever applies.[232]

Qualified health insurance does not include any state-based coverage (i.e., coverage described in (2)-(7) in the preceding paragraph), unless the state has elected to have such coverage treated as qualified health insurance and such coverage meets certain requirements.[233] Such state coverage must provide that each qualifying individual is guaranteed enrollment if the individual pays the premium for enrollment or provides a qualified health insurance costs eligibility certificate and pays the remainder of the premium. In addition, the state-based coverage cannot impose any pre-existing condition limitation with respect to qualifying individuals. State-based coverage cannot require a qualifying individual to pay a premium or contribution that is greater than the premium or contribution for a similarly situated individual who is not a qualified individual. Finally, benefits under the state-based coverage must be the same as (or substantially similar to) benefits provided to similarly situated individuals who are not qualifying individuals.

A qualifying individual is an eligible individual who seeks to enroll in the state-based coverage and who has aggregate periods of creditable coverage[234] of three months or longer, does not have other specified coverage, and who is not imprisoned. In general terms, creditable coverage includes health care coverage without a gap of more than 63 days. Therefore, if an individual's qualifying coverage were terminated more than 63 days before the individual enrolled in the state-based coverage, the individual would not be a qualifying individual and would not be entitled to the state-based protections. A qualifying individual also includes qualified family members of such an eligible individual.

Qualified health insurance does not include coverage under a flexible spending or similar arrangement or any insurance if substantially all of the coverage is for excepted benefits.

Other rules

Amounts taken into account in determining the credit may not be taken into account in determining the amount allowable under the itemized deduction for medical expenses or the

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[232] For this purpose, "individual health insurance" means any insurance which constitutes medical care offered to individuals other than in connection with a group health plan. Such term does not include federal- or state-based health insurance coverage.

[233] For guidance on how a state elects a health program to be qualified health insurance for purposes of the credit, see Rev. Proc. 2004-12, 2004-1 C.B. 528.

[234] Creditable coverage is determined under the Health Insurance Portability and Accountability Act. IRC section 9801(c).

deduction for health insurance expenses of self-employed individuals. Amounts distributed from a medical savings account or health savings accounts are not eligible for the credit. The amount of the credit available through filing a tax return is reduced by any credit received on an advance basis. Married taxpayers filing separate returns are eligible for the credit; however, if both spouses are eligible individuals and the spouses file separate returns, then the spouse of the taxpayer is not a qualifying family member.

The Secretary of the Treasury is authorized to prescribe such regulations and other guidance as may be necessary or appropriate to carry out the credit provision.

COBRA

The Consolidated Omnibus Reconciliation Act of 1985 ("COBRA") requires that a group health plan must offer continuation coverage to qualified beneficiaries in the case of a qualifying event. An excise tax under the IRC applies on the failure of a group health plan to meet the requirement.[235] Qualifying events include the death of the covered employee, termination of the covered employee's employment, divorce or legal separation of the covered employee, and certain bankruptcy proceedings of the employer. In the case of termination from employment, the coverage must be extended for a period of not less than 18 months. In certain other cases, coverage must be extended for a period of not less than 36 months. Under such period of continuation coverage, the plan may require payment of a premium by the beneficiary of up to 102 percent of the applicable premium for the period.

<u>New Federal Law (Act sections 1899A – 1899I affecting IRC sections 1, 35, 4980B, 7527, and 9801)</u>

1899A - Increase in credit percentage amount

The provision increases the amount of the HCTC to 80 percent of the taxpayer's premiums for qualified health insurance of the taxpayer and qualifying family members.

<u>Effective date</u> -- The provision is effective for coverage months beginning on or after the first day of the first month beginning 60 days after February 17, 2009. The increased credit rate does not apply to months beginning after December 31, 2010.

1899B - Payment for monthly premiums paid prior to commencement of advance payment of credit

The provision provides that the Secretary of Treasury shall make one or more retroactive payments on behalf of certified individuals equal to 80 percent of the premiums for coverage of the taxpayer and qualifying family members for qualified health insurance for eligible coverage months occurring prior to the first month for which an advance payment is made on behalf of such individual. The amount of the payment must be reduced by the amount of any payment made to

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[235] IRC section 4980B.

the taxpayer under a national emergency grant pursuant to section 173(f) of the Workforce Investment Act of 1998 for a taxable year including such eligible coverage months.

Effective date --The provision is effective for eligible coverage months beginning after December 31, 2008. The Secretary of the Treasury, however, is not required to make any payments under the provision until after the date that is six months after February 17, 2009. The provision does not apply to months beginning after December 31, 2010.

1899C - TAA recipients not enrolled in training programs eligible for credit

The provision modifies the definition of an eligible TAA recipient to eliminate the requirement that an individual be enrolled in training in the case of an individual receiving unemployment compensation. In addition, the provision clarifies that the definition of an eligible TAA recipient includes an individual who would be eligible to receive a trade readjustment allowance except that the individual is in a break in training that exceeds the period specified in section 233(c) of the Trade Act of 1974, but is within the period for receiving the allowance.

Effective date --The provision is effective for months beginning after February 17, 2009, in taxable years ending after such date. The provision does not apply to months beginning after December 31, 2010.

1899D - TAA pre-certification period rule for purposes of determining whether there is a 63-day lapse in creditable coverage

Under the provision, in determining if there has been a 63-day lapse in coverage (which determines, in part, if the state-based consumer protections apply), in the case of a TAA-eligible individual, the period beginning on the date the individual has a TAA-related loss of coverage and ending on the date which is seven days after the date of issuance by the Secretary (or by any person or entity designated by the Secretary) of a qualified health insurance costs credit eligibility certificate (under IRC section 7527) for such individual is not taken into account.

Effective date --The provision is effective for plan years beginning after February 17, 2009. The provision does not apply to plan years beginning after December 31, 2010.

1899E - Continued qualification of family members after certain events

The provision provides continued eligibility for the credit for family members after certain events. The rule applies in the case of (1) the eligible individual becoming entitled to Medicare, (2) divorce and (3) death.

In the case of a month which would be an eligible coverage month with respect to an eligible individual except that the individual is entitled to benefits under Medicare Part A or enrolled in Medicare Part B, the month is treated as an eligible coverage month with respect to the individual solely for purposes of determining the amount of the credit with respect to qualifying family members (i.e., the credit is allowed for expenses paid for qualifying family members after the eligible individual is eligible for Medicare). Such treatment applies only with respect to the first 24 months after the eligible individual is first entitled to benefits under Medicare Part A or enrolled in Medicare Part B.

In the case of the finalization of a divorce between an eligible individual and the individual's spouse, the spouse is treated as an eligible individual for a period of 24 months beginning with the date of the finalization of the divorce. Under such rule, the only family members that may be taken into account with respect to the spouse as qualifying family members are those individuals who were qualifying family members immediately before such divorce finalization.

In the case of the death of an eligible individual, the spouse of such individual (determined at the time of death) is treated as an eligible individual for a period of 24 months beginning with the date of death. Under such rule, the only qualifying family members that may be taken into account with respect to the spouse are those individuals who were qualifying family members immediately before such death. In addition, any individual who was a qualifying family member of the decedent immediately before such death[236] is treated as an eligible individual for a period of 24 months beginning with the date of death, except that in determining the amount of the HCTC only such qualifying family member may be taken into account.

Effective date --The provision is effective for months beginning after December 31, 2009. The provision does not apply to months that begin after December 31, 2010.

1899F - Alignment of COBRA coverage

The maximum required COBRA continuation coverage period is modified by the provision with respect to certain individuals whose qualifying event is a termination of employment or a reduction in hours. First, in the case of such a qualifying event with respect to a covered employee who has a nonforfeitable right to a benefit any portion of which is paid by the PBGC, the maximum coverage period must end not earlier than the date of death of the covered employee (or in the case of the surviving spouse or dependent children of the covered employee, not earlier than 24 months after the date of death of the covered employee). Second, in the case of such a qualifying event where the covered employee is a TAA eligible individual as of the date that the maximum coverage period would otherwise terminate, the maximum coverage period must extend during the period that the individual is a TAA eligible individual.

Effective date. --The provision is effective for periods of coverage that would, without regard to the provision, end on or after February 17, 2009, provided that the provision does not extend any periods of coverage beyond December 31, 2010.

1899G - Addition of coverage through voluntary employees' beneficiary associations

The provision expands the definition of qualified health insurance by including coverage under an employee benefit plan funded by a voluntary employees' beneficiary association ("VEBA", as defined in IRC section 501(c)(9)) established pursuant to an order of a bankruptcy court, or by

[236] In the case of a dependent, the rule applies to the taxpayer to whom the personal exemption deduction under IRC section 151 is allowable.

agreement with an authorized representative, as provided in section 1114 of title 11, United States Code.

Effective date --The provision is effective on February 17, 2009. The provision does not apply with respect to certificates of eligibility issued after December 31, 2010.

1899H-Notice requirements

The provision requires that the qualified health insurance costs credit eligibility certificate provided in connection with the advance payment of the HCTC must include (1) the name, address, and telephone number of the state office or offices responsible for providing the individual with assistance with enrollment in qualified health insurance, (2) a list of coverage options that are treated as qualified health insurance by the state in which the individual resides, (3) in the case of a TAA-eligible individual, a statement informing the individual that the individual has 63 days from the date that is seven days after the issuance of such certificate to enroll in such insurance without a lapse in creditable coverage, and (4) such other information as the Secretary may provide.

Effective date The provision is effective for certificates issued after August 17, 2009. The provision does not apply to months beginning after December 31, 2010.

1899I - Survey and report on enhanced health coverage tax credit program

Survey

The provision requires that the Secretary of the Treasury must conduct a biennial survey of eligible individuals containing the following information:

1. In the case of eligible individuals receiving the HCTC (including those participating in the advance payment program (the "HCTC program")) (A) demographic information of such individuals, including income and education levels, (B) satisfaction of such individuals with the enrollment process in the HCTC program, (C) satisfaction of such individuals with available health coverage options under the credit, including level of premiums, benefits, deductibles, cost-sharing requirements, and the adequacy of provider networks, and (D) any other information that the Secretary determines is appropriate.
2. In the case of eligible individuals not receiving the HCTC (A) demographic information on each individual, including income and education levels, (B) whether the individual was aware of the HCTC or the HCTC program, (C) the reasons the individual has not enrolled in the HCTC program, including whether such reasons include the burden of process of enrollment and the affordability of coverage, (D) whether the individual has health insurance coverage, and, if so, the source of such coverage, and (E) any other information that the Secretary determines is appropriate.

Not later than December 31 of each year in which a survey described above is conducted (beginning in 2010), the Secretary of Treasury must report to the Committee on Finance and the Committee on Health, Education, Labor, and Pensions of the Senate and the Committee on Ways and Means and the Committee on Education and Labor of the House of Representatives the findings of the most recent survey.

Report

Not later than October 1 of each year (beginning in 2010), the Secretary of Treasury must report to the Committee on Finance and the Committee on Health, Education, Labor, and Pensions of the Senate and the Committee on Ways and Means and the Committee on Education and Labor of the House of Representatives the following information with respect to the most recent taxable year ending before such date:

1. In each state and nationally (A) the total number of eligible individuals and the number of eligible individuals receiving the HCTC, (B) the total number of such eligible individuals who receive an advance payment of the HCTC through the HCTC program, (C) the average length of the time period of participation of eligible individuals in the HCTC program, and (D) the total number of participating eligible individuals in the HCTC program who are enrolled in each category of qualified health insurance with respect to each category of eligible individuals.

2. In each state and nationality, an analysis of (A) the range of monthly health insurance premiums, for self-only coverage and for family coverage, for individuals receiving the benefit of the HCTC and (B) the average and median monthly health insurance premiums, for self-only coverage and for family coverage, for individuals receiving the HCTC with respect to each category of qualified health insurance.

3. In each state and nationally, an analysis of the following information with respect to the health insurance coverage of individuals receiving the HCTC who are enrolled in State-based coverage: (A) deductible amounts, (B) other out-of-pocket cost-sharing amounts, and (C) a description of any annual or lifetime limits on coverage or any other significant limits on coverage services or benefits. The information must be reported with respect to each category of coverage.

4. In each state and nationally, the gender and average age of eligible individuals who receive the HCTC in each category of qualified health insurance with respect to each category of eligible individuals.

5. The steps taken by the Secretary of the Treasury to increase the participation rates in the HCTC program among eligible individuals, including outreach and enrollment activities.

6. The cost of administering the HCTC program by function, including the cost of subcontractors, and recommendations on ways to reduce the administrative costs, including recommended statutory changes.

7. After consultation with the Secretary of Labor, the number of States applying for and receiving national emergency grants under section 173(f) of the Workforce Investment Act of 1998, the activities funded by such grants on a State-by-State basis, and the time necessary for application approval of such grants.

Effective Date

The provision is generally effective February 17, 2009, excepted as otherwise noted above.

California Law (None)

California has no comparable credit.

Impact on California Revenue

Not applicable.

SUBTITLE A of TITLE II – UNEMPLOYMENT INSURANCE

Section	Section Title
2001	Extension of Emergency Unemployment Compensation Program

Title IV, Emergency Unemployment Compensation, of the Supplemental Appropriations Act, 2008 (Public Law 110–252; 26 U.S.C. 3304 note) as amended by the Unemployment Compensation Act of 2008 (Public Law 110–449) created a temporary emergency unemployment compensation program (EUC08). The program ends on the week ending on or before March 31, 2009. No compensation under the program is payable for any week beginning after August 27, 2009. Funds in the extended unemployment compensation account (EUCA) of the unemployment trust fund (UTF) are used for financing EUC08 payments. State administration funds are made from the employment security administration account (ESAA). Compensation for EUC08 payments to former employees of nonprofits and governments are from the general fund of the Treasury.

New Federal Law (Act section 2001 affecting IRC section 3304)

The duration of the EUC08 program is extended through the week ending on or before December 31, 2009. No benefits are payable for any week beginning after May 31, 2010. The extension is financed through the general fund of the Treasury. The funds do not need to be repaid.

Effective Date

The provision is effective February 17, 2009.

California Law

The Franchise Tax Board does not administer unemployment compensation. Defer to the Employment Development Department (EDD).

Impact on California Revenue

Defer to the EDD.

Section	Section Title
2002	Increase in Unemployment Compensation Benefits

Background

Federal law does not provide formulas, floors, or ceilings of regular weekly state unemployment compensation amounts. In general, the states set weekly benefit amounts as a fraction of the individual's average weekly wage up to some state-determined maximum. Some states include dependents' allowances in addition to the underlying benefit.

New Federal Law (Act section 2002 affecting IRC section 3304)

The provision creates an additional, federally-funded $25 weekly benefit that would be available to all individuals receiving regular unemployment compensation (UC) benefits. All the provisions of Act section 2002 also apply to regular UC, extended benefits (EB), and EUC08 benefits. It requires states to not take the additional compensation into consideration when determining regular UC benefits (including any dependants' allowances). The additional benefit is payable either at the same time and in the same manner as any regular UC payable for the week involved or payable separately but on the same weekly basis as any regular compensation otherwise payable. States are allowed to alter the method governing the computation of UC under state law in such a manner that the weekly benefit amount would be less than the benefit amount that would have been payable under state law as of December 31, 2008. Funding for the additional benefit is appropriated from the general fund of the Treasury, without fiscal year limitation. The funds are not required to be repaid.

States pay the additional compensation to individuals once the state enters into an agreement with the Labor Secretary and ending before January 1, 2010. The additional compensation is ''grandfathered'' for individuals who have not exhausted the right to regular compensation as of January 1, 2010. No additional compensation is payable for any week beginning after June 30, 2010.

The additional benefit is disregarded in considering the amount of income of any individual for any purposes under Medicaid and SCHIP.

Effective Date

The provision is effective February 17, 2009.

California Law

The Franchise Tax Board does not administer unemployment compensation. Defer to the Employment Development Department (EDD).

Impact on California Revenue

Defer to the EDD.

Section	Section Title
2005	Full Federal Funding of Extended Unemployment Compensation for a Limited Period

Background

The Extended Benefit (EB) program, established by the Federal-State Extended Unemployment Compensation Act of 1970 (EUCA), Public Law 91–373 (26 U.S.C. 3304, note), may extend receipt of unemployment benefits (extended benefits) at the state level if certain economic situations exist within the state. Extended benefits (EB) are funded half (50 percent) by the federal government through its account for that purpose in the UTF; states fund the other half (50 percent) through their state accounts in the UTF.

Individual eligibility for EB payments, among other matters, requires that the worker has exhausted all rights to regular unemployment compensation (UC) benefits and be within the state-determined benefit year (generally within 52 weeks of first claiming regular UC eligibility) when a state's EB program becomes active on account of economic conditions.

States that do not require a one-week UC waiting period, or that have an exception for any reason to the waiting period, must pay 100 percent of the first week of EB (rather than 50 percent). Public Law 110–449, the Unemployment Compensation Extension Act of 2008, suspended this waiting week requirement from the time of its enactment until the week ending on or before December 8, 2009.

New Federal Law (Act section 2005 affecting IRC section 3304)

The provision temporarily alters federal-state funding ratios. Extended benefits are 100 percent federally financed from February 17, 2009, through January 1, 2010. The agreement also temporarily allows states to ignore benefit year calculations but instead base EB eligibility upon having qualified for and exhausted EUC08 benefits, disregarding benefit year calculations as long as the EB period fell between the date of enactment and before January 1, 2010.

The provision allows states to opt to grandfather those workers who received EUC08 payments and exhausted them on or after January 1, 2010. Those workers would be eligible to receive EB payments based on EUC08 exhaustion and disregarding benefit year determinations until the week ending on or before June 1, 2010.

The provision continues the temporary suspension of the waiting week requirement for federal funding until the week ending before May 30, 2010.

Effective Date

This provision is effective as if included in the enactment of the Unemployment Compensation Extension Act of 2008 (Public Law 110-449).

California Law

The Franchise Tax Board does not administer unemployment compensation. Defer to the Employment Development Department (EDD).

Impact on California Revenue

Defer to the EDD.

SUBTITLE C of TITLE II – ECONOMIC REOCOVERY PAYMENTS TO CERTAIN INDIVIDUALS

Section	Section Title
2201	Economic Recovery Payment to Recipients of Social Security, Supplemental Security Income, Railroad Retirement Benefits, and Veterans Disability Compensation or Pension Benefits

Background

Title II of the Social Security Act authorizes cash benefits for retired and disabled workers and their dependents and survivors under the Old Age and Survivors Insurance (OASI) and Disability Insurance (DI) programs. Title XVI of the Social Security Act authorizes monthly cash benefits for blind and disabled persons and persons age 65 or over who have limited income and resources under the Supplemental Security Income (SSI) program.

The Railroad Retirement Act of 1974 authorizes cash benefits for retired and disabled railroad workers and their dependents and survivors.

Title 38 of the United States Code authorizes cash benefits for certain veterans and their dependents and survivors.

Current law does not authorize any one-time emergency payments for any of these programs.

Under Title II of the Social Security Act, a person is eligible for Social Security benefits only if he or she has insured status as the result of sufficient employment that was covered by the Social Security system and for which Social Security payroll taxes were paid. Federal employees hired before 1983 were covered by the Civil Service Retirement System (CSRS) and, unless they were eligible for the CSRS-Offset or elected to enroll in the Federal Employees Retirement System (FERS), they are not eligible for Social Security benefits on the basis of their federal service. In addition, some state and local government employees are not covered by the Social Security system and thus are not eligible for Social Security benefits on the basis of their public service.

Current law does not authorize any one-time tax credit for government retirees who are not eligible for Social Security benefits.

New Federal Law (Act section 2201 affecting IRC section 6428)

The provision directs the Secretary of the Treasury to disburse a onetime Economic Recovery Payment of $250 to adults who were eligible for Social Security benefits, Railroad Retirement benefits, or veteran's compensation or pension benefits; or individuals who were eligible for Supplemental Security Income (SSI) benefits (excluding individuals who receive SSI while in a Medicaid institution). Only individuals who were eligible for one of the four programs for any of the three months prior to the month of enactment shall receive an Economic Recovery Payment.

The provision stipulates that Economic Recovery Payments will only be made to individuals whose address of record is in 1 of the 50 states, the District of Columbia, Puerto Rico, Guam, the United States Virgin Islands, American Samoa, or the Northern Mariana Islands.

An individual shall only receive one $250 Economic Recovery Payment under this section regardless of whether the individual is eligible for a benefit from more than one of the four federal programs. If the individual is also eligible for the "Making Work Pay" credit from Act section 1001, that credit shall be reduced by the Economic Recovery Payment made under this section.

Individuals who are otherwise eligible for an Economic Recovery Payment will not receive a payment if their federal program benefits have been suspended because they are in prison, a fugitive, a probation or parole violator, have committed fraud, or are no longer lawfully present in the United States.

The provision directs the Commissioner of Social Security, the Railroad Retirement Board, and the Secretary of Veterans Affairs to provide the Secretary of the Treasury with information and data to send the payments to eligible individuals and to disburse the payments.

The provision provides that the Economic Recovery Payments shall not be taken into account as income, or taken into account as resources for the month of receipt and the following nine months, for purposes of determining the eligibility of such individual or any other individual for benefits or assistance, or the amount or extent of benefits or assistance, under any federal program or under any state or local program financed in whole or in part with federal funds.

The provision provides that Economic Recovery Payments shall not be considered gross income for income tax purposes and that the payments are protected by the assignment and garnishment provisions of the four federal benefit programs. The payments will be subject to the Treasury Offset Program.

The provision stipulates that if an individual who is eligible for an Economic Recovery Payment has a representative payee, the payment shall be made to the representative payee and the entire payment shall only be used for the benefit of the individual who is entitled to the Economic Recovery Payment.

The provision appropriates the following amounts for FY2009 through FY2011: to the Secretary of the Treasury, $131 million for administrative costs to carry out the provisions of this section and the new IRC section 36A (the Making Work Pay credit); to the Commissioner of Social Security, such funds as are necessary to make the payments and $90 million to carry out the provisions of this section; to the Railroad Retirement Board, such funds as are necessary to make the payments and $1.4 million to carry out the provisions of this section; and to the Secretary of Veterans Affairs, such funds as are necessary to make the payments, $100,000 for the Information Systems Technology account and $7.1 million to the General Operating Expenses account.

The Secretary of the Treasury shall commence making payments as soon as possible, but no later than 120 days after February 17, 2009. No Economic Recovery Payments shall be made after December 31, 2010.

Effective Date

The provision is effective on February 17, 2009.

California Law (R&TC sections 17081, 17087)

California has no comparable provision.

The economic recovery payments under this provision are treated as Social Security payments. Because California specifically does not include Social Security payments in gross income, the economic recovery payments under this provision are not includible in gross income.

Impact on California Revenue

Not applicable.

Section	Section Title
2202	Special Credit for Certain Government Retirees

Background

None.

New Federal Law (Act Section 2202 affecting IRC section 6428)

The provision creates a $250 credit ($500 for a joint return where both spouses are eligible) against income taxes owed for tax year 2009 for individuals who receive a government pension or annuity from work not covered by Social Security, and were not eligible to receive a payment under Act section 2201. If the individual is also eligible for the "Making Work Pay" credit from Act section 1001, that credit shall be reduced by the credit made under this section. Each tax return on which this credit is claimed must include the social security number of the taxpayer (in the case of a joint return, the social security number of at least one spouse). The provision states that the credit under this section shall be a refundable credit.

The provision provides that any credit or refund allowed or made by this provision shall not be taken into account as income and shall not be taken into account as resources for the month of receipt and the following two months for purposes of determining the eligibility of such individual or any other individual for benefits or assistance, or the amount or extent of benefits or assistance, under any federal program or under any state or local program financed in whole or in part with federal funds.

Effective Date

The provision is effective on February 17, 2009.

California Law (None)

California has no comparable credit.

Impact on California Revenue

Not applicable.

TITLE III – PREMIUM ASSISTANCE FOR COBRA BENEFITS

Section	Section Title
3001	Premium Assistance for COBRA Benefits

Background

In general

The IRC contains rules that require certain group health plans to offer certain individuals ("qualified beneficiaries") the opportunity to continue to participate for a specified period of time in the group health plan ("continuation coverage") after the occurrence of certain events that otherwise would have terminated such participation ("qualifying events").[237] These continuation coverage rules are often referred to as "COBRA continuation coverage" or "COBRA," which is a reference to the acronym for the law that added the continuation coverage rules to the IRC.[238]

The IRC imposes an excise tax on a group health plan if it fails to comply with the COBRA continuation coverage rules with respect to a qualified beneficiary. The excise tax with respect to a qualified beneficiary generally is equal to $100 for each day in the noncompliance period with respect to the failure. A plan's noncompliance period generally begins on the date the failure first occurs and ends when the failure is corrected. Special rules apply that limit the amount of the excise tax if the failure would not have been discovered despite the exercise of reasonable diligence or if the failure is due to reasonable cause and not willful neglect.

In the case of a multiemployer plan, the excise tax generally is imposed on the group health plan. A multiemployer plan is a plan to which more than one employer is required to contribute, that is maintained pursuant to one or more collective bargaining agreements between one or more employee organizations and more than one employer, and that satisfies such other requirements as the Secretary of Labor may prescribe by regulation. In the case of a plan other than a multiemployer plan (a "single employer plan"), the excise tax generally is imposed on the employer.

Plans subject to COBRA

A group health plan is defined as a plan of, or contributed to by, an employer (including a self-employed person) or employee organization to provide health care (directly or otherwise) to the employees, former employees, the employer, and others associated or formerly associated with the employer in a business relationship, or their families. A group health plan includes a self-

[237] IRC section 4980B.

[238] The COBRA rules were added to the IRC by the Consolidated Omnibus Budget Reconciliation Act of 1985, Public Law 99-272. The rules were originally added as IRC sections 162(i) and (k). The rules were later restated as IRC section 4980B, pursuant to the Technical and Miscellaneous Revenue Act of 1988, Public Law 100-647.

insured plan. The term group health plan does not, however, include a plan under which substantially all of the coverage is for qualified long-term care services.

The following types of group health plans are not subject to the IRC's COBRA rules: (1) a plan established and maintained for its employees by a church or by a convention or association of churches which is exempt from tax under IRC section 501 (a "church plan"); (2) a plan established and maintained for its employees by the federal government, the government of any state or political subdivision thereof, or by any instrumentality of the foregoing (a "governmental plan");[239] and (3) a plan maintained by an employer that normally employed fewer than 20 employees on a typical business day during the preceding calendar year[240] (a "small employer plan").

Qualifying events and qualified beneficiaries

A qualifying event that gives rise to COBRA continuation coverage includes, with respect to any covered employee, the following events which would result in a loss of coverage of a qualified beneficiary under a group health plan (but for COBRA continuation coverage): (1) death of the covered employee; (2) the termination (other than by reason of such employee's gross misconduct), or a reduction in hours, of the covered employee's employment; (3) divorce or legal separation of the covered employee; (4) the covered employee becoming entitled to Medicare benefits under title XVIII of the Social Security Act; (5) a dependent child ceasing to be a dependent child under the generally applicable requirements of the plan; and (6) a proceeding in a case under the U.S. Bankruptcy Code commencing on or after July 1, 1986, with respect to the employer from whose employment the covered employee retired at any time.

A "covered employee" is an individual who is (or was) provided coverage under the group health plan on account of the performance of services by the individual for one or more persons maintaining the plan and includes a self-employed individual. A "qualified beneficiary" means, with respect to a covered employee, any individual who on the day before the qualifying event for the employee is a beneficiary under the group health plan as the spouse or dependent child of the employee. The term qualified beneficiary also includes the covered employee in the case of a qualifying event that is a termination of employment or reduction in hours.

Continuation coverage requirements

Continuation coverage that must be offered to qualified beneficiaries pursuant to COBRA must consist of coverage which, as of the time coverage is being provided, is identical to the coverage provided under the plan to similarly situated non-COBRA beneficiaries under the plan with respect to whom a qualifying event has not occurred. If coverage under a plan is modified for any group of similarly situated non-COBRA beneficiaries, the coverage must also be modified in the same manner for qualified beneficiaries. Similarly situated non-COBRA beneficiaries means the group of covered employees, spouses of covered employees, or dependent children of covered employees who (i) are receiving coverage under the group health plan for a reason other than

[239] A governmental plan also includes certain plans established by an Indian tribal government.

[240] If the plan is a multiemployer plan, then each of the employers contributing to the plan for a calendar year must normally employ fewer than 20 employees during the preceding calendar year.

pursuant to COBRA, and (ii) are the most similarly situated to the situation of the qualified beneficiary immediately before the qualifying event, based on all of the facts and circumstances.

The maximum required period of continuation coverage for a qualified beneficiary (i.e., the minimum period for which continuation coverage must be offered) depends upon a number of factors, including the specific qualifying event that gives rise to a qualified beneficiary's right to elect continuation coverage. In the case of a qualifying event that is the termination, or reduction of hours, of a covered employee's employment, the minimum period of coverage that must be offered to the qualified beneficiary is coverage for the period beginning with the loss of coverage on account of the qualifying event and ending on the date that is 18 months[241] after the date of the qualifying event. If coverage under a plan is lost on account of a qualifying event but the loss of coverage actually occurs at a later date, the minimum coverage period may be extended by the plan so that it is measured from the date when coverage is actually lost.

The minimum coverage period for a qualified beneficiary generally ends upon the earliest to occur of the following events: (1) the date on which the employer ceases to provide any group health plan to any employee, (2) the date on which coverage ceases under the plan by reason of a failure to make timely payment of any premium required with respect to the qualified beneficiary, and (3) the date on which the qualified beneficiary first becomes (after the date of election of continuation coverage) either (i) covered under any other group health plan (as an employee or otherwise) which does not include any exclusion or limitation with respect to any preexisting condition of such beneficiary or (ii) entitled to Medicare benefits under title XVIII of the Social Security Act. Mere eligibility for another group health plan or Medicare benefits is not sufficient to terminate the minimum coverage period. Instead, the qualified beneficiary must be actually covered by the other group health plan or enrolled in Medicare. Coverage under another group health plan or enrollment in Medicare does not terminate the minimum coverage period if such other coverage or Medicare enrollment begins on or before the date that continuation coverage is elected.

Election of continuation coverage

The COBRA rules specify a minimum election period under which a qualified beneficiary is entitled to elect continuation coverage. The election period begins not later than the date on which coverage under the plan terminates on account of the qualifying event, and ends not earlier than the later of 60 days or 60 days after notice is given to the qualified beneficiary of the qualifying event and the beneficiary's election rights.

Notice requirements

A group health plan is required to give a general notice of COBRA continuation coverage rights to employees and their spouses at the time of enrollment in the group health plan.

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[241] In the case of a qualified beneficiary who is determined, under Title II or XVI of the Social Security Act, to have been disabled during the first 60 days of continuation coverage, the 18 month minimum coverage period is extended to 29 months with respect to all qualified beneficiaries if notice is given before the end of the initial 18 month continuation coverage period.

An employer is required to give notice to the plan administrator of certain qualifying events (including a loss of coverage on account of a termination of employment or reduction in hours) generally within 30 days of the qualifying event. A covered employee or qualified beneficiary is required to give notice to the plan administrator of certain qualifying events within 60 days after the event. The qualifying events giving rise to an employee or beneficiary notification requirement are the divorce or legal separation of the covered employee or a dependent child ceasing to be a dependent child under the terms of the plan. Upon receiving notice of a qualifying event from the employer, covered employee, or qualified beneficiary, the plan administrator is then required to give notice of COBRA continuation coverage rights within 14 days to all qualified beneficiaries with respect to the event.

Premiums

A plan may require payment of a premium for any period of continuation coverage. The amount of such premium generally may not exceed 102 percent[242] of the "applicable premium" for such period and the premium must be payable, at the election of the payor, in monthly installments.

The applicable premium for any period of continuation coverage means the cost to the plan for such period of coverage for similarly situated non-COBRA beneficiaries with respect to whom a qualifying event has not occurred, and is determined without regard to whether the cost is paid by the employer or employee. The determination of any applicable premium is made for a period of 12 months (the "determination period") and is required to be made before the beginning of such 12 month period.

In the case of a self-insured plan, the applicable premium for any period of continuation coverage of qualified beneficiaries is equal to a reasonable estimate of the cost of providing coverage during such period for similarly situated non-COBRA beneficiaries which is determined on an actuarial basis and takes into account such factors as the Secretary of Treasury prescribes in regulations. A self-insured plan may elect to determine the applicable premium on the basis of an adjusted cost to the plan for similarly situated non-COBRA beneficiaries during the preceding determination period.

A plan may not require payment of any premium before the day which is 45 days after the date on which the qualified beneficiary made the initial election for continuation coverage. A plan is required to treat any required premium payment as timely if it is made within 30 days after the date the premium is due or within such longer period as applies to, or under, the plan.

Other continuation coverage rules

Continuation coverage rules which are parallel to the IRC's continuation coverage rules apply to group health plans under the Employee Retirement Income Security Act of 1974 (ERISA).[243]

[242] In the case of a qualified beneficiary whose minimum coverage period is extended to 29 months on account of a disability determination, the premium for the period of the disability extension may not exceed 150 percent of the applicable premium for the period.

[243] Sections 601 to 608 of ERISA.

ERISA generally permits the Secretary of Labor and plan participants to bring a civil action to obtain appropriate equitable relief to enforce the continuation coverage rules of ERISA, and in the case of a plan administrator who fails to give timely notice to a participant or beneficiary with respect to COBRA continuation coverage, a court may hold the plan administrator liable to the participant or beneficiary in the amount of up to $110 a day from the date of such failure.

Although the federal government and state and local governments are not subject to the IRC and ERISA's continuation coverage rules, other laws impose similar continuation coverage requirements with respect to plans maintained by such governmental employers.[244] In addition, many states have enacted laws or promulgated regulations that provide continuation coverage rights that are similar to COBRA continuation coverage rights in the case of a loss of group health coverage. Such state laws, for example, may apply in the case of a loss of coverage under a group health plan maintained by a small employer.

<u>New Federal Law (Act section 3001 affecting IRC sections 35, 101, 139C, 6411, 6432, 6671, and 6720C)</u>

In general

A temporary reduction in premiums for COBRA coverage is provided to assistance eligible individuals who are involuntarily terminated from their employment. A premium subsidy of 65 percent is provided for a period of coverage. The period of the premium subsidy is limited to a maximum of 9 months of coverage. The premium subsidy is only provided with respect to involuntary terminations that occur on or after September 1, 2008, and before January 1, 2010.

A provision permits a group health plan to provide a special enrollment right to “assistance eligible individuals” (AEI) to allow them to change coverage options under the plan in conjunction with electing COBRA continuation coverage.[245] The provision only allows a group health plan to offer additional coverage options to assistance eligible individuals and does not change the basic requirement under Federal COBRA continuation coverage requirements that a group health plan must allow an assistance eligible individual to choose to continue with the coverage in which the individual is enrolled as of the qualifying event.[246] However, once the election of the other coverage is made, it becomes COBRA continuation coverage under the applicable COBRA continuation provisions. Thus, for example, under the federal COBRA continuation coverage provisions, if a covered employee chooses different coverage pursuant to being provided this option, the different coverage elected must generally be permitted to be continued for the

[244] Continuation coverage rights similar to COBRA continuation coverage rights are provided to individuals covered by health plans maintained by the federal government. 5 U.S.C. sec. 8905a. Group health plans maintained by a state that receives funds under Chapter 6A of Title 42 of the United States Code (the Public Health Service Act) are required to provide continuation coverage rights similar to COBRA continuation coverage rights for individuals covered by plans maintained by such state (and plans maintained by political subdivisions of such state and agencies and instrumentalities of such state or political subdivision of such state). 42 U.S.C. sec. 300bb-1.

[245] An employer can make this option available to covered employees under current law.

[246] All references to “Federal COBRA continuation coverage” mean the COBRA continuation coverage provisions of the IRC, ERISA, and PHSA.

applicable required period (generally 18 months or 36 months, absent an event that permits coverage to be terminated under the federal COBRA continuation provisions) even though the premium subsidy is only for nine months.

The new federal law provides an income threshold as an additional condition on an individual's entitlement to the premium subsidy during any taxable year. The income threshold applies based on the modified AGI for an individual income tax return for the taxable year in which the subsidy is received (i.e., either 2009 or 2010) with respect to which the AEI is the taxpayer, the taxpayer's spouse or a dependent of the taxpayer (within the meaning of IRC section 152, determined without regard to IRC sections 152(b)(1), (b)(2) and (d)(1)(B)). Modified AGI for this purpose means AGI as defined in IRC section 62, increased by any amount excluded from gross income under IRC sections 911, 931, or 933. Under this income threshold, if the premium subsidy is provided with respect to any COBRA continuation coverage which covers the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer during a taxable year and the taxpayer's modified AGI exceeds $145,000 (or $290,000 for joint filers), then the amount of the premium subsidy for all months during the taxable year must be repaid. The mechanism for repayment is an increase in the taxpayer's income tax liability for the year equal to such amount. For taxpayers with AGI between $125,000 and $145,000 (or $250,000 and $290,000 for joint filers), the amount of the premium subsidy for the taxable year that must be repaid is reduced proportionately.

Under this income threshold, for example, an AEI who is eligible for federal COBRA continuation coverage based on the involuntary termination of a covered employee in August 2009 but who is not entitled to the premium subsidy for the periods of coverage during 2009 due to having income above the threshold, may nevertheless be entitled to the premium subsidy for any periods of coverage in the remaining period (e.g. 5 months of coverage) during 2010 to which the subsidy applies if the modified AGI for 2010 of the relevant taxpayer is not above the income threshold.

The new federal law allows an individual to make a permanent election (at such time and in such form as the Secretary of Treasury may prescribe) to waive the right to the premium subsidy for all periods of coverage. For the election to take effect, the individual must notify the entity (to which premiums are reimbursed under IRC section 6432(a)) of the election. This waiver provision allows an AEI who is certain that the modified AGI limit prevents the individual from being entitled to any premium subsidy for any coverage period to decline the subsidy for all coverage periods and avoid being subject to the recapture tax. However, this waiver applies to all periods of coverage (regardless of the tax year of the coverage) for which the individual might be entitled to the subsidy. The premium subsidy for any period of coverage cannot later be claimed as a tax credit or otherwise be recovered, even if the individual later determines that the income threshold was not exceeded for a relevant tax year. This waiver is made separately by each qualified beneficiary (who could be an AEI) with respect to a covered employee.

Technical changes

The provision clarifies that a reference to a period of coverage in the provision is a reference to the monthly or shorter period of coverage with respect to which premiums are charged with respect to such coverage. For example, the provision is effective for a period of coverage beginning after the date of enactment. In the case of a plan that provides and charges for COBRA continuation coverage on a calendar month basis, the provision is effective for the first calendar month following date of enactment.

The provision specifically provides that if a person other than the individual's employer pays on the individual's behalf then the individual is treated as paying 35 percent of the premium, as required to be entitled to the premium subsidy. Thus, the provision makes clear that, for this purpose, payment by an AEI includes payment by another individual paying on behalf of the individual, such as a parent or guardian, or an entity paying on behalf of the individual, such as a state agency or charity.

The provision clarifies that, for the special 60-day election period for a qualified beneficiary who is eligible for a reduced premium and who has not elected COBRA continuation coverage as of the date of enactment, the election period begins on the date of enactment and ends 60 days after the notice is provided to the qualified beneficiary of the special election period. In addition, the provision clarifies that coverage elected under this special election right begins with the first period of coverage beginning on or after the date of enactment. The provision also extends this special COBRA election opportunity to a qualified beneficiary who elected COBRA coverage but who is no longer enrolled on the date of enactment, for example, because the beneficiary was unable to continue paying the premium.

The provision clarifies that a violation of the new notice requirements is also a violation of the notice requirements of the underlying COBRA provision. A notice must be provided to all individuals who terminated employment during the applicable time period, and not just to individuals who were involuntarily terminated.

Coverage under a flexible spending account (FSA) is not eligible for the subsidy. The provision clarifies that an FSA is defined as a health flexible spending account offered under a cafeteria plan within the meaning of IRC section 125.[247]

A provision provides for an expedited review, by the Secretary of Labor or Health and Human Services (in consultation with the Secretary of the Treasury), of denials of the premium subsidy. Such reviews must be completed within 15 business days after receipt of the individual's application for review. The 15 business days time-frame is intended to give the Secretaries the flexibility necessary to make determinations within based upon evidence they believe, in their discretion, to be appropriate. Additionally, the provision intends that, if an individual is denied treatment as an AEI and also submits a claim for benefits to the plan that would be denied by reason of not being eligible for federal COBRA continuation coverage (or failure to pay full premiums), the individual would be eligible to proceed with expedited review irrespective of any claims for benefits that may be pending or subject to review under the provisions of section 503 of ERISA. Either Secretary's determination upon review is de novo and is the final determination of such Secretary.

[247] Other FSA coverage does not terminate eligibility for coverage. Coverage under another group Health Reimbursement Account (HRA) will not terminate an individual's eligibility for the subsidy as long as the HRA is properly classified as an FSA under relevant IRS guidance. See Notice 2002-45, 2002-2 CB 93.

The provision also requires that various aspects of the new law, including the premium reduction, are treated as part of ERISA for purposes of administration and enforcement, including provisions that preempt state laws.

The provision clarifies the reimbursement mechanism for the premium subsidy in several respects. First, it clarifies that the person to whom the reimbursement is payable is either (1) the multiemployer group health plan, (2) the employer maintaining the group health plan subject to federal COBRA continuation coverage requirements, and (3) the insurer providing coverage under an insured plan. Thus, this is the person who is eligible to offset its payroll taxes for purposes of reimbursement. It also clarifies that the credit for the reimbursement is treated as a payment of payroll taxes. Thus, it clarifies that any reimbursement for an amount in excess of the payroll taxes owed is treated in the same manner as a tax refund. Similarly, it clarifies that overstatement of reimbursement is a payroll tax violation. For example, IRS can assert appropriate penalties for failing to truthfully account for the reimbursement. However, it is not intended that any portion of the reimbursement is taken into account when determining the amount of any penalty to be imposed against any person, required to collect, truthfully account for, and pay over any tax under IRC section 6672.

It is intended that reimbursement not be mirrored in the U.S. possessions that have mirror income tax codes (the Commonwealth of the Northern Mariana Islands, Guam, and the Virgin Islands). Rather, the intent of Congress is that reimbursement will have direct application to persons in those possessions.

Moreover, it is intended that income tax withholding payable to the government of any possession (American Samoa, the Commonwealth of the Northern Mariana Islands, the Commonwealth of Puerto Rico, Guam, or the Virgin Islands) (in contrast with FICA withholding payable to the U.S. Treasury) will not be reduced as a result of the application of this provision. A person liable for both FICA withholding payable to the U.S. Treasury and income tax withholding payable to a possession government will be credited or refunded any excess of (1) the amount of FICA taxes treated as paid under the reimbursement rule of the provision over (2) the amount of the person's liability for those FICA taxes.

Summary of new IRC provisions

A. IRC section 139C – COBRA premium assistance

The provision provides that an AEI who elects COBRA coverage under the employer’s group health plan is required to pay no more than 35 percent of the applicable premium for COBRA coverage, and that IRS will provide a “subsidy” for the remaining 65 percent. The provision establishes that an AEI’s premium reduction is excluded from the gross income. Thus a taxpayer’s receipt of the subsidy for COBRA continuation coverage is not subject to federal income tax.

B. IRC section 6432 – COBRA premium assistance reimbursement

The provision provides a mechanism for reimbursing the person to which premiums are payable for the difference between the full premium and the amount paid by an AEI. Specifically, the person to which premiums are payable under COBRA continuation coverage must be reimbursed for the amount of the premiums that are not paid by AEI's on account of the 35 percent premium deduction.

The person to whom premiums are payable will be, except as IRS provides otherwise, would be either the employer, or the insurer. Specifically, the person entitled to reimbursement is:

- In the case of a group health plan that is a multiemployer plan (as defined by ERISA section 3(37)), the plan;
- In the case of a group health plan which is not a multiemployer plan and which is subject to the COBRA continuation provisions contained in the IRC, ERISA, Public Health Service Act, or civil service provisions of the U.S. Code, and under which some or all of the coverage is not provided by insurance, the employer; and
- In the case of any group health plan not described in (1) or (2) above, the insurer providing the coverage under the plan.

A person entitled to reimbursement and who files a claim for reimbursement at such time and in such manner as the IRS may require will be treated as having paid to the IRS, on the date that the AEI's premium payment is received, payroll taxes in an amount equal to the portion of the reimbursement relating to that premium. To the extent that the amount treated as paid exceeds the amount of the person's liability for payroll taxes, the IRS will credit or refund the excess in the same manner as if it were an overpayment of payroll taxes.

C. *IRC section 6720C – Penalty for failure to notify health plan of cessation of eligibility for COBRA premium assistance*

The provision provides that an AEI who is no longer eligible for the subsidized COBRA premium because of eligibility coverage under another group health plan or Medicare must notify the group health plan providing the subsidized COBRA coverage The notice must be in writing and be provided in the time and manner that Department of Labor (DOL) may specify. The notice must inform the group health plan providing COBRA coverage of the eligibility under the other plan or Medicare. Any person who fails to provide the notice in the time and manner required by the DOL must pay a penalty of 110 percent of the premium reduction after termination of eligibility for the subsidized COBRA coverage. No penalty will be imposed if it is shown that the failure to provide the required notice is due to reasonable cause and not to willful neglect.

<u>Effective Date</u>

The premium subsidy provision is effective for tax years ending after February 17, 2009. The penalty for failure to provide notification of cessation of eligibility for COBRA premium assistance is effective for notification failures occurring after February 17, 2009. The reimbursement provision is effective for premiums for a period of coverage beginning on or after February 17, 2009.

California Law & Impact on California Revenue (provided separately for IRC provisions A, B, and C)

A. IRC section 139C provision

California Law (R&TC section 17131)

California conforms by reference in PITL to Part III of Subchapter B of Chapter 1 of Subtitle A of the IRC, relating to items that are specifically excluded from gross income in R&TC section 17131 as of the "specified date" of January 1, 2005. Because the federal change was made after the "specified date," California has not conformed to the new federal law that establishes that an AEI's premium reduction is excludable from gross income.

However, the premium reduction is treated as a part of ERISA. As a result, it appears that any state taxation of the premium reduction would be prohibited by the ERISA preemption of state law.

Impact on California Revenue

Baseline.

B. IRC section 6432 provision

California Law

The Franchise Tax Board does not administer payroll taxes. Defer to the Employment Development Department (EDD).

Impact on California Revenue

Defer to the EDD.

C. IRC section 6720C provision

California Law (None)

California law has no comparable provision similar to IRC section 6720C.

Impact on California Revenue

Baseline.

CONSUMER ASSISTANCE TO RECYCLE AND SAVE ACT OF 2009 (CASH FOR CLUNKERS)
Title XIII of Public Law 111-32, June 24, 2009

Section	Section Title
1301	Consumer Assistance to Recycle and Save Program

Background

This program is established to encourage owners of high-polluting automobiles to replace their vehicles with new more fuel-efficient and less-polluting vehicles.

New Federal Law (Title XIII Sections 1301 and 1302 of the Supplemental Appropriations Act of 2009)

Under the National Highway Traffic Safety Administration (NHTSA), this provision establishes the Consumer Assistance to Recycle and Save Program (the "Program").

Electronic vouchers

This provision requires the Secretary of Transportation to authorize the issuance of an electronic voucher to offset the purchase or lease price for a new fuel-efficient automobile upon the surrender of an eligible trade-in vehicle to a participating dealer.

Qualifications for and value of vouchers

$3,500 voucher

A voucher may be used to offset the purchase price or lease price of a new fuel-efficient automobile by $3,500 if the new fuel-efficient automobile is any of the following:

- A passenger automobile and the combined fuel economy value of such automobile is at least four miles per gallon higher than the combined fuel economy value of the eligible trade-in vehicle;

- A category one truck and the combined fuel economy value of such truck is at least two miles per gallon higher than the combined fuel economy of the eligible trade-in value;

- A category one truck and the combined fuel economy value of such truck is at least two miles per gallon higher than the combined fuel-economy value of the eligible trade-in vehicle; the new fuel-efficient automobile is a category two truck that has a combined fuel-economy value of at least 15 miles per gallon and, (i) the eligible trade-in vehicle is a category two truck and the combined fuel-economy value of the new fuel-efficient automobile is at least one mile per gallon higher than the combined fuel-economy value of the eligible trade-in vehicle; or, (ii) the eligible trade-in vehicle is a category three truck of model year 2001 or earlier; or

- A category three truck and the eligible trade-in vehicle is a category three truck of model year of 2001 or earlier and is of similar size or larger than the new fuel-efficient automobile as determined in a manner prescribed by the Secretary of Transportation.

$4,500 voucher

A voucher may be used to offset the purchase price or lease price of the new-fuel efficient automobile by $4,500 if the new fuel-efficient automobile is any of the following:

- A passenger automobile and the combined fuel-economy value of such automobile is at least ten miles per gallon higher than the combined fuel-economy value of the eligible trade-in vehicle;

- A category one truck and the combined fuel-economy value of such truck is at least five miles per gallon higher than the combined fuel-economy value of the eligible trade-in vehicle; or

- A category two truck that has a combined fuel-economy value of at least 15 miles per gallon and the combined fuel-economy value of such truck is at least two miles per gallon higher than the combined fuel-economy value of the eligible trade-in vehicle and the eligible trade-in vehicle is a category two truck.

Definitions

Passenger automobile – A “passenger automobile” means an automobile that has a combined fuel-economy value of at least 22 miles per gallon.

Category one truck – A “category one truck” means a non-passenger automobile that has a combined fuel-economy value of at least 18 miles per gallon, except that such term does not include a category two truck.

Category two truck – A “category two truck” means a large van or a large pickup, as categorized by the Secretary of Transportation using the method used by the Environmental Protection Agency and described in the report entitled “Light-Duty Automotive Technology and Fuel Economy Trends: 1975 through 2008.”

Category three truck – A “category three truck” means a work truck, as defined in section 32901(a)(19) of title 49, United States Code.

Combined fuel-economy value – The term ‘‘combined fuel-economy value’’ means:

- For a new fuel-efficient automobile, the number, expressed in miles per gallon, on the label required to be affixed or caused to be affixed on a new automobile;

- For an eligible trade-in vehicle, the equivalent of the number posted under the words ‘‘Estimated New EPA MPG’’ and above the word ‘‘Combined’’ for vehicles of model year

1984 through 2007, or posted under the words ''New EPA MPG'' and above the word ''Combined'' for vehicles of model year 2008 or later on the fueleconomy.gov website of the Environmental Protection Agency for the make, model, and year of such vehicle; and

- For an eligible trade-in vehicle manufactured between model years 1978 through 1985, the equivalent of the number using data maintained by the Environmental Protection Agency for the make, model, and year of such vehicle.

Dealer – The term ''dealer'' means a person licensed by a state who engages in the sale of new automobiles to ultimate purchasers.

Eligible trade-in vehicle – The term ''eligible trade-in vehicle'' means an automobile or a work truck that, at the time it is presented for trade in, is in drivable condition, has been continuously insured consistent with the applicable state law and registered to the same owner for a period of not less than one year immediately prior to such trade in, was manufactured less than 25 years before the date of the trade in, and, in the case of an automobile, has a combined fuel-economy value of 18 miles per gallon or less.

New fuel-efficient automobile – The term ''new fuel-efficient automobile'' means an automobile the equitable or legal title of which has not been transferred to any person other than the ultimate purchaser, that carries a manufacturer's suggested retail price of $45,000 or less, and that has the combined fuel-economy value of at least: (i) 22 miles per gallon for a passenger automobile, (ii) 18 miles per gallon for a category one truck, or (iii) 15 miles per gallon for a category two truck.

Qualifying lease – The term ''qualifying lease'' means a lease of an automobile for a period of not less than five years.

Scrappage value – The term ''scrappage value'' means the amount received by the dealer for a vehicle upon transferring title of such vehicle to the person responsible for ensuring the dismantling and destroying of the vehicle.

Ultimate purchaser – The term ''ultimate purchaser'' means, with respect to any new automobile, the first person who in good faith purchases such automobile for purposes other than resale.

Vehicle identification number – The term ''vehicle identification number'' means the 17 character number used by the automobile industry to identify individual automobiles.

Voucher – The term ''voucher'' means an electronic transfer of funds to a dealer based on an eligible transaction under the Program.

General period of eligibility

A voucher issued under the Program may be used only in connection with the purchase or qualifying lease of new fuel-efficient automobiles that occur between July 1, 2009, and November 1, 2009.

Exclusion of vouchers from income

A voucher will not be regarded as income and will not be regarded as a resource for the month of receipt of the voucher and the following 12 months, for purposes of determining the eligibility of the recipient of the voucher (or the recipient's spouse or other family or household members) for benefits or assistance, or the amount or extent of benefits or assistance, under any federal or state program.

A voucher issued under the Program or any payment made for such a voucher will not be considered as gross income of the purchaser of a vehicle for purposes of the IRC.

Dealer registration and dealer requirements

This provision requires the Secretary of Transportation to register dealers for participation in the Program and require that all registered dealers: (1) accept vouchers as partial down payment of the purchase or qualifying lease of any new fuel-efficient automobile offered for sale or lease by that dealer, and (2) transfer each eligible trade-in vehicle surrendered to the dealer to an entity for disposal.

For each eligible trade-in vehicle, the dealer is required to certify to the Secretary of Transportation that the dealer has not and will not sell, lease, exchange, or otherwise dispose of the vehicle for use in the United States or any other country, and will transfer the vehicle (including the engine block) to an entity that will ensure that the vehicle will be crushed or shredded, and that vehicle has not been, and will not be, sold, leased, exchanged, or otherwise disposed of for use as an automobile in the United States or any other country.

A person who is responsible for ensuring that the vehicle is crushed or shredded is not precluded from selling any parts of the disposed vehicle other than the engine block or drive train (unless with respect to the drive train, the transmission, drive shaft, or rear end are sold as separate parts), or from retaining the proceeds from such sale.

The Secretary of Transportation shall coordinate with the Attorney General to ensure that the National Motor Vehicle Title Information System and other publicly accessible systems are appropriately updated on a timely basis to reflect the crushing and shredding of vehicles and appropriate reclassification of the vehicles' titles. The commercial market shall also have electronic and commercial access to the vehicle identification numbers of vehicles that have been disposed of on a timely basis.

Limitations

Not more than one voucher may be issued for a single person and not more than one voucher may be issued for the joint registered owners of a single eligible trade-in vehicle. Only one voucher issued under the Program may be applied toward the purchase or qualifying lease of a single new fuel-efficient automobile. Not more than 7.5 percent of the total funds made available for vouchers shall be used for vouchers for the purchase or qualifying lease of category three trucks.

The availability or use of a federal, state, or local incentive or a state-issued voucher for the purchase or lease of a new fuel-efficient automobile will not limit the value or issuance of a voucher under the Program to any person otherwise eligible to receive such a voucher. A dealer participating in the Program may not charge a person purchasing or leasing a new fuel-efficient automobile any additional fees associated with the use of a voucher under The Program. The total number and value of vouchers issued under the Program may not exceed the amounts appropriated for such purpose.

Appropriation

This provision appropriates $1 billion to the Secretary of Transportation, of which up to $50 million is available for the administration of the Program.

Anti-fraud provisions

It is unlawful for any person to violate any provision under this section or any regulations, other than by making a clerical error. Any person who commits a violation shall be liable to the United States Government for a civil penalty of not more than $15,000 for each violation. The Secretary of Transportation has the authority to assess and compromise such penalties, and has the authority to require from any entity the records and inspections necessary to enforce the Program. In determining the amount of the civil penalty, the severity of the violation and the intent and history of the person committing the violation shall be taken into account.

Record keeping and report

The Secretary of Transportation shall submit a report to the Committee on Energy and Commerce of the House of Representatives and the Committee on Commerce, Science, and Transportation of the Senate describing the efficacy of the Program not later than December 31, 2009.

Regulations

The Secretary of Transportation is required to issue final regulations to implement the Program not later than July 24, 2009.

<u>Effective Date</u>

The effective date of the provision is June 24, 2009.

<u>California Law (RT&C sections 17071 and 24271)</u>

California law does not conform to the Consumer Assistance to Recycle and Save Program.

For state income tax purposes, trade-in vehicles are treated as normal sales or exchanges; and, in some cases, the value of the voucher received may result in a taxable gain. To determine whether a gain or loss is realized on the disposition of a used vehicle, the basis (generally the cost of the used vehicle) of the vehicle traded in is subtracted from the amount realized (the applicable voucher amount, plus any other salvage value the dealer offers as part of the exchange). For example, if a vehicle is originally purchased for $19,500, and later traded in for a $4,500 discount under the Program, there is no taxable gain. The $15,000 difference is a personal loss under personal income tax law and may not be deducted for tax purposes. However, if a vehicle is purchased for $3,000, and is later traded in for a $3,500 discount under the Program, the $500 difference is taxable gain for state income tax purposes.

Any scrap value received by the consumer for the trade-in vehicle is also used in computing the amount of gain or loss.

Different tax rules apply for vehicles used in a trade or business. For example, when a business trades in an old company truck for a new company truck under the Cash-for-Clunkers program that is "like kind," the gain or loss may be deferred for income tax purposes under the “like-kind exchange” rules.[248]

Impact on California Revenue

Estimated Revenue Impact of Consumer Assistance to Recycle and Save Program Enactment Assumed After June 30, 2010		
2010-11	2011-12	2012-13
-$150,000	-$150,000	-$150,000

[248] IRC section 1031; R&TC sections 18031 and 24941.

WORKER, HOMEOWNERSHIP, AND BUSINESS ASSISTANCE ACT OF 2009
Public Law 111-92, November 6, 2009

Section	Section Title
2 – 6	Emergency Unemployment Compensation

Background

Federal-state agreement

The Supplemental Appropriations Act of 2008 (PL 110-252), authorizes a state to enter an agreement with the Secretary of Labor under which the state agency will make emergency compensation payments to individuals who: (1) have exhausted all rights to regular compensation under state or federal law with respect to a benefit year ending on or after May 1, 2007; (2) have no rights to regular compensation or extended compensation with respect to a week under such law or any other state or federal unemployment compensation law, and (3) are not receiving compensation for such week under the unemployment compensation law of Canada.

The act provision authorizes a state's governor in an extended benefit period, if state law permits, to provide for the payment of emergency unemployment compensation to individuals who otherwise meet the requirements of the act provisions and allow the payment of unemployment to aliens only if they are legally authorized to work in the United States.

The act provision require states to establish an emergency unemployment compensation account for an applicant's benefit year and prescribe a formula for crediting amounts to such accounts.

The act provision requires federal payments to states that have entered into such agreements to cover 100% of emergency unemployment compensation payments but prohibits such payments from being made to any state if it is entitled to reimbursement in respect of such compensation under any federal law other than this title or federal law relating to unemployment compensation for federal employees and ex-servicemen.

The act provision appropriates out of the employment security administration account of such Fund, without fiscal year limitation, the funds necessary to assist states in meeting the costs of administration of such agreements.

The act provision appropriates from the general fund of the Treasury, without fiscal year limitation, to the extended unemployment compensation account of the Unemployment Trust Fund such sums as the Secretary estimates are necessary to make payments for: (1) compensation payable to federal employees and ex-servicemen; and (2) compensation payable on the basis of certain services performed for nonprofit organizations or governmental entities. The act provision declares that none of these appropriations shall be required to be repaid.

An individual, ineligible for further emergency unemployment compensation, who knowingly has made, or caused another to make, a false statement or representation of a material fact, or knowingly has failed, or caused another to fail, to disclose a material fact, and as a result of such actions the individual has received such emergency unemployment compensation to which he or she was not entitled, will be subject fines and imprisonment of up to five years, or both.

The act provision directs the state to require such an individual to repay the compensation to the state agency unless the state determines that: (1) the overpayment was without fault on the individual's part; and (2) such repayment would be contrary to equity and good conscience.

The act provision requires any agreement entered into under this title to apply only to weeks of unemployment: (1) beginning after the agreement is entered into; and (2) ending on or before March 31, 2009.

New Federal Law (Sections 4002, 4004, and 4007 of the Supplemental Appropriations Act of 2008)

The Worker, Homeownership, and Business Assistance Act (WHBAA) of 2009 amends the Supplemental Appropriations Act of 2008 to repeal the requirement that a state be in an extended benefit period before it augments the Tier-2 amounts in an applicant's emergency unemployment compensation account (EUCA) for a benefit year.

The WHBAA continues to require, as under current law, that the amount established in an individual's EUCA must be exhausted before augmenting the Tier-2 amounts.

The WHBAA revises the formula for making such Tier-2 credits. The change increases the figures in the formula (the lesser of which shall be the amount credited): (1) from 50% to 54% of the total amount of regular compensation (including dependents' allowances) payable to the individual during the benefit year; and (2) from 13 to 14 times the individual's average weekly benefit amount for the benefit year. The WHBAA repeals the formula for determining if a state is an extended benefit period.

In addition, the Act provides the following:

- Requires an additional Tier-3 deposit to an individual's EUCA, using the current formula for the Tier-2 period, if at the time that the amount established under this Act is exhausted, or at any time thereafter, the individual's state is in an extended benefit period.
- Prescribes a formula for determining if a state is in an extended benefit period.
- Allows application of the Tier-3 augmentation to the individual's EUCA only once.
- Requires an additional Tier-4 augmentation as well if the individual's EUCA after the Tier-3 augmentation is again exhausted and the state is still in an extended benefit period.
- Decreases the figures in the formula for the Tier-4 period (the lesser of which shall be the amount credited): (1) from 50 percent to 24 percent of the total amount of regular compensation (including dependents' allowances) payable to the individual during the benefit year; and (2) from 13 to six times the individual's average weekly benefit amount for the benefit year.
- Prescribes a formula for determining if a state is in an extended benefit period.
- Allows application of the Tier-4 augmentation to the individual's EUCA only once.

- Authorizes a state to pay extended compensation to an otherwise eligible individual before any emergency unemployment compensation (EUC) is paid under this Act, if the individual claimed extended compensation for at least one week of unemployment after the initial exhaustion of EUC.
- Authorizes a state to elect to pay Tier-3 EUC before payment of an increased Tier-2 EUC until the state determines that such increased Tier-2 EUC may be paid without undue delay.

Effective Date

The provisions shall apply as if included in the enactment of the Supplemental Appropriations Act 2008, except that no amount shall be payable by virtue of such amendments with respect to any week of unemployment commencing before November 6, 2009.

California Law

The Employment Development Department (EDD) administers California's Unemployment Insurance Program.

Impact on California Revenue

Defer to the EDD.

Section	Section Title
8	Treatment of Additional Regular Compensation

Background

Federal law does not provide formulas, floors, or ceilings of regular weekly state unemployment compensation amounts. In general, states set weekly benefit amounts as a fraction of the individual's average weekly wage up to some state-determined maximum. Some states include dependents' allowances in addition to the underlying benefit.

New Federal Law (Section 8 of WHBAA modifying Act section 2002 of the Assistance for Unemployed Workers and Struggling Families Act)

This uncodified provision of the WHBAA requires disregard in the consideration of an individual's income and assets with respect to benefits under the Supplemental Nutrition Assistance Program (SNAP) of the monthly equivalent of any additional compensation paid to the individual by reason of the Assistance for Unemployed Workers and Struggling Families Act.

Effective Date

The provision is effective after November 6, 2009.

California Law

The Employment Development Department (EDD) administers California's Unemployment Insurance Program.

Impact on California Revenue

Defer to the EDD.

Section	Section Title
10	0.2 Percent FUTA Surtax

Background

The Federal Unemployment Tax Act ("FUTA") imposes a 6.2 percent gross tax rate on the first $7,000 paid annually by covered employers to each employee. Employers in states with programs approved by the federal government and with no delinquent federal loans may credit 5.4 percentage points against the 6.2 percent tax rate, making the minimum, net federal unemployment tax rate 0.8 percent. Since all states have approved programs, 0.8 percent is the federal tax rate that generally applies. This federal revenue finances administration of the unemployment system, half of the federal-state extended benefits program, and a federal account for state loans. The states use the revenue turned back to them by the 5.4 percent credit to finance their regular state programs and half of the federal-state extended benefits program.

In 1976, Congress passed a temporary surtax of 0.2 percent of taxable wages to be added to the permanent FUTA tax rate. Thus, the current 0.8 percent FUTA tax rate has two components: a permanent tax rate of 0.6 percent, and a temporary surtax rate of 0.2 percent. The temporary surtax subsequently has been extended through December 31, 2009.

New Federal Law (IRC section 3301)

The WHBAA extends from 2009 through June 30, 2011, the overall 6.2 percent tax on employers under the Federal Unemployment Tax Act (FUTA). This tax consists of the 6 percent permanent tax rate and the temporary 0.2 percent surtax rate. The WHBAA delays the repeal of the temporary surtax.

Effective Date

The provision is effective for wages paid after December 31, 2009.

California Law

The Employment Development Department (EDD) administers California Unemployment Insurance Program.

Impact on California Revenue

Defer to the EDD.

Section	Section Title
11 – 12	Extension and Modification of First-Time Homebuyer Tax Credit and Provisions to Enhance the Administration of the First-Time Homebuyer Tax Credit

Background

An individual who is a first-time homebuyer is allowed a refundable tax credit equal to the lesser of $8,000 ($4,000 for a married individual filing separately) or 10 percent of the purchase price of a principal residence. The credit is allowed for qualifying home purchases on or after April 9, 2008, and before December 1, 2009.[249]

The credit phases out for individual taxpayers with modified adjusted gross income between $75,000 and $95,000 ($150,000 and $170,000 for joint filers) for the year of purchase.

An individual is considered a first-time homebuyer if the individual had no ownership interest in a principal residence in the United States during the 3-year period prior to the purchase of the home.

An election is provided to treat a residence purchased after December 31, 2008, and before December 1, 2009, as purchased on December 31, 2008, so that the credit may be claimed on the 2008 income tax return.

No District of Columbia first-time homebuyer credit[250] is allowed to any taxpayer with respect to the purchase of a residence after December 31, 2008, and before December 1, 2009, if the national first-time homebuyer credit is allowable to such taxpayer (or the taxpayer's spouse) with respect to such purchase.

[249] For purchases before January 1, 2009, the dollar limits are $7,500 ($3,750 for a married individual filing separately).

[250] IRC section 1400C.

Recapture

If the individual sells the home (or the home ceases to be used as the principal residence of the individual or the individual's spouse) prior to complete recapture of the credit, the amount of any credit not previously recaptured is due on the tax return for the year in which the home is sold (or ceases to be used as the principal residence).[251]

For homes purchased on or before December 31, 2008, the credit is recaptured ratably over fifteen years with no interest charge beginning in the second taxable year after the taxable year in which the home is purchased. For example, if an individual purchases a home in 2008, recapture commences with the 2010 tax return. However, in the case of a sale to an unrelated person, the amount recaptured may not exceed the amount of gain from the sale of the residence. For this purpose, gain is determined by reducing the basis of the residence by the amount of the credit to the extent not previously recaptured. No amount is recaptured after the death of an individual. In the case of an involuntary conversion of the home, recapture is not accelerated if a new principal residence is acquired within a two-year period. In the case of a transfer of the residence to a spouse or to a former spouse incident to divorce, the transferee spouse (and not the transferor spouse) will be responsible for any future recapture. Recapture does not apply to a home purchased after December 31, 2008, that is treated (at the election of the taxpayer) as purchased on December 31, 2008.

For homes purchased after December 31, 2008, and before December 1, 2009, the credit is recaptured only if the taxpayer disposes of the home (or the home otherwise ceases to be the principal residence of the taxpayer) within 36 months from the date of purchase.

New Federal Law (IRC sections 36, 1400C, and 6213)

Extension of application period

In general, the credit is extended to apply to a principal residence purchased by the taxpayer before May 1, 2010. The credit applies to the purchase of a principal residence before July 1, 2010, by any taxpayer who enters into a written binding contract before May 1, 2010, to close on the purchase of a principal residence before July 1, 2010.

The waiver of recapture, except in the case of disposition of the home (or the home otherwise ceases to be the principal residence of the taxpayer) within 36 months from the date of purchase, is extended to any purchase of a principal residence after December 31, 2008.

The election to treat a purchase as occurring in a prior year is modified. In the case of a purchase of a principal residence after December 31, 2008, a taxpayer may elect to treat such purchase as made on December 31 of the calendar year preceding the purchase for purposes of claiming the credit on the prior year's tax return.

[251] If the individual sells the home (or the home ceases to be used as the principal residence of the individual and the individual's spouse) in the same taxable year the home is purchased, no credit is allowed.

No District of Columbia first-time homebuyer credit[252] is allowed to any taxpayer with respect to the purchase of a residence after December 31, 2008, if the national first-time homebuyer credit is allowable to such taxpayer (or the taxpayer's spouse) with respect to such purchase.

Long time residents of the same principal residence

An individual (and, if married, the individual's spouse) who has maintained the same principal residence for any five-consecutive year period during the eight-year period ending on the date of the purchase of a subsequent principal residence is treated as a first-time homebuyer. The maximum allowable credit for such taxpayers is $6,500 ($3,250 for a married individual filing separately). An individual (and, if married, the individual's spouse) who has maintained the same principal residence for any five-consecutive year period during the eight-year period ending on the date of the purchase of a subsequent principal residence is treated as a first-time homebuyer. The maximum allowable credit for such taxpayers is $6,500 ($3,250 for a married individual filing separately).

Limitations

The WHBAA raises the income limitations to qualify for the credit. The credit phases out for individual taxpayers with modified adjusted gross income between $125,000 and $145,000 ($225,000 and $245,000 for joint filers) for the year of purchase.

No credit is allowed for the purchase of any residence if the purchase price exceeds $800,000.

No credit is allowed unless the taxpayer is 18 years of age as of the date of purchase. A taxpayer who is married is treated as meeting the age requirement if the taxpayer or the taxpayer's spouse meets the age requirement.

The definition of purchase excludes property acquired from a person related to the person acquiring such property or the spouse of the person acquiring the property, if married.

No credit is allowed to any taxpayer if the taxpayer is a dependent of another taxpayer.

No credit is allowed unless the taxpayer attaches to the relevant tax return a properly executed copy of the settlement statement used to complete the purchase.

Waiver of recapture for individuals on qualified official extended duty

In the case of a disposition of principal residence by an individual (or a cessation of use of the residence that otherwise would cause recapture) after December 31, 2008, in connection with Government orders received by the individual (or the individual's spouse) for qualified official extended duty service, no recapture applies by reason of the disposition of the residence,[253] and

[252] IRC section 1400C.

[253] If the individual sells the home (or the home ceases to be used as the principal residence of the individual and the individual's spouse) in connection with such orders in the same taxable year the home is purchased, the credit is allowable.

any 15-year recapture with respect to a home acquired before January 1, 2009, ceases to apply in the taxable year the disposition occurs.

Qualified official extended duty service means service on official extended duty as a member of the uniformed services, a member of the Foreign Service of the United States, or an employee of the intelligence community.[254]

Qualified official extended duty is any period of extended duty while serving at a place of duty at least 50 miles away from the taxpayer's principal residence or under orders compelling residence in government furnished quarters. Extended duty is defined as any period of duty pursuant to a call or order to such duty for a period in excess of 90 days or for an indefinite period.

The uniformed services include: (1) the Armed Forces (the Army, Navy, Air Force, Marine Corps, and Coast Guard); (2) the commissioned corps of the National Oceanic and Atmospheric Administration; and (3) the commissioned corps of the Public Health Service.

The term "member of the Foreign Service of the United States" includes: (1) chiefs of mission; (2) ambassadors at large; (3) members of the Senior Foreign Service; (4) Foreign Service officers; and (5) Foreign Service personnel.

The term "employee of the intelligence community" means an employee of the Office of the Director of National Intelligence, the Central Intelligence Agency, the National Security Agency, the Defense Intelligence Agency, the National Geospatial-Intelligence Agency, or the National Reconnaissance Office.

The term also includes employment with: (1) any other office within the Department of Defense for the collection of specialized national intelligence through reconnaissance programs; (2) any of the intelligence elements of the Army, the Navy, the Air Force, the Marine Corps, the Federal Bureau of Investigation, the Department of the Treasury, the Department of Energy, and the Coast Guard; (3) the Bureau of Intelligence and Research of the Department of State; and (4) the elements of the Department of Homeland Security concerned with the analyses of foreign intelligence information.

Extension of the first-time homebuyer credit for individuals on qualified official extended duty outside of the United States

In the case of any individual (and, if married, the individual's spouse) who serves on qualified official extended duty service outside of the United States for at least 90 days during the period beginning after December 31, 2008, and ending before May 1, 2010, the expiration date of the first-time homebuyer credit is extended for one year, through May 1, 2011 (July 1, 2011, in the case of an individual who enters into a written binding contract before May 1, 2011, to close on the purchase of a principal residence before July 1, 2011).

[254] These terms have the same meaning as under the provision for exclusion of gain on the sale of certain principal residences. IRC section 121.

Mathematical error authority

The WHBAA makes a number of changes to expand the definition of mathematical or clerical error for purposes of administration of the credit by the Internal Revenue Service ("IRS"). The IRS may assess additional tax without issuance of a notice of deficiency as otherwise required[255] in the case of: an omission of any increase in tax required by the recapture provisions of the credit; information from the person issuing the taxpayer identification number of the taxpayer that indicates that the taxpayer does not meet the age requirement of the credit; information provided to the Secretary by the taxpayer on an income tax return for at least one of the two preceding taxable years that is inconsistent with eligibility for such credit; or, failure to attach to the return a properly executed copy of the settlement statement used to complete the purchase.

Effective Date

The extension of the first-time homebuyer credit and coordination with the first-time homebuyer credit for the District of Columbia apply to residences purchased after November 30, 2009.

Provisions relating to long-time residents of the same principal residence, and income, purchase price, age, related party, dependent, and documentation limitations apply for purchases after the date of enactment.

The waiver of recapture provision applies to dispositions and cessations after December 31, 2008.

The expansion of mathematical and clerical error authority applies to returns for taxable years ending on or after April 9, 2008.

California Law (R&TC section 17059)

California does not conform to the federal first-time homebuyer credit. However, California provides a state credit for the purchase of a principal residence that has never been previously occupied. The credit is equal to the lesser of 5 percent of the purchase price of the principal residence or $10,000, and applies to homes purchased after February 28, 2009, and before March 1, 2010. The credit must be claimed on a timely filed original return.

$100 million limitation

The total credit allowable is limited to $100 million. Upon receipt of certification from the seller, the credit was allocated by the FTB on a first-come, first-served basis. As of July 2, 2009, FTB received over 12,000 applications, an amount determined to be more than enough to allocate the full $100 million of credit. The determination by the FTB with respect to the date a certification was received, and whether a return has been timely filed, may not be reviewed in any administrative or judicial proceeding.

[255] IRC section 6213.

Taxpayers who received an FTB credit certification may, if they otherwise qualify under both the federal and California credit statutes, claim both the state and federal credits.

Impact on California Revenue

Not applicable.

Section	Section Title
13	5-Year Carryback of Operating Losses

Background

Under present law, a net operating loss ("NOL") generally means the amount by which a taxpayer's business deductions exceed its gross income. In general, an NOL may be carried back two years and carried over 20 years to offset taxable income in such years.[256] NOLs offset taxable income in the order of the taxable years to which the NOL may be carried.[257]

For purposes of computing the alternative minimum tax ("AMT"), a taxpayer's NOL deduction cannot reduce the taxpayer's alternative minimum taxable income ("AMTI") by more than 90 percent of the AMTI.[258]

In the case of a life insurance company, present law allows a deduction for the operations loss carryovers and carrybacks to the taxable year, in lieu of the deduction for net operation losses allowed to other corporations.[259] A life insurance company is permitted to treat a loss from operations (as defined under section 810(c)) for any taxable year as an operations loss carryback to each of the three taxable years preceding the loss year and an operations loss carryover to each of the 15 taxable years following the loss year.[260]

Temporary rule for small business

Present law provides an eligible small business with an election[261] to increase the present law carryback period for an "applicable 2008 NOL" from two years to any whole number of years

[256] IRC section 172(b)(1)(A). Different carryback periods apply with respect to NOLs arising in certain special circumstances.

[257] IRC section 172(b)(2).

[258] IRC section 56(d).

[259] IRC sections 810, and 805(a)(5).

[260] IRC section 810(b)(1).

[261] IRC section 172(b)(1)(H).

elected by the taxpayer that is more than two and less than six. An eligible small business is a taxpayer meeting a $15,000,000 gross receipts test. An applicable 2008 NOL is the taxpayer's NOL for any taxable year ending in 2008, or if elected by the taxpayer, the NOL for any taxable year beginning in 2008. However, any election under this provision may be made only with respect to one taxable year.

New Federal Law (IRC sections 56, 172, and 810)

The WHBAA provides an election[262] to increase the present-law carryback period for an applicable NOL from two years to any whole number of years elected by the taxpayer which is more than two and less than six. An applicable NOL is the taxpayer's NOL for a taxable year beginning or ending in either 2008 or 2009. Generally, a taxpayer may elect an extended carryback period for only one taxable year.

The amount of an NOL that may be carried back to the fifth taxable year preceding the loss year is limited to 50 percent of taxable income for such taxable year (computed without regard to the NOL for the loss year or any taxable year thereafter).[263] The limitation does not apply to the applicable 2008 NOL of an eligible small business with respect to which an election is made (either before or after November 6, 2009) under the provision as presently in effect. The amount of the NOL otherwise carried to taxable years subsequent to such fifth taxable year is to be adjusted to take into account that the NOL could offset only 50 percent of the taxable income in such year. Thus, in determining the excess of the applicable NOL over the sum of the taxpayer's taxable income for each of the prior taxable years to which the loss may be carried, only 50 percent of the taxable income for the taxable year for which the limitation applies is to be taken into account.

The provision also suspends the 90-percent limitation on the use of any alternative tax NOL deduction attributable to carrybacks of the applicable NOL for which an extended carryback period is elected.[264]

For life insurance companies, the provision provides an election to increase the present law carryback period for an applicable loss from operations from three years to four or five years. An applicable loss from operations is the taxpayer's loss from operations for any taxable year beginning or ending in either 2008 or 2009. A 50-percent of taxable income limitation applies to the fifth taxable year preceding the loss year.

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[262] For all elections under this provision, the common parent of a group of corporations filing a consolidated return makes the election, which is binding on all such corporations.

[263] The taxable income limitation only applies to that portion of an applicable NOL that is carried back to the fifth preceding taxable year under subparagraph (H) of section 172(b)(1). The limitation does not apply to the portion of the loss carried back under another subparagraph of section 172(b)(1), such as a specified liability loss, farming loss, or qualified disaster loss.

[264] It is intended that in applying the 50-percent taxable income limitation with respect to the carryback of an alternative tax NOL deduction to the fifth preceding taxable year, the limitation is applied separately based on alternative minimum taxable income.

A taxpayer must make the election by the extended due date for filing the return for the taxpayer's last taxable year beginning in 2009, and in such manner as may be prescribed by the Secretary.[265] An election, once made, is irrevocable.

An eligible small business that timely made (or timely makes) an election under the provision as in effect on the day before November 6, 2009, to carryback its applicable 2008 NOL may also elect to carryback a 2009 NOL under the amended provision.[266] It is intended that an eligible small business may continue to make the present-law election under procedures prescribed in Revenue Procedure 2009-26 following November 6, 2009.

The provision generally does not apply to: (1) any taxpayer if (a) the federal government acquired or acquires at any time,[267] an equity interest in the taxpayer pursuant to the Emergency Economic Stabilization Act of 2008,[268] or (b) the federal government acquired or acquires, at any time, any warrant (or other right) to acquire any equity interest with respect to the taxpayer pursuant to such Act; (2) the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation; and (3) any taxpayer that in 2008 or 2009[269] is a member of the same affiliated group (as defined in IRC section 1504 without regard to subsection (b) thereof) as a taxpayer to which the provision does not otherwise apply. An equity interest (or right to acquire an equity interest) is disregarded for this purpose if acquired by the federal government after the date of enactment from a financial institution[270] pursuant to a program established by the Secretary for the stated purpose of increasing the availability of credit to small businesses using funding made available under the Emergency Economic Stabilization Act of 2008.

Effective Date

The provision is generally effective for net operating losses arising in taxable years ending after December 31, 2007. The modification to the alternative tax NOL deduction applies to taxable years ending after December 31, 2002. The modification with respect to operating loss

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[265] It is anticipated that the procedures for making the election will be substantially similar to those prescribed for eligible small businesses under present law. See Rev. Proc. 2009-26, 2009-19 I.R.B. 935.

[266] Present law IRC section 172(b)(1)(H)(iii) provides that an eligible small business must make the election by the extended due date for filing its return for the taxable year of the net operating loss. An eligible small business that did not (or does not) timely elect to carryback its applicable 2008 NOL under present law is subject to the general provision (i.e., election available for either 2008 or 2009 NOL and 50 percent of taxable income limitation applies for the 5th taxable year preceding the loss year).

[267] For example, if the federal government acquires an equity interest in the taxpayer during 2010, or in later years, the taxpayer is not entitled to the extended carryback rules under this provision. If the carryback has previously been claimed, amended filings may be necessary to reflect this disallowance. Additionally, if the federal government acquired an equity interest in the taxpayer pursuant to the Emergency Economic Stabilization Act of 2008 and the taxpayer has repaid that investment, it is not entitled to the extended carryback rules under this provision.

[268] Public Law 110-343.

[269] For example, a taxpayer with an NOL in 2008 that in 2009 joins an affiliated group with a member in which the federal government has acquired an equity interest pursuant to the Emergency Economic Stabilization Act of 2008 may not utilize the extended carryback rules under this provision with regard to the 2008 NOL. The taxpayer is required to amend prior filings to reflect the permitted carryback period.

[270] As defined in section 3 of the Emergency Economic Stabilization Act of 2008 (Public Law 110-343).

deductions of life insurance companies applies to losses from operations arising in taxable years ending after December 31, 2007.

Under transition rules, a taxpayer may revoke any election to waive the carryback period under either section 172(b)(3) or section 810(b)(3) with respect to an applicable NOL or an applicable loss from operations for a taxable year ending before November 6, 2009, by the extended due date for filing the tax return for the taxpayer's last taxable year beginning in 2009. Similarly, any application for a tentative carryback adjustment under IRC section 6411(a) with respect to such loss is treated as timely filed if filed by the extended due date for filing the tax return for the taxpayer's last taxable year beginning in 2009.

California Law (See A, B, and C, below)

A. Changes to IRC section 56

(R&TC sections 17062, 17062.3, 23400, 23456, and 23456.6)

California conforms to IRC sections 55 through 59 in R&TC sections 17062 and 23400, relating to alternative minimum tax (AMT), as of the specified date of January 1, 2005, with modifications.

For California purposes, the alternative minimum tax rate is 7 percent for any taxable year beginning on or after January 1, 1996, and before January 1, 2009. A change in 2009 legislation temporarily increased the AMT rate to 7.25 percent, effective for taxable years beginning on or after January 1, 2009, and before January 1, 2011. The alternative minimum tax rate returns to 7 percent for any taxable year beginning on or after January 1, 2011. The basis of the tax is the applicable percentage of the alternative minimum taxable income for the taxable year that exceeds the exemption amount.

California does not conform to the federal NOL carryback rules for NOLs incurred before 2011. Thus, this change to IRC section 56 is not applicable for California tax purposes.

B. Changes to IRC section 172

(R&TC sections 17201, 17207, 17276-17276.7, and 24416 - 24416.7)

In general

A California taxpayer generally calculates its NOL in accordance with federal rules, as California conforms by reference under PITL and CTL to IRC section 172, as of the specified date of January 1, 2005, relating to net operating loss deductions, with modifications.

Disaster losses

State tax law identifies specific events as disasters and excess disaster losses are allowed special carry forward treatment. That is, 100 percent of the excess disaster loss may be carried over for up to 15 taxable years. In addition, for disasters that were the subject of a Governor's proclamation, but not the subject of a Presidential disaster declaration, enactment of state law identifying a specific event as a disaster for state tax law purposes authorizes the taxpayer to elect to deduct the disaster loss on the return for the prior taxable year.

General NOLs - taxable years beginning before January 1, 2008

For taxable years beginning on or before January 1, 2008, the amount of NOL that is eligible to be carried forward and the number of years it can be carried forward vary, depending on the type of taxpayer or amount of a taxpayer's income. Two important differences are (1) California does not generally allow the carryback of NOLs incurred in taxable years beginning before January 1, 2011, and (2) California has different carryforward periods.

General NOLs - taxable years beginning on or after January 1, 2008

In 2008, the following changes were made:[271]

- NOL deductions are suspended for taxable years 2008 and 2009 for a taxpayer with net business income (PITL) and income subject to tax (CTL) of $500,000 or more. However, deductions for NOL carrybacks from taxable years beginning on or after January 1, 2011, will be allowed.
- For PIT, "net business income" means income from a trade or business, whether conducted by the taxpayer or by a pass-through entity (partnership or S corporation), income from rental activity, and income attributable to a farming business.
- If the deduction of an NOL is suspended, the NOL carryover period is extended by one year for NOLs incurred in taxable year 2008, and two years for NOLs attributable to taxable years beginning before January 1, 2008.
- A 20-year NOL carryover period is allowed for NOLs attributable to taxable years beginning on or after January 1, 2008.
- California conforms to the federal NOL carryback rules, as of the specified date of January 1, 2005, for NOLs attributable to taxable years beginning on or after January 1, 2011, with the following modifications:
    - NOLs may only be carried back 2 years. (federal law has special rules that in some cases, allow an NOL to be carried back for a longer period).
    - The amount of NOL carryback attributable to taxable year 2011 is limited to 50 percent of the net operating loss.
    - The amount of NOL carryback attributable to taxable year 2012 is limited to 75 percent of the net operating loss.
- California conforms to the federal carryback period for a Real Estate Investment Trusts (REITS) and a corporate equity reduction interest loss, which is zero.

[271] Ch. 763, Laws of 2008 (A.B. 1452).

C. Changes to IRC section 810

(None)

California has no comparable provision to IRC section 810 (operation loss deduction for insurance companies).

Impact on California Revenue

Not applicable.

Section	Section Title
14	Exclusion from Gross Income of Qualified Military Base Realignment and Closure Fringe

Background

Homeowner Assistance Program payment

The Department of Defense Homeowners Assistance Program ("HAP") provides payments to certain employees and members of the Armed Forces to offset the adverse effects on housing values that result from a military base realignment or closure. In general, under the HAP, eligible individuals receive either: (1) a cash payment as compensation for losses that may be or have been sustained in a private sale, in an amount not to exceed the difference between (a) 95 percent of the fair market value of their property prior to public announcement of intention to close all or part of the military base or installation and (b) the fair market value of such property at the time of the sale; or (2) as the purchase price for their property, an amount not to exceed 90 percent of the prior fair market value as determined by the Secretary of Defense, or the amount of the outstanding mortgages.

The American Recovery and Reinvestment Act of 2009[272] expands the HAP in various ways. It amends the Demonstration Cities and Metropolitan Development Act of 1966[273] to allow, under the HAP under such Act, the Secretary of Defense to provide assistance or reimbursement for certain losses in the sale of family dwellings by members of the Armed Forces living on or near a military installation in situations where: (1) there was a base closure or realignment; (2) the property was purchased before July 1, 2006, and sold between that date and September 30, 2012; (3) the property is the owner's primary residence; and (4) the owner has not previously received benefits under the HAP. Further, it authorizes similar HAP assistance or reimbursement

[272] Public Law 111-5.

[273] Public Law 89-754, 42 U.S.C. 3374.

with respect to: (1) wounded members and wounded civilian Department of Defense and Coast Guard employees (and their spouses); and (2) members permanently reassigned from an area at or near a military installation to a new duty station more than 50 miles away (with similar purchase and sale date, residence, and no-previous-benefit requirements as above). It allows the Secretary to provide compensation for losses from home sales by such individuals to ensure the realization of at least 90 percent (in some cases, 95 percent) of the pre-mortgage-crisis assessed value of such property.

Tax treatment

Present law generally excludes from gross income amounts received under the HAP (as in effect on November 11, 2003).[274] Amounts received under the program also are not considered wages for FICA tax purposes (including Medicare). The excludable amount is limited to the reduction in the fair market value of property.

New Federal Law (IRC section 132)

The WHBAA expands the exclusion to HAP payments authorized under the American Recovery and Reinvestment Tax Act of 2009.

Effective Date

The provision is effective for payments made after February 17, 2009 (the date of enactment of the American Recovery and Reinvestment Tax Act of 2009).

California Law (R&TC sections 17131 and 17154)

California conforms by reference to Part III of Subchapter B of Chapter 1 of Subtitle A of the IRC, relating to items that are specifically excluded from gross income, as of the "specified date" of January 1, 2005, in R&TC section 17131, with modifications in R&TC section 17154. Because this federal change was made after the "specified date" of January 1, 2005, California does not conform to this provision.

Impact on California Revenue

Estimated Revenue Impact of Exclusion from Gross Income of Qualified Military Base Realignment and Closure Fringe For Payments Made After December 31, 2009, to September 30, 2012 Enactment Assumed After June 30, 2010		
2010-11	2011-12	2012-13
-$900,000	-$12,000	-$6,000

Estimates are based on a proration of federal projections developed for the Worker, Homeownership, and Business Assistance Act 2009 (PL 111-92), adjusted to reflect California differences.

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[274] IRC section 132(n).

Section	Section Title
15	Delay in Application of Worldwide Allocation of Interest

Background

In general

To compute the foreign tax credit limitation, a taxpayer must determine the amount of its taxable income from foreign sources. Thus, the taxpayer must allocate and apportion deductions between items of U.S.-source gross income, on the one hand, and items of foreign-source gross income, on the other.

In the case of interest expense, the rules generally are based on the approach that money is fungible and that interest expense is properly attributable to all business activities and property of a taxpayer, regardless of any specific purpose for incurring an obligation on which interest is paid.[275] For interest allocation purposes, all members of an affiliated group of corporations generally are treated as a single corporation (the so-called "one-taxpayer rule") and allocation must be made on the basis of assets rather than gross income. The term "affiliated group" in this context generally is defined by reference to the rules for determining whether corporations are eligible to file consolidated returns.

For consolidation purposes, the term "affiliated group" means one or more chains of includible corporations connected through stock ownership with a common parent corporation that is an includible corporation, but only if: (1) the common parent owns directly stock possessing at least 80 percent of the total voting power and at least 80 percent of the total value of at least one other includible corporation; and (2) stock meeting the same voting power and value standards with respect to each includible corporation (excluding the common parent) is directly owned by one or more other includible corporations.

Generally, the term "includible corporation" means any domestic corporation except certain corporations exempt from tax under section 501 (for example, corporations organized and operated exclusively for charitable or educational purposes), certain life insurance companies, corporations electing application of the possession tax credit, regulated investment companies, real estate investment trusts, and domestic international sales corporations. A foreign corporation generally is not an includible corporation.

Subject to exceptions, the consolidated return and interest allocation definitions of affiliation generally are consistent with each other.[276] For example, both definitions generally exclude all foreign corporations from the affiliated group. Thus, while debt generally is considered fungible among the assets of a group of domestic affiliated corporations, the same rules do not apply as

[275] However, exceptions to the fungibility principle are provided in particular cases.

[276] One such exception is that the affiliated group for interest allocation purposes includes IRC section 936 corporations (certain electing domestic corporations that have income from the active conduct of a trade or business in Puerto Rico or another U.S. possession) that are excluded from the consolidated group.

between the domestic and foreign members of a group with the same degree of common control as the domestic affiliated group.

Banks, savings institutions, and other financial affiliates

The affiliated group for interest allocation purposes generally excludes what are referred to in the Treasury regulations as "financial corporations."[277] A financial corporation includes any corporation, otherwise a member of the affiliated group for consolidation purposes, that is a financial institution (described in IRC sections 581 or 591), the business of which is predominantly with persons other than related persons or their customers, and which is required by state or federal law to be operated separately from any other entity that is not a financial institution.[278] The category of financial corporation also includes, to the extent provided in regulations, bank holding companies (including financial holding companies), subsidiaries of banks and bank holding companies (including financial holding companies), and savings institutions predominantly engaged in the active conduct of a banking, financing, or similar business.[279]

A financial corporation is not treated as a member of the regular affiliated group for purposes of applying the one-taxpayer rule to other non-financial members of that group. Instead, all such financial corporations that would be so affiliated are treated as a separate single corporation for interest allocation purposes.

Worldwide interest allocation

In general

The American Jobs Creation Act of 2004 ("AJCA")[280] modified the interest expense allocation rules described above (which generally apply for purposes of computing the foreign tax credit limitation) by providing a one-time election (the "worldwide affiliated group election") under which the taxable income of the domestic members of an affiliated group from sources outside the United States generally is determined by allocating and apportioning interest expense of the domestic members of a worldwide affiliated group on a worldwide-group basis (i.e., as if all members of the worldwide group were a single corporation). If a group makes this election, the taxable income of the domestic members of a worldwide affiliated group from sources outside the United States is determined by allocating and apportioning the third-party interest expense of those domestic members to foreign-source income in an amount equal to the excess (if any) of (1) the worldwide affiliated group's worldwide third-party interest expense multiplied by the ratio that the foreign assets of the worldwide affiliated group bears to the total assets of the worldwide affiliated

[277] Treas. Reg. sec. 1.861-11T(d)(4).

[278] IRC section 864(e)(5)(C).

[279] IRC section 864(e)(5)(D).

[280] Public Law 108-357, section 401.

group,[281] over (2) the third-party interest expense incurred by foreign members of the group to the extent such interest would be allocated to foreign sources if the principles of worldwide interest allocation were applied separately to the foreign members of the group.[282]

For purposes of the new elective rules based on worldwide fungibility, the worldwide affiliated group means all corporations in an affiliated group as well as all controlled foreign corporations that, in the aggregate, either directly or indirectly,[283] would be members of such an affiliated group if IRC section 1504(b)(3) did not apply (i.e., in which at least 80 percent of the vote and value of the stock of such corporations is owned by one or more other corporations included in the affiliated group). Thus, if an affiliated group makes this election, the taxable income from sources outside the United States of domestic group members generally is determined by allocating and apportioning interest expense of the domestic members of the worldwide affiliated group as if all of the interest expense and assets of 80-percent or greater owned domestic corporations (i.e., corporations that are part of the affiliated group, as modified to include insurance companies) and certain controlled foreign corporations were attributable to a single corporation.

Financial institution group election

Taxpayers are allowed to apply the bank group rules to exclude certain financial institutions from the affiliated group for interest allocation purposes under the worldwide fungibility approach. The rules also provide a one-time “financial institution group” election that expands the bank group. At the election of the common parent of the pre-election worldwide affiliated group, the interest expense allocation rules are applied separately to a subgroup of the worldwide affiliated group that consists of (1) all corporations that are part of the bank group, and (2) all “financial corporations.” For this purpose, a corporation is a financial corporation if at least 80 percent of its gross income is financial services income (as described in IRC section 904(d)(2)(C)(i) and the regulations thereunder) that is derived from transactions with unrelated persons.[284] For these purposes, items of income or gain from a transaction or series of transactions are disregarded if a principal purpose for the transaction or transactions is to qualify any corporation as a financial corporation.

In addition, anti-abuse rules are provided under which certain transfers from one member of a financial institution group to a member of the worldwide affiliated group outside of the financial institution group are treated as reducing the amount of indebtedness of the separate financial institution group. Regulatory authority is provided with respect to the election to provide for the direct allocation of interest expense in circumstances in which such allocation is appropriate to

[281] For purposes of determining the assets of the worldwide affiliated group, neither stock in corporations within the group nor indebtedness (including receivables) between members of the group is taken into account.

[282] Although the interest expense of a foreign subsidiary is taken into account for purposes of allocating the interest expense of the domestic members of the electing worldwide affiliated group for foreign tax credit limitation purposes, the interest expense incurred by a foreign subsidiary is not deductible on a U.S. return.

[283] Indirect ownership is determined under the rules of IRC section 958(a)(2) or through applying rules similar to those of IRC section 958(a)(2) to stock owned directly or indirectly by domestic partnerships, trusts, or estates.

[284] See Treas. Reg. sec. 1.904-4(e)(2).

carry out the purposes of these rules, to prevent assets or interest expense from being taken into account more than once, or to address changes in members of any group (through acquisitions or otherwise) treated as affiliated under these rules.

Effective date of worldwide interest allocation

The common parent of the domestic affiliated group must make the worldwide affiliated group election. It must be made for the first taxable year beginning after December 31, 2010, in which a worldwide affiliated group exists that includes at least one foreign corporation that meets the requirements for inclusion in a worldwide affiliated group.[285]

The common parent of the pre-election worldwide affiliated group must make the election for the first taxable year beginning after December 31, 2010, in which a worldwide affiliated group includes a financial corporation. Once either election is made, it applies to the common parent and all other members of the worldwide affiliated group or to all members of the financial institution group, as applicable, for the taxable year for which the election is made and all subsequent taxable years, unless revoked with the consent of the Secretary of the Treasury.

Phase-in rule

HERA also provided a special phase-in rule in the case of the first taxable year to which the worldwide interest allocation rules apply. For that year, the amount of the taxpayer's taxable income from foreign sources is reduced by 70 percent of the excess of (i) the amount of its taxable income from foreign sources as calculated using the worldwide interest allocation rules over (ii) the amount of its taxable income from foreign sources as calculated using the present law interest allocation rules. For that year, the amount of the taxpayer's taxable income from domestic sources is increased by a corresponding amount. Any foreign tax credits disallowed by virtue of this reduction in foreign-source taxable income may be carried back or forward under the normal rules for carrybacks and carryforwards of excess foreign tax credits.

<u>New Federal Law (IRC section 864)</u>

The WHBAA delays the effective date of worldwide interest allocation rules for seven years, until taxable years beginning after December 31, 2017. The required dates for making the worldwide affiliated group election and the financial institution group election are changed accordingly.

The provision also eliminates the special phase-in rule that applies in the case of the first taxable year to which the worldwide interest allocation rules apply.

<u>Effective Date</u>

The provision is effective for taxable years beginning after December 31, 2010.

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[285] As originally enacted under AJCA, the worldwide interest allocation rules were effective for taxable years beginning after December 31, 2008. However, the Housing and Economic Recovery Act of 2008 ("HERA") delayed the implementation of the worldwide interest allocation rules for two years, until taxable years beginning after December 31, 2010. Public Law 110-289, section 3093.

California Law (R&TC sections 24344, 24425, 25110, and 25116)

In general

California does not conform to IRC section 864. California instead has its own stand-alone interest expense allocation rules.

Water's-edge method

Certain corporations doing business in California may elect to determine their business income under a water-edge's method. This water's-edge election generally allows the unitary business to exclude foreign corporations from the calculation of business income, but includes the entire income and apportionment factors of certain affiliated foreign corporations. In addition, a foreign corporation with U.S. source income and a controlled foreign corporation with Subpart F income may have income and apportionment factors includable in the water's-edge return.

Under R&TC section 25116, provisions in the water's edge election reference the IRC as in effect for federal purposes. Thus, California is already conformed to the federal interest-expense allocation changes for water's-edge purposes.

Foreign tax credit

California does not allow a foreign tax credit.

Impact on California Revenue

Not applicable.

Section	Section Title
16	Increase in Penalty for Failure to File a Partnership or S Corporation Return

Background

Both partnerships and S corporations are generally treated as pass-through entities that do not incur an income tax at the entity level. Income earned by a partnership, whether distributed or not, is taxed to the partners. Distributions from the partnership generally are tax-free. The items of income, gain, loss, deduction or credit of a partnership generally are taken into account by a partner as allocated under the terms of the partnership agreement. If the agreement does not provide for an allocation, or the agreed allocation does not have substantial economic effect, then the items are to be allocated in accordance with the partners' interests in the partnership. To prevent double taxation of these items, a partner's basis in its interest is increased by its share of partnership income (including tax-exempt income), and is decreased by its share of any losses (including nondeductible losses). An S corporation generally is not subject to corporate-level income tax on its items of income and loss. Instead, the S corporation passes through its items of income and loss to its shareholders. The shareholders take into account separately their shares of these items on their individual income tax returns.

Under present law, both partnerships and S corporations are required to file tax returns for each taxable year.[286] The partnership's tax return is required to include the names and addresses of the individuals who would be entitled to share in the taxable income if distributed and the amount of the distributive share of each individual. The S corporation's tax return is required to include the following: the names and addresses of all persons owning stock in the corporation at any time during the taxable year; the number of shares of stock owned by each shareholder at all times during the taxable year; the amount of money and other property distributed by the corporation during the taxable year to each shareholder and the date of such distribution; each shareholder's pro rata share of each item of the corporation for the taxable year; and such other information as the Secretary may require.

In addition to applicable criminal penalties, present law imposes assessable civil penalties for both the failure to file a partnership return and the failure to file an S corporation return.[287] Each of these penalties is currently $89 times the number of shareholders or partners for each month (or fraction of a month) that the failure continues, up to a maximum of 12 months for returns required to be filed after December 31, 2008.

New Federal Law (IRC sections 6698 and 6699)

Under the WHBAA, the base amount on which a penalty is computed for a failure with respect to filing either a partnership or S corporation return is increased to $195 per partner or shareholder.

Effective Date

The provision applies to returns for taxable years beginning after December 31, 2009.

California Law (R&TC sections 19172, 19131, 19132, and 23802)

California does not conform by reference to IRC sections 6698 or 6699.

Partnership Returns

California has a stand-alone penalty that parallels the federal penalty for failure to file partnership returns, except that the California penalty is $10 per partner (rather than $89 or $195 per partner for federal purposes) for each month (or fraction of a month) that the failure continues, up to a maximum of five months (rather than the federal twelve-month period).[288]

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[286] IRC sections 6031 and 6037, respectively.

[287] IRC sections 6698 and 6699, respectively.

[288] R&TC section 19172.

S corporation returns

Currently, there is no California S corporation penalty similar to the federal penalty under IRC section 6699 (i.e. there is no California penalty that parallels the $89 or $195 per shareholder penalty).

However, because an S corporation is subject to a 1.5 percent tax on its net income,[289] such S corporation tax is subject to the general failure-to-file-a-return and failure-to-pay-tax penalties.

Failure-to-file-a-return penalty[290]

In general, the penalty for the failure to file a return applies to taxpayers who fail to make and file a return by the original or extended due date, unless reasonable cause is shown. The penalty is 5 percent of the tax for each month (or fraction thereof) during which the failure continues, up to a maximum of 25 percent of the tax.

Failure-to-pay-tax penalty[291]

In general, the failure-to-pay-tax penalty is 5 percent of the unpaid tax, plus 0.5 percent of the remaining tax unpaid tax per month, up to a maximum of 25 percent.

Coordination between failure-to-file-a-return and failure-to-pay-tax penalties

If both the failure-to-file-a-return and the failure-to-pay-tax penalties apply, the penalty for failure to pay tax is not assessed to the extent that the penalty for failure to file a return is assessed for the same taxable year.[292]

Impact on California Revenue

Estimated Revenue Impact of Increase in Penalty for Failure to File a Partnership or S Corporation Return Enactment Assumed After June 30, 2010			
2009-10	2010-11	2011-12	2012-13
$70,000	$2,500,000	$2,700,000	$5,100,000

Estimates are based on a proration of federal projections developed for the Mortgage Forgiveness Debt Relief Act of 2007 (Public Law 110-142), the Worker, Retiree and Employer Recovery Act of 2008 (Public Law 110-458), and the Worker, Homeownership, and Business Assistance Act of 2009 (Public Law 111-92), adjusted to reflect California differences.

[289] R&TC section 23802.

[290] R&TC section 19131.

[291] R&TC section 19132.

[292] R&TC section 19132(b).

Section	Section Title
17	Certain Tax Return Preparers Required to File Returns Electronically

Background

The IRS Restructuring and Reform Act of 1998[293] ("RRA 1998") states a Congressional policy to promote the paperless filing of federal tax returns. Section 2001(a) of RRA 1998 sets a goal for the IRS to have at least 80 percent of all federal tax and information returns filed electronically by 2007. Section 2001(b) of RRA 1998 requires the IRS to establish a 10-year strategic plan to eliminate barriers to electronic filing.

Present law authorizes the IRS to issue regulations specifying which returns must be filed electronically.[294] There are several limitations on this authority. First, it can only apply to persons required to file at least 250 returns during the calendar year.[295] Second, the Secretary is prohibited from requiring that income tax returns of individuals, estates, and trusts be submitted in any format other than paper, although these returns may be filed electronically by choice.

Regulations require corporations and tax-exempt organizations that have assets of $10 million or more and file at least 250 returns during a calendar year, including income tax, information, excise tax, and employment tax returns, to file electronically their Form 1120/1120S income tax returns and Form 990 information returns for tax years ending on or after December 31, 2006.[296] Private foundations and charitable trusts that file at least 250 returns during a calendar year are required to file electronically their Form 990-PF information returns for tax years ending on or after December 31, 2006, regardless of their asset size. Taxpayers can request waivers of the electronic filing requirement if they cannot meet that requirement due to technological constraints, or if compliance with the requirement would result in undue financial burden on the taxpayer.

New Federal Law (IRC section 6011)

The WHBAA generally maintains the current rule that regulations may not require any person to file electronically unless the person files at least 250 tax returns during the calendar year. However, the WHBAA also provides an exception to this rule and mandates that the Secretary require electronic filing by specified tax return preparers. "Specified tax return preparers" are all return preparers except those who neither prepare nor reasonably expect to prepare ten or more

[293] Public Law 105-206.

[294] IRC section 6011(e).

[295] Partnerships with more than 100 partners are required to file electronically. IRC section 6011(e)(2).

[296] Treasury Regulation sections 301.6011-5, 301.6033-4 and 301.6037-2.

individual income tax returns in a calendar year. The term "individual income tax return" is defined to include returns for estates and trusts as well as individuals.

Effective Date

The provision is effective for tax returns filed after December 31, 2010.

California Law (R&TC sections 18407, 18409, 18621.9, and 19170)

In general, California conforms to IRC section 6011, relating to general requirement of return, statement, or list in R&TC section 18407, as of a "specified date" of January 1, 2005, with certain modifications in R&TC section 18409. With the exception of returns for estates and trusts, the Franchise Tax Board (FTB) may prescribe regulations providing standards for determining the filing of returns on magnetic media or other machine-readable forms.

California has its own electronic filing requirement for tax preparers.[297] An income tax preparer that (1) prepares more than 100 timely original individual income tax returns during any calendar year, beginning with the 2003 calendar year, and (2) prepares one or more acceptable individual income tax returns using tax-preparation software in the current year, then, for that calendar year and each subsequent calendar year, that preparer is required to file all acceptable individual income tax returns electronically. In addition, an income tax preparer that is subject to these requirements is subject to a $50 penalty for each acceptable individual income tax return that is prepared and then not e-filed, unless the failure to e-file is due to reasonable cause and not due to willful neglect.[298]

Impact on California Revenue

Estimated Revenue Impact of Certain Tax Return Preparers Required to File Returns Electronically For Returns Filed On or After January 1, 2010 Enactment Assumed After June 30, 2010		
2010 - 11	2011 - 12	2012 - 13
$0	$0	$0

The Joint Committee on Taxation estimated that this provision would result in a negligible revenue effect.

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[297] R&TC section 18621.9.

[298] R&TC section 19170.

Section	Section Title
18	Time for Payment of Corporate Estimated Taxes

Background

In general, corporations are required to make quarterly estimated tax payments of their income tax liability.[299] For a corporation whose taxable year is a calendar year, these estimated tax payments must be made by April 15, June 15, September 15, and December 15. In the case of a corporation with assets of at least $1 billion (determined as of the end of the preceding tax year), payments due in July, August, or September, 2014, are increased to 100.25 percent of the payment otherwise due and the next required payment is reduced accordingly.[300]

New Federal Law (IRC section 6655)

The WHBAA increases the required payment of estimated tax otherwise due in July, August, or September, 2014, by 33.0 percentage points.

Effective Date

The provision is effective on November 6, 2009.

California Law (R&TC section 19025)

California law does not conform to IRC section 6655 by reference, but instead has its own stand-alone rules for estimated tax payments.

Taxable years beginning before January 1, 2009

For taxable years beginning before January 1, 2009, estimated payments of tax liability are due in quarterly increments of 25 percent of estimated liability each, beginning 3 months and 15 days after the beginning of the taxable year. The first estimated tax payment may not be less than the minimum franchise tax, if applicable. Additional payments of 25 percent of estimated tax are due on the 15th day of the 6th, 9th, and 12th months of the taxable year. Taxpayers are subject to penalties if estimated payments remitted over the course of the year are less than prescribed minimum percentages of tax liability.

[299] IRC section 6655.

[300] Public Law 111-42, section 202(b)(1).

Taxable years beginning on or after January 1, 2009, and before January 1, 2010

For taxable years beginning on or after January 1, 2009, and before January 1, 2010, required estimated payments were revised from four equal installments to the following:

Quarter Installment	Percent Estimated Tax
1st	30
2nd	30
3rd	20
4th	20

Corporate taxpayers who are not required to make an estimate payment installment in the first quarter are required to make the following installment payments in subsequent quarters:

Quarter Installment	Percent Estimated Tax
2nd	40
3rd	30
4th	30

Corporate taxpayers who are not required to make an estimate payment installment in the first two quarters are required to make the following installment payments in subsequent quarters:

Quarter Installment	Percent Estimated Tax
3rd	50
4th	50

Corporate taxpayers who are not required to make an estimate payment installment in the first three quarters are required to pay 100 percent in the fourth quarter.

Taxable years beginning on or after January 1, 2010

For taxable years beginning on or after January 1, 2010, required estimated payments are revised to the following:

Quarter Installment	Percent Estimated Tax
1st	30
2nd	40
3rd	0
4th	30

Corporate taxpayers who are not required to make an estimate payment installment in the first quarter are required to make the following installment payments in subsequent quarters:

Quarter Installment	Percent Estimated Tax
2nd	60
3rd	0
4th	40

Corporate taxpayers who are not required to make an estimate payment installment in the first two quarters are required to make the following installment payments in subsequent quarters:

Quarter Installment	Percent Estimated Tax
3rd	70
4th	30

Corporate taxpayers who are not required to make an estimate payment installment in the first three quarters are required to pay 100 percent in the fourth quarter.

Impact on California Revenue

Not applicable.

MILITARY SPOUSES RESIDENCY RELIEF ACT
Public Law 111-97, November 11, 2009

Section	Section Title
3	Determination for Tax Purposes of Residence of Spouses of Military Personnel

Background

Under section 511(a) of the SCRA (50 U.S.C. App.571), a servicemember does not lose or acquire residence or domicile, for purposes of income taxes and personal property taxes, based on the fact that the servicemember is absent from or present in any tax jurisdiction of the United States solely in compliance with military orders. Under section 511(b) of the SCRA, the servicemember's military compensation will not be considered income in a tax jurisdiction where the servicemember is serving in accordance with military orders and is not a resident. Also, under section 511(c) of the SCRA, the personal property of a servicemember will not be deemed to be present in a tax jurisdiction in which the servicemember is serving in accordance with military orders, unless that jurisdiction is the servicemember's domicile or residence.

With these protections, if a servicemember is ordered to a duty location in a new state, the servicemember is free to bring to the new state his or her personal property, such as an automobile, without risk that the property will be taxed in that state. Also, the servicemember will not be required to pay income taxes on his or her military income in a state other than the one he or she has declared as his or her home state.

However, in some states, if the servicemember's personal property is jointly titled with his or her spouse, the SCRA protection regarding personal property taxes will not apply. In fact, in 1992, the National Military Family Association testified before the House Committee on Veterans' Affairs that, ''in some States, [the family] car must be registered in the servicemember's name only in order for the family to be protected against personal property tax'' and that, ''[i]n addition to creating difficulties if the servicemember dies or in cases of divorce, the current situation has left many military spouses feeling they are perceived as excess baggage.''

More recently, the Department of Defense submitted testimony for the Committee's April 29, 2009, hearing addressing the same issue. In part, the Department of Defense provided this explanation of the current problem:

> (i) Section 511 of the SCRA states that the personal property of a servicemember shall not be deemed to be located within a tax jurisdiction of the United States if the servicemember is not a resident or domiciliary of the jurisdiction in which the servicemember is serving in compliance with military orders.
>
> (ii) Many states conclude that property (most often this is an automobile) jointly held by a servicemember and spouse is not protected from taxation by Section 511 of the SCRA.

> (iii) Thus to ensure the tax benefit, the servicemember must register the property in his or her name only. This is contrary to the recommendations that we provide Servicemembers for estate planning purposes.

In addition, at the Committee's April 29, 2009, hearing, Rebecca Poynter provided a description of how this impacts military families:

> For personal property; current, and often conflicting, state laws create financial and administrative burdens for the military spouse resulting in the suppression of assets. While an active duty servicemember may title, register, and maintain, a car in their home state, their spouse may not. With each move, if a spouse chooses to keep his/her joint tenancy of personal property, they must change the registration and/or titling to the new state; requiring the spouse pay several hundred dollars each time they relocate. To alleviate these types of fees, many spouses are forced to put all property in the name of the servicemember.

Military families are also impacted by the current state of the law regarding state income taxes. There are significant differences between the states, ranging from states that have no income tax to those that impose up to an 11 percent marginal income tax. Because the income of a military spouse is not protected under the SCRA, a spouse's income may be taxed in any jurisdiction where the spouse moves to accompany the servicemember. As a result, if a working military spouse moves around the country with the servicemember, their family income may vary significantly based on where the servicemember is sent by the military.

In addition to the potential financial burdens this may cause for military families, the military spouse may be required to file tax returns in multiple jurisdictions. The complexities of this situation were described by a military spouse in the attachment to testimony for the Committee's April 29, 2009, hearing:

> Taxes are a confusing mess. My husband has residency in one state and I have residency in another state. Just this year our tax attorney had to redo our taxes because she was confused about both of our states of residence. Next year is going to be even more confusing when I have a business registered in one state. My husband is a resident in another state and I will have been a resident of both Virginia and California.

<u>New Federal Law (Section 511 of the Servicemember's Civil Relief Act (50 U.S.C. App. 571))</u>

This provision amends section 511 of the SCRA (50 U.S.C. App. 571) to provide that, for purposes of income taxes and personal property taxes, the spouse of a servicemember will not be deemed to have lost or acquired domicile or residence by reason of being absent from or present in a tax jurisdiction solely to be with a servicemember who is in compliance with military orders and has the same original residence or domicile as the spouse. In addition, this provision adds a new subsection to section 511 of the SCRA providing that income for services performed by the spouse of a servicemember will not be deemed to be income in a tax jurisdiction where the spouse is located solely to be with the servicemember who is serving there in compliance with military orders.

Also, the provision amends section 511 of the SCRA to provide that the personal property of the spouse of a servicemember will not be deemed to be present in a tax jurisdiction in which the servicemember is serving in accordance with military orders, unless that jurisdiction is the servicemember's or the spouse's domicile or residence. These changes would apply with respect to any state or local income tax return filed for any taxable year beginning with the taxable year that includes November 11, 2009.

These changes allow spouses to title personal property in their own names or jointly with their servicemember-spouses, without the potential tax ramifications that were possible under prior law. In addition, these changes will reduce some of the confusion, difficulties, and burdens now faced by military families when they are moved to a new state.

Effective Date

The provision applies to any return of state or local income tax filed for any taxable year beginning with the taxable year that includes November 11, 2009.

California Law (R&TC Sections 17041, 17140.5, and 17951)

The provisions of the Servicemembers Civil Relief Act (SCRA) apply to California without regard to a "specified date." Thus, any changes made to the SCRA automatically apply to California.

Impact on California Revenue

Baseline.

DEPARTMENT OF DEFENSE APPROPRIATIONS, 2010
Public Law 111-118, December 19, 2009

Division B – Other Matters

Section	Section Title
1009	Untitled (Relates to Emergency Unemployment Compensation)

Background

Section 4007 of Public Law 110-252 added an uncodified provision providing payments to states having agreements for the payment of emergency unemployment compensation.

New Federal Law

This provision extends the eligibility period for emergency unemployment compensation provided in Section 4007 of Public Law 110-252 to February 28, 2010.

Effective Date

The provision is effective December 19, 2009.

California Law

Defer to the Employment Development Department (EDD).

Impact on California Revenue

Defer to the EDD.

Section	Section Title
1010	Extension of Eligibility Period

Background

In general

The IRC contains rules that require certain group health plans to offer certain individuals ("qualified beneficiaries") the opportunity to continue to participate for a specified period of time in the group health plan ("continuation coverage") after the occurrence of certain events that otherwise would have terminated such participation ("qualifying events").[301] These continuation

[301] IRC section 4980B.

coverage rules are often referred to as "COBRA continuation coverage" or "COBRA," which is a reference to the acronym for the law that added the continuation coverage rules to the IRC.[302]

The IRC imposes an excise tax on a group health plan if it fails to comply with the COBRA continuation coverage rules with respect to a qualified beneficiary. The excise tax with respect to a qualified beneficiary generally is equal to $100 for each day in the noncompliance period with respect to the failure. A plan's noncompliance period generally begins on the date the failure first occurs and ends when the failure is corrected. Special rules apply that limit the amount of the excise tax if the failure would not have been discovered despite the exercise of reasonable diligence or if the failure is due to reasonable cause and not willful neglect.

In the case of a multiemployer plan, the excise tax generally is imposed on the group health plan. A multiemployer plan is a plan to which more than one employer is required to contribute, that is maintained pursuant to one or more collective bargaining agreements between one or more employee organizations and more than one employer, and that satisfies such other requirements as the Secretary of Labor may prescribe by regulation. In the case of a plan other than a multiemployer plan (a "single employer plan"), the excise tax generally is imposed on the employer.

Plans subject to COBRA

A group health plan is defined as a plan of, or contributed to by, an employer (including a self-employed person) or employee organization to provide health care (directly or otherwise) to the employees, former employees, the employer, and others associated or formerly associated with the employer in a business relationship, or their families. A group health plan includes a self-insured plan. The term group health plan does not, however, include a plan under which substantially all of the coverage is for qualified long-term care services.

The following types of group health plans are not subject to the IRC's COBRA rules: (1) a plan established and maintained for its employees by a church or by a convention or association of churches which is exempt from tax under IRC section 501 (a "church plan"); (2) a plan established and maintained for its employees by the federal government, the government of any state or political subdivision thereof, or by any instrumentality of the foregoing (a "governmental plan");[303] and (3) a plan maintained by an employer that normally employed fewer than 20 employees on a typical business day during the preceding calendar year[304] (a "small employer plan").

[302] The COBRA rules were added to the Code by the Consolidated Omnibus Budget Reconciliation Act of 1985, Public Law 99-272. The rules were originally added as IRC sections 162(i) and (k). The rules were later restated as IRC section 4980B, pursuant to the Technical and Miscellaneous Revenue Act of 1988, Public Law 100-647.

[303] A governmental plan also includes certain plans established by an Indian tribal government.

[304] If the plan is a multiemployer plan, then each of the employers contributing to the plan for a calendar year must normally employ fewer than 20 employees during the preceding calendar year.

Qualifying events and qualified beneficiaries

A qualifying event that gives rise to COBRA continuation coverage includes, with respect to any covered employee, the following events which would result in a loss of coverage of a qualified beneficiary under a group health plan (but for COBRA continuation coverage): (1) death of the covered employee; (2) the termination (other than by reason of such employee's gross misconduct), or a reduction in hours, of the covered employee's employment; (3) divorce or legal separation of the covered employee; (4) the covered employee becoming entitled to Medicare benefits under title XVIII of the Social Security Act; (5) a dependent child ceasing to be a dependent child under the generally applicable requirements of the plan; and (6) a proceeding in a case under the U.S. Bankruptcy Code commencing on or after July 1, 1986, with respect to the employer from whose employment the covered employee retired at any time.

A "covered employee" is an individual who is (or was) provided coverage under the group health plan on account of the performance of services by the individual for one or more persons maintaining the plan and includes a self-employed individual. A "qualified beneficiary" means, with respect to a covered employee, any individual who on the day before the qualifying event for the employee is a beneficiary under the group health plan as the spouse or dependent child of the employee. The term qualified beneficiary also includes the covered employee in the case of a qualifying event that is a termination of employment or reduction in hours.

Continuation coverage requirements

Continuation coverage that must be offered to qualified beneficiaries pursuant to COBRA must consist of coverage which, as of the time coverage is being provided, is identical to the coverage provided under the plan to similarly situated non-COBRA beneficiaries under the plan with respect to whom a qualifying event has not occurred. If coverage under a plan is modified for any group of similarly situated non-COBRA beneficiaries, the coverage must also be modified in the same manner for qualified beneficiaries. Similarly situated non-COBRA beneficiaries means the group of covered employees, spouses of covered employees, or dependent children of covered employees who (i) are receiving coverage under the group health plan for a reason other than pursuant to COBRA, and (ii) are the most similarly situated to the situation of the qualified beneficiary immediately before the qualifying event, based on all of the facts and circumstances.

The maximum required period of continuation coverage for a qualified beneficiary (i.e., the minimum period for which continuation coverage must be offered) depends upon a number of factors, including the specific qualifying event that gives rise to a qualified beneficiary's right to elect continuation coverage. In the case of a qualifying event that is the termination, or reduction of hours, of a covered employee's employment, the minimum period of coverage that must be offered to the qualified beneficiary is coverage for the period beginning with the loss of coverage on account of the qualifying event and ending on the date that is 18 months[305] after the date of the qualifying event. If coverage under a plan is lost on account of a qualifying event but the loss

[305] In the case of a qualified beneficiary who is determined, under Title II or XVI of the Social Security Act, to have been disabled during the first 60 days of continuation coverage, the 18 month minimum coverage period is extended to 29 months with respect to all qualified beneficiaries if notice is given before the end of the initial 18 month continuation coverage period.

of coverage actually occurs at a later date, the minimum coverage period may be extended by the plan so that it is measured from the date when coverage is actually lost.

The minimum coverage period for a qualified beneficiary generally ends upon the earliest to occur of the following events: (1) the date on which the employer ceases to provide any group health plan to any employee, (2) the date on which coverage ceases under the plan by reason of a failure to make timely payment of any premium required with respect to the qualified beneficiary, and (3) the date on which the qualified beneficiary first becomes (after the date of election of continuation coverage) either (i) covered under any other group health plan (as an employee or otherwise) which does not include any exclusion or limitation with respect to any preexisting condition of such beneficiary or (ii) entitled to Medicare benefits under title XVIII of the Social Security Act. Mere eligibility for another group health plan or Medicare benefits is not sufficient to terminate the minimum coverage period. Instead, the qualified beneficiary must be actually covered by the other group health plan or enrolled in Medicare. Coverage under another group health plan or enrollment in Medicare does not terminate the minimum coverage period if such other coverage or Medicare enrollment begins on or before the date that continuation coverage is elected.

Election of continuation coverage

The COBRA rules specify a minimum election period under which a qualified beneficiary is entitled to elect continuation coverage. The election period begins not later than the date on which coverage under the plan terminates on account of the qualifying event, and ends not earlier than the later of 60 days or 60 days after notice is given to the qualified beneficiary of the qualifying event and the beneficiary's election rights.

Notice requirements

A group health plan is required to give a general notice of COBRA continuation coverage rights to employees and their spouses at the time of enrollment in the group health plan.

An employer is required to give notice to the plan administrator of certain qualifying events (including a loss of coverage on account of a termination of employment or reduction in hours) generally within 30 days of the qualifying event. A covered employee or qualified beneficiary is required to give notice to the plan administrator of certain qualifying events within 60 days after the event. The qualifying events giving rise to an employee or beneficiary notification requirement are the divorce or legal separation of the covered employee or a dependent child ceasing to be a dependent child under the terms of the plan. Upon receiving notice of a qualifying event from the employer, covered employee, or qualified beneficiary, the plan administrator is then required to give notice of COBRA continuation coverage rights within 14 days to all qualified beneficiaries with respect to the event.

Premiums

A plan may require payment of a premium for any period of continuation coverage. The amount of such premium generally may not exceed 102 percent[306] of the "applicable premium" for such period and the premium must be payable, at the election of the payor, in monthly installments.

The applicable premium for any period of continuation coverage means the cost to the plan for such period of coverage for similarly situated non-COBRA beneficiaries with respect to whom a qualifying event has not occurred, and is determined without regard to whether the cost is paid by the employer or employee. The determination of any applicable premium is made for a period of 12 months (the "determination period") and is required to be made before the beginning of such 12 month period.

In the case of a self-insured plan, the applicable premium for any period of continuation coverage of qualified beneficiaries is equal to a reasonable estimate of the cost of providing coverage during such period for similarly situated non-COBRA beneficiaries which is determined on an actuarial basis and takes into account such factors as the Secretary of Treasury prescribes in regulations. A self-insured plan may elect to determine the applicable premium on the basis of an adjusted cost to the plan for similarly situated non-COBRA beneficiaries during the preceding determination period.

A plan may not require payment of any premium before the day which is 45 days after the date on which the qualified beneficiary made the initial election for continuation coverage. A plan is required to treat any required premium payment as timely if it is made within 30 days after the date the premium is due or within such longer period as applies to, or under, the plan.

Other continuation coverage rules

Continuation coverage rules which are parallel to the IRC's continuation coverage rules apply to group health plans under the Employee Retirement Income Security Act of 1974 (ERISA).[307] ERISA generally permits the Secretary of Labor and plan participants to bring a civil action to obtain appropriate equitable relief to enforce the continuation coverage rules of ERISA, and in the case of a plan administrator who fails to give timely notice to a participant or beneficiary with respect to COBRA continuation coverage, a court may hold the plan administrator liable to the participant or beneficiary in the amount of up to $110 a day from the date of such failure.

Although the federal government and state and local governments are not subject to the IRC and ERISA's continuation coverage rules, other laws impose similar continuation coverage requirements with respect to plans maintained by such governmental employers.[308] In addition,

[306] In the case of a qualified beneficiary whose minimum coverage period is extended to 29 months on account of a disability determination, the premium for the period of the disability extension may not exceed 150 percent of the applicable premium for the period.

[307] Sections 601 to 608 of ERISA.

[308] Continuation coverage rights similar to COBRA continuation coverage rights are provided to individuals covered by health plans maintained by the federal government. 5 U.S.C. sec. 8905a. Group health plans maintained by a state that

many states have enacted laws or promulgated regulations that provide continuation coverage rights that are similar to COBRA continuation coverage rights in the case of a loss of group health coverage. Such state laws, for example, may apply in the case of a loss of coverage under a group health plan maintained by a small employer.

The American Recovery and Reinvestment Act of 2009 (ARRA) provides the following:

A temporary reduction in premiums for COBRA coverage is provided to assistance eligible individuals who are involuntarily terminated from their employment. A premium subsidy of 65 percent is provided for a period of coverage. The period of the premium subsidy is limited to a maximum of 9 months of coverage (this provision extends this to 15 months). The premium subsidy is only provided with respect to involuntary terminations that occur on or after September 1, 2008, and before January 1, 2010 (this provision extends this to March 1, 2010).

The provision permits a group health plan to provide a special enrollment right to "assistance eligible individuals" (AEI) to allow them to change coverage options under the plan in conjunction with electing COBRA continuation coverage.[309] The provision only allows a group health plan to offer additional coverage options to assistance eligible individuals and does not change the basic requirement under federal COBRA continuation coverage requirements that a group health plan must allow an assistance eligible individual to choose to continue with the coverage in which the individual is enrolled as of the qualifying event.[310] However, once the election of the other coverage is made, it becomes COBRA continuation coverage under the applicable COBRA continuation provisions. Thus, for example, under the federal COBRA continuation coverage provisions, if a covered employee chooses different coverage pursuant to being provided this option, the different coverage elected must generally be permitted to be continued for the applicable required period (generally 18 months or 36 months, absent an event that permits coverage to be terminated under the federal COBRA continuation provisions) even though the premium subsidy is only for nine months.

This provision provides an income threshold as an additional condition on an individual's entitlement to the premium subsidy during any taxable year. The income threshold applies based on the modified AGI for an individual income tax return for the taxable year in which the subsidy is received (i.e., either 2009 or 2010) with respect to which the AEI is the taxpayer, the taxpayer's spouse or a dependent of the taxpayer (within the meaning of IRC section 152, determined without regard to IRC sections 152(b)(1), (b)(2) and (d)(1)(B)). Modified AGI for this purpose means AGI as defined in IRC section 62, increased by any amount excluded from gross income under IRC sections 911, 931, or 933. Under this income threshold, if the premium subsidy is provided with respect to any COBRA continuation coverage which covers the taxpayer, the

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receives funds under Chapter 6A of Title 42 of the United States Code (the Public Health Service Act) are required to provide continuation coverage rights similar to COBRA continuation coverage rights for individuals covered by plans maintained by such state (and plans maintained by political subdivisions of such state and agencies and instrumentalities of such state or political subdivision of such state). 42 U.S.C. sec. 300bb-1.

[309] An employer can make this option available to covered employees under current law.

[310] All references to "federal COBRA continuation coverage" mean the COBRA continuation coverage provisions of the IRC, ERISA, and PHSA.

taxpayer's spouse, or any dependent of the taxpayer during a taxable year and the taxpayer's modified AGI exceeds $145,000 (or $290,000 for joint filers), then the amount of the premium subsidy for all months during the taxable year must be repaid. The mechanism for repayment is an increase in the taxpayer's income tax liability for the year equal to such amount. For taxpayers with AGI between $125,000 and $145,000 (or $250,000 and $290,000 for joint filers), the amount of the premium subsidy for the taxable year that must be repaid is reduced proportionately.

Under this income threshold, for example, an AEI who is eligible for federal COBRA continuation coverage based on the involuntary termination of a covered employee in August 2009 but who is not entitled to the premium subsidy for the periods of coverage during 2009 due to having income above the threshold, may nevertheless be entitled to the premium subsidy for any periods of coverage in the remaining period (e.g. 5 months of coverage) during 2010 to which the subsidy applies if the modified AGI for 2010 of the relevant taxpayer is not above the income threshold.

This provision allows an individual to make a permanent election (at such time and in such form as the Secretary of Treasury may prescribe) to waive the right to the premium subsidy for all periods of coverage. For the election to take effect, the individual must notify the entity (to which premiums are reimbursed under IRC section 6432(a)) of the election. This waiver provision allows an AEI who is certain that the modified AGI limit prevents the individual from being entitled to any premium subsidy for any coverage period to decline the subsidy for all coverage periods and avoid being subject to the recapture tax. However, this waiver applies to all periods of coverage (regardless of the tax year of the coverage) for which the individual might be entitled to the subsidy. The premium subsidy for any period of coverage cannot later be claimed as a tax credit or otherwise be recovered, even if the individual later determines that the income threshold was not exceeded for a relevant tax year. This waiver is made separately by each qualified beneficiary (who could be an AEI) with respect to a covered employee.

Technical changes

The provision clarifies that a reference to a period of coverage in the provision is a reference to the monthly or shorter period of coverage with respect to which premiums are charged with respect to such coverage. For example, the provision is effective for a period of coverage beginning after the date of enactment. In the case of a plan that provides and charges for COBRA continuation coverage on a calendar month basis, the provision is effective for the first calendar month following date of enactment.

The provision specifically provides that if a person other than the individual's employer pays on the individual's behalf then the individual is treated as paying 35 percent of the premium, as required to be entitled to the premium subsidy. Thus, the provision makes clear that, for this purpose, payment by an AEI includes payment by another individual paying on behalf of the individual, such as a parent or guardian, or an entity paying on behalf of the individual, such as a state agency or charity.

The provision clarifies that, for the special 60-day election period for a qualified beneficiary who is eligible for a reduced premium and who has not elected COBRA continuation coverage as of the date of enactment, the election period begins on the date of enactment and ends 60 days after the notice is provided to the qualified beneficiary of the special election period. In addition, the provision clarifies that coverage elected under this special election right begins with the first period of coverage beginning on or after the date of enactment. The provision also extends this special COBRA election opportunity to a qualified beneficiary who elected COBRA coverage but who is no longer enrolled on the date of enactment, for example, because the beneficiary was unable to continue paying the premium.

The provision clarifies that a violation of the new notice requirements is also a violation of the notice requirements of the underlying COBRA provision. A notice must be provided to all individuals who terminated employment during the applicable time period, and not just to individuals who were involuntarily terminated.

Coverage under a flexible spending account (FSA) is not eligible for the subsidy. The provision clarifies that an FSA is defined as a health flexible spending account offered under a cafeteria plan within the meaning of IRC section 125.[311]

The provision provides for an expedited review, by the Secretary of Labor or Health and Human Services (in consultation with the Secretary of the Treasury), of denials of the premium subsidy. Such reviews must be completed within 15 business days after receipt of the individual's application for review. The 15 business days time-frame is intended to give the Secretaries the flexibility necessary to make determinations within based upon evidence they believe, in their discretion, to be appropriate. Additionally, the provision intends that, if an individual is denied treatment as an AEI and also submits a claim for benefits to the plan that would be denied by reason of not being eligible for federal COBRA continuation coverage (or failure to pay full premiums), the individual would be eligible to proceed with expedited review irrespective of any claims for benefits that may be pending or subject to review under the provisions of section 503 of ERISA. Either Secretary's determination upon review is de novo and is the final determination of such Secretary.

The provision also requires that various aspects of the new law, including the premium reduction, are treated as part of ERISA for purposes of administration and enforcement, including provisions that preempt state laws.

The provision clarifies the reimbursement mechanism for the premium subsidy in several respects. First, it clarifies that the person to whom the reimbursement is payable is either (1) the multiemployer group health plan, (2) the employer maintaining the group health plan subject to federal COBRA continuation coverage requirements, and (3) the insurer providing coverage under an insured plan. Thus, this is the person who is eligible to offset its payroll taxes for purposes of reimbursement. It also clarifies that the credit for the reimbursement is treated as a payment of payroll taxes. Thus, it clarifies that any reimbursement for an amount in excess of the payroll taxes owed is treated in the same manner as a tax refund. Similarly, it clarifies that overstatement of reimbursement is a payroll tax violation. For example, the IRS can assert

311 Other FSA coverage does not terminate eligibility for coverage. Coverage under another group Health Reimbursement Account (HRA) will not terminate an individual's eligibility for the subsidy as long as the HRA is properly classified as an FSA under relevant IRS guidance. See Notice 2002-45, 2002-2 CB 93.

appropriate penalties for failing to truthfully account for the reimbursement. However, it is not intended that any portion of the reimbursement is taken into account when determining the amount of any penalty to be imposed against any person, required to collect, truthfully account for, and pay over any tax under IRC section 6672.

It is intended that reimbursement not be mirrored in the U.S. possessions that have mirror income tax codes (the Commonwealth of the Northern Mariana Islands, Guam, and the Virgin Islands). Rather, the intent of Congress is that reimbursement will have direct application to persons in those possessions.

Moreover, it is intended that income tax withholding payable to the government of any possession (American Samoa, the Commonwealth of the Northern Mariana Islands, the Commonwealth of Puerto Rico, Guam, or the Virgin Islands) (in contrast with FICA withholding payable to the U.S. Treasury) will not be reduced as a result of the application of this provision. A person liable for both FICA withholding payable to the U.S. Treasury and income tax withholding payable to a possession government will be credited or refunded any excess of (1) the amount of FICA taxes treated as paid under the reimbursement rule of the provision over (2) the amount of the person's liability for those FICA taxes.

Summary of ARRA IRC provisions

A. IRC section 139C – COBRA premium assistance

The provision provides that an AEI who elects COBRA coverage under the employer's group health plan is required to pay no more than 35 percent of the applicable premium for COBRA coverage, and that IRS will provide a "subsidy" for the remaining 65 percent. The provision establishes that an AEI's premium reduction is excluded from the gross income. Thus a taxpayer's receipt of the subsidy for COBRA continuation coverage is not subject to federal income tax.

B. IRC section 6432 – COBRA premium assistance reimbursement

The provision provides a mechanism for reimbursing the person to which premiums are payable for the difference between the full premium and the amount paid by an AEI. Specifically, the person to which premiums are payable under COBRA continuation coverage must be reimbursed for the amount of the premiums that are not paid by AEI's on account of the 35 percent premium deduction.

The person to whom premiums are payable will be, except as the IRS provides otherwise, would be either the employer, or the insurer. Specifically, the person entitled to reimbursement is:

- In the case of a group health plan that is a multiemployer plan (as defined by ERISA section 3(37)), the plan;
- In the case of a group health plan which is not a multiemployer plan and which is subject to the COBRA continuation provisions contained in the IRC, ERISA, Public Health Service Act, or civil service provisions of the U.S. Code, and under which some or all of the coverage is not provided by insurance, the employer; and

- In the case of any group health plan not described in (1) or (2) above, the insurer providing the coverage under the plan.

A person entitled to reimbursement and who files a claim for reimbursement at such time and in such manner as the IRS may require will be treated as having paid to the IRS, on the date that the AEI's premium payment is received, payroll taxes in an amount equal to the portion of the reimbursement relating to that premium. To the extent that the amount treated as paid exceeds the amount of the person's liability for payroll taxes, the IRS will credit or refund the excess in the same manner as if it were an overpayment of payroll taxes.

C. IRC section 6720C – Penalty for failure to notify health plan of cessation of eligibility for COBRA premium assistance

The provision provides that an AEI who is no longer eligible for the subsidized COBRA premium because of eligibility coverage under another group health plan or Medicare must notify the group health plan providing the subsidized COBRA coverage. The notice must be in writing and be provided in the time and manner that Department of Labor (DOL) may specify. The notice must inform the group health plan providing COBRA coverage of the eligibility under the other plan or Medicare. Any person who fails to provide the notice in the time and manner required by DOL must pay a penalty of 110 percent of the premium reduction after termination of eligibility for the subsidized COBRA coverage. No penalty will be imposed if it is shown that the failure to provide the required notice is due to reasonable cause and not to willful neglect.

The premium subsidy provision is effective for tax years ending after February 17, 2009. The penalty for failure to provide notification of cessation of eligibility for COBRA premium assistance is effective for notification failures occurring after February 17, 2009. The reimbursement provision is effective for premiums for a period of coverage beginning on or after February 17, 2009.

<u>New Federal Law (Act section 1010 affecting IRC sections 35, 101, 139C, 6411, 6432, 6671, and 6720C)</u>

This provision extends the maximum period of coverage provided in the American Recovery and Reinvestment Act of 2009 (ARRA), that was enacted into federal law on February 17, 2009, from 9 months to 15 months. In addition, this provision extends the period for involuntary terminations for an additional 60 days, to involuntary terminations before March 1, 2010.

<u>California Law & Impact on California Revenue (provided separately for new IRC provisions A, B, and C)</u>

A. IRC section 139C provision

<u>California Law (R&TC section 17131)</u>

California conforms by reference in PITL to Part III of Subchapter B of Chapter 1 of Subtitle A of the IRC, relating to items that are specifically excluded from gross income, in R&TC section 17131 as of the “specified date” of January 1, 2005. Because the federal change was made after the "specified date," California has not conformed to the new federal law that establishes that an AEI's premium reduction is excludable from gross income.

However, the premium reduction provision is treated as a part of ERISA. As a result, any state taxation of the premium reduction is prohibited by the ERISA preemption of state law.

<u>Impact on California Revenue</u>

Baseline.

B. IRC section 6432 provision

<u>California Law</u>

The Franchise Tax Board does not administer payroll taxes. Defer to the Employment Development Department (EDD).

<u>Impact on California Revenue</u>

Defer to the EDD.

C. IRC section 6720C provision

<u>California Law (None)</u>

California law has no comparable provision similar to IRC section 6720C.

<u>Impact on California Revenue</u>

Baseline.

ADDENDUM

2008 Federal Act Not Previously Reported On
Fostering Connections to Success and Increasing Adoptions Act of 2008
Public Law 110-351, October 7, 2008

Section	Section Title
501	Uniform Definition of a Child

Background

Uniform definition of qualifying child

In general

Present law provides a uniform definition of qualifying child (the ''uniform definition'') for purposes of the dependency exemption, the child credit, the earned income credit, the dependent care credit, and head of household filing status. A taxpayer generally may claim an individual who does not meet the uniform definition (with respect to any taxpayer) as a dependent if the dependency requirements are satisfied. The uniform definition generally does not modify other parameters of each tax benefit (e.g., the earned income requirements of the earned income credit) or the rules for determining whether individuals other than children of the taxpayer qualify for each tax benefit.

Under the uniform definition, in general, a child is a qualifying child of a taxpayer if the child satisfies each of three tests: (1) the child has the same principal place of abode as the taxpayer for more than one half the taxable year; (2) the child has a specified relationship to the taxpayer; and (3) the child has not yet attained a specified age. A tie-breaking rule applies if more than one taxpayer claims a child as a qualifying child.

The support and gross income tests for determining whether an individual is a dependent generally do not apply to a child who meets the requirements of the uniform definition.

Residency test

Under the uniform definition's residency test, a child must have the same principal place of abode as the taxpayer for more than one half of the taxable year. Temporary absences due to special circumstances, including absences due to illness, education, business, vacation, or military service, are not treated as absences.

Relationship test

In order to be a qualifying child, the child must be the taxpayer's son, daughter, stepson, stepdaughter, brother, sister, stepbrother, stepsister, or a descendant of any such individual. For purposes of determining whether an adopted child is treated as a child by blood, an adopted child means an individual who is legally adopted by the taxpayer, or an individual who is lawfully placed with the taxpayer for legal adoption by the taxpayer. A foster child who is placed with the taxpayer by an authorized placement agency or by judgment, decree, or other order of any court of competent jurisdiction is treated as the taxpayer's child.

Age test

The age test varies depending upon the tax benefit involved. In general, a child must be under age 19 (or under age 24 in the case of a full-time student) in order to be a qualifying child. In general, no age limit applies with respect to individuals who are totally and permanently disabled within the meaning of IRC section 22(e)(3) at any time during the calendar year. A child must be under age 13 (if he or she is not disabled) for purposes of the dependent care credit, and under age 17 (whether or not disabled) for purposes of the child credit.

Children who support themselves

A child who provides over one half of his or her own support generally is not considered a qualifying child of another taxpayer. However, a child who provides over one half of his or her own support may constitute a qualifying child of another taxpayer for purposes of the earned income credit.

Tie-breaking rules

If a child would be a qualifying child with respect to more than one individual (e.g., a child lives with his or her mother and grandmother in the same residence) and more than one person claims a benefit with respect to that child, then the following ''tie-breaking'' rules apply. First, if only one of the individuals claiming the child as a qualifying child is the child's parent, the child is deemed the qualifying child of the parent. Second, if both parents claim the child and the parents do not file a joint return, then the child is deemed a qualifying child first with respect to the parent with whom the child resides for the longest period of time, and second with respect to the parent with the highest adjusted gross income. Third, if the child's parents do not claim the child, then the child is deemed a qualifying child with respect to the claimant with the highest adjusted gross income.

Interaction with other rules

Taxpayers generally may claim an individual who does not meet the uniform definition with respect to any taxpayer as a dependent if the dependency requirements (including the gross income and support tests) are satisfied. Thus, for example, a taxpayer may claim a parent as a dependent if the taxpayer provides more than one half of the support of the parent and the parent's gross income is less than the personal exemption amount. As another example, a grandparent may claim a dependency exemption with respect to a grandson who does not reside with any taxpayer for over one half the year, if the grandparent provides more than one half of the support of the grandson and the grandson's gross income is less than the personal exemption amount.

Children of divorced or legally separated parents

In the case of divorced or legally separated parents, a custodial parent may release the claim to a dependency exemption and the child credit to a noncustodial parent. While the definition of qualifying child is generally uniform, this custodial waiver rule does not apply with respect to the earned income credit, head of household status, or the dependent care credit.

Other provisions

A taxpayer identification number for a child must be provided on the taxpayer's return. For purposes of the earned income credit, a qualifying child is required to have a social security number that is valid for employment in the United States (that is, the child must be a U.S. citizen, permanent resident, or have a certain type of temporary visa).

Dependency rules

In general

An individual may be claimed as a taxpayer's dependent if such individual is a qualifying child or a qualifying relative of the taxpayer and meets certain other requirements. An individual is a taxpayer's qualifying relative if such individual (1) bears the appropriate relationship to the taxpayer; (2) has a gross income that does not exceed the personal exemption amount; (3) receives one-half of his or her support from the taxpayer; and (4) is not a qualifying child of the taxpayer. Generally, an individual bears the appropriate relationship to the taxpayer if the individual is the taxpayer's lineal descendent or ancestor, brother, sister, aunt, uncle, niece, or nephew. Some relations by marriage also qualify, including stepmothers, stepfathers, stepbrothers, stepsisters, sons-in-law, daughters-in-law, fathers-in-law, mothers-in-law, brothers-in-law, and sisters-in-law. In addition, an individual bears the appropriate relationship if the individual has the same principal place of abode as the taxpayer and is a member of the taxpayer's household.

Dependents of dependents

Generally, if an individual is a dependent of a taxpayer for any taxable year, such individual is treated as having no dependents for such taxable year. Therefore, the individual is ineligible to claim:

1. Head of household filing status;[312]
2. The dependent care credit;[313] or
3. A dependency exemption.[314]

[312] IRC section 2.

[313] IRC section 21.

Married dependents

Generally, an individual filing a joint return with such individual's spouse is not treated as the dependent of a taxpayer. Therefore, the taxpayer is ineligible to claim the earned income credit or a dependency exemption with respect to such individual.

Citizenship and residency

Children who are U.S. citizens or nationals living abroad or non-U.S. citizens or nationals living in Canada or Mexico may qualify as dependents. In addition, a legally adopted child who does not satisfy the residency or citizenship requirement may nevertheless qualify as a dependent if (1) the child's principal place of abode is the taxpayer's home and (2) the taxpayer is a citizen or national of the United States.

Earned income credit

The earned income credit is a refundable tax credit available to certain lower-income individuals. Generally, the amount of an individual's allowable earned income credit is dependent on the individual's earned income, adjusted gross income, and the number of qualifying children.

An individual who is a qualifying child of another individual is not eligible to claim the earned income credit. Thus, in certain cases a taxpayer caring for a younger sibling in a home with no parents would be ineligible to claim the earned income credit based solely on the fact that the taxpayer is a qualifying child of the younger sibling if the taxpayer meets the age, relationship, and residency tests.

<u>New Federal Law (IRC section 152)</u>

Limit definition of qualifying child

The provision adds a new requirement to the uniform definition. Specifically, it provides that an individual who otherwise satisfies the uniform definition is not treated as a qualifying child unless he or she is either: (1) younger than the individual claiming him or her as a qualifying child or (2) permanently and totally disabled.

The provision also provides that an individual who is married and files a joint return (unless the return is filed only as a claim for a refund) will not be considered a qualifying child for child-related tax benefits, including the child tax credit.

Restrict qualifying child tax benefits to child's parent

The provision provides that if a parent may claim a particular qualifying child, no other individual may claim that child. There is one exception to this rule: if no parent claims the qualifying child,

[314] IRC section 151.

another individual may claim such child if such other individual (1) is otherwise eligible to claim the child and (2) has a higher adjusted gross income for the taxable year than any parent eligible to claim the child.

The provision further provides that dependent filers are not eligible for child-related tax benefits.

Effective Date

The provision is effective for taxable years beginning after December 31, 2008.

California Law (R&TC sections 17042, 17052.18, 17054, and 17056)

California law follows the federal definition of a qualifying child for purposes of the head-of-household filing status, the dependent care credit, and the dependent exemption credit.

Head of household

California law conforms by reference to the federal definition of head of household as it read on the "specified date" of January 1, 2005. Because the federal change to the definition of a qualifying child was made after the "specified date" of January 1, 2005, California does not conform to this federal change.

Dependent care credit

California allows a refundable dependent care credit computed as a percentage of the allowable federal credit. The percentage varies by adjusted gross income (AGI) as follows:

AGI Amount	*Percentage*
$40,000 or less	50
$40,001 - $70,000	43
$70,001 - $100,000	34
Over $100,000	0

Because the California credit is based on the allowable amount of the federal credit, California automatically conforms to any federal changes in the definition of a qualifying child for purposes of the dependent care credit.

Dependent exemption credit

The dependent exemption credit conforms to the federal definition of a dependent as of the "specified date" of January 1, 2005. Because the federal definition of a dependent includes a qualifying child, and the federal change to the definition of a qualifying child was made after the "specified date" of January 1, 2005, California does not conform to this federal change.

Impact on California Revenue

Estimated Revenue Impact of Uniform Definition of Qualifying Child For Taxable Years Beginning On or After January 1, 2010 Enactment Assumed After June 30, 2010		
2010-11	2011-12	2012-13
$4,900,000	$2,900,000	$2,700,000

Estimates are based on a proration of federal projections developed for the Fostering Connections to Success and Increasing Adoptions Act of 2008.

EXHIBIT A – 2009 MISCELLANEOUS FEDERAL ACTS IMPACTING THE IRC NOT REQUIRING A CALIFORNIA RESPONSE

1. Public Law 111-8, Omnibus Appropriations Act, authorizes the U.S. Tax Court to pay on behalf of its judges, age 65 or over, any increase in the cost of Federal Employees Group Life Insurance imposed after April 24, 1999, that is incurred after the enactment of the Pension Protection Act of 2006. This Act also makes appropriations to Department of Labor for the Black Lung Disability Trust Fund authorized under IRC section 9501.

IRC Code Section	Public Law No.	Act Section No.	123 Stat. Page
7472	111-8	618(a)	677
7472	111-8	618(b)	677
9501	111-8		757

2. Public Law 111-12 Federal Aviation Administration Extension Act of 2009, amends the IRC to extend the funding and expenditure authority of the Airport and Airway Trust Fund; and, amends title 49, United States Code, to extend authorizations for the airport improvement program, and for other purposes.

IRC Code Section	Public Law No.	Act Section No.	123 Stat. Page
1	111-12	1	1457
4081	111-12	2(a)	1457
4261	111-12	2(b)(1)	1457
4271	111-12	2(b)(2)	1457
4081	111-12	2(c)	1457
9502	111-12	3(a)(b)	1457
9502	111-12	3(c)	1457

3. Public Law 111-42, Corporate Estimated Tax Shift Act of 2009, to increase the required payment of estimated tax of certain corporations in July, August, or September, 2014, to approve the renewal of import restrictions contained in the Burmese Freedom and Democracy Act of 2003, and for other purposes.

IRC Code Section	Public Law No.	Act Section No.	123 Stat. Page
1	111-42	201	1963
6655	111-42	202	1963

4. Public Law 111-46, Funding of Highway Trust Fund, amends the IRC with respect to determination of the balances of the Highway Trust Fund September 30, 1998, and replaces the $8.017 billion Restoration of Fund balance appropriation with a $7 billion Increase in Fund balance appropriation (without fiscal-year limitation).

IRC Code Section	Public Law No.	Act Section No.	123 Stat. Page
9503	111-46	1	1970

5. Public Law 111-68, Continuing Appropriations Resolution, continues excise taxes on aviation fuels and the air transportation of persons and property, provides authority to make expenditures from the Highway Trust Fund, and authorizes expenditures from the Sport Fish Restoration and Boating Trust Fund. Excise taxes are not administered by the FTB; defer to the Board of Equalization.

IRC Code Section	Public Law No.	Act Section No.	123 Stat. Page
9502	111-68	156(c)	2050
9503	111-68	159(a)(2)	2052
9503	111-68	159(b)(2)	2052
9504	111-68	161(a)	2052

6. Public Law 111-69, Fiscal Year 2010 Federal Aviation Administration Extension Act, amends the IRC relating to airport and airway trust fund. Excise taxes are not administered by the FTB; defer to the Board of Equalization.

IRC Code Section	Public Law No.	Act Section No.	123 Stat. Page
1	111-69	1	2054
4081	111-69	2(a)	2054
4261	111-69	2(b)(1)	2054
4271	111-69	2(b)(2)	2054
4081	111-69	2(c)	2054
9502	111-69	3(a), (b)	2054
9502	111-69	3(d)	2054

7. Public Law 111-88, makes appropriations for the Department of the Interior, Environment and Related Agencies for the Fiscal year Ending September 30, 2010, and amends the IRC relating to the Highway Trust Fund and the Sport Fish Restoration and Boating Trust Fund.

IRC Code Section	Public Law No.	Act Section No.	123 Stat. Page
9503	111-88	103	2972
9504	111-88	103	2972

8. Public Law 111-116, Fiscal Year 2010 Federal Aviation Administration Extension Act, Part II, amends the IRC to extend the funding and expenditure authority of the Airport and Airway Trust Fund, amends title 49, United States Code, to extend authorizations for the airport improvement program, and for other purposes.

IRC Code Section	Public Law No.	Act Section No.	123 Stat. Page
1	111-116	1	3031
4081	111-116	2(a)	3031
4261	111-116	2(b)(1)	3031
4271	111-116	2(b)(2)	3031
4081	111-116	2(c)	3031
9502	111-116	3(a)(b)	3031
9502	111-116	3(c)	3031

9. Public Law 111-117, Consolidated Appropriations Act, 2010, makes appropriations for the Departments of Transportation, Housing and Urban Development, and related agencies for the fiscal year ending September 30, 2010.

IRC Code Section	Public Law No.	Act Section No.	123 Stat. Page
9501	111-117		3233

EXHIBIT B – EXPIRING TAX PROVISIONS

California Sunset[315]	California Section	Federal Section	Federal Sunset	Description
12/31/09	17039.2[316] 23036.2[317]	N/A	N/A	Temporary Limit on Business Credits
12/31/09	18510	N/A	N/A	Payment and Reporting of Qualified Use Tax
12/31/09	18845 – 18845.3	N/A	N/A	Voluntary Contribution: California Prostate Cancer Research Fund
12/31/09	17651 23732	512	12/31/09	Exclusion of Gain or Loss on Sale or Exchange of Certain Brownfield Sites from Unrelated Business Taxable Income
12/31/09	17276.9[318] 24416.9[319]	N/A	N/A	Temporary Suspension of Net Operating Losses
12/31/09	24990	1202	12/31/09	Increased Exclusion of Gain on Sale of Qualified Business Stock of an Empowerment Zone Business
03/10/10	17059	N/A	N/A	Principal Residence Purchase Credit
12/31/10	18825 – 18830	N/A	N/A	Voluntary Contribution: Veteran's Quality of Life Fund
12/31/10	18846 – 18846.3	N/A	N/A	Voluntary Contribution: California Sexual Violence Victim Service Fund
12/31/10	18847 – 18847.3	N/A	N/A	Voluntary Contribution: California Colorectal Cancer Prevention Fund
01/01/11	17041	N/A	N/A	Temporary Increase in the Personal Income Tax Rates[320]
12/31/11	17052.17 – 23617	N/A	N/A	Credit: Employer Child Care Assistance
12/31/11	17052.18 – 23617.5	N/A	N/A	Credit: Employer Dependent Care Plan
12/31/11	17053.57 – 23657	N/A	N/A	Credit: Community Development Financial Institution Deposits

[315] In general, this is the last taxable year to which the provision applies. Fiscal years beginning within this taxable year are, in general, also covered by the provision. In some cases, the repeal date of the section is listed or the expiration applies to transactions occurring after this date.

[316] The limitation does not apply to taxpayers with net business income of less than $500,000.

[317] The limitation does not apply to taxpayers with taxable income of less than $500,000.

[318] The suspension does not apply to taxpayers with net business income of less than $500,000.

[319] The suspension does not apply to taxpayers with taxable income of less than $500,000.

[320] Temporarily adds 0.25 to each personal-income-tax rate percentage for taxable years 2009 and 2010.

EXHIBIT B – EXPIRING TAX PROVISIONS

California Sunset[315]	California Section	Federal Section	Federal Sunset	Description
01/01/11	17062	N/A	N/A	Temporary Increase in the Alternative Minimum Tax[321]
12/31/11	18750 - 18753	N/A	N/A	Voluntary Contribution: California Sea Otter Fund
12/31/12	18711 – 18716	N/A	N/A	Voluntary Contribution: State Children's Trust Fund
12/31/12	18741 – 18744	N/A	N/A	Voluntary Contribution: Fish and Game Preservation
12/31/12	18755 – 18755.3	N/A	N/A	Voluntary Contribution: Municipal Shelter Spray Neuter Fund
12/31/12	18791 – 18796	N/A	N/A	Voluntary Contribution: Designations to California Breast Cancer Research Fund
12/31/12	18797 – 18797.5	N/A	N/A	Voluntary Contribution: California Ovarian Cancer Research Fund
12/31/12	18881 - 18886	N/A	N/A	Voluntary Contribution: ALS/Lou Gehrig"s Disease Research Fund
12/31/12	18861 – 18864	N/A	N/A	Voluntary Contribution: California Cancer Research Fund
12/31/13	18851 – 18855	N/A	N/A	Voluntary Contribution: Emergency Food Assistance Program Fund
12/31/13	19551.1	N/A	N/A	City Business Tax/License Information Mandate
12/31/13	24601	420	12/31/13	Transfer of Excess Pension Assets to Retiree Health Accounts
12/31/14	18721 – 18724	N/A	N/A	Voluntary Contribution: California Fund for Senior Citizens
12/31/14	18761 – 18766	N/A	N/A	Voluntary Contribution: California Alzheimer's Disease and Related Research Fund
12/31/14	18705 – 18709	N/A	N/A	Voluntary Contribution: California Military Family Relief Fund
12/31/15	18801 – 18804	N/A	N/A	Voluntary Contribution: California Firefighter's Memorial Fund
12/31/15	18805 – 18808	N/A	N/A	Voluntary Contribution: California Peace Officer's Memorial Foundation Fund
12/31/17	17053.62 - 23662	45H	Permanent	Credit: Environmental Credit for Production of Ultra Low Sulfur Diesel Fuel

[321] Temporarily adds 0.25 to the personal-alternative-minimum-tax rate percentage for taxable years 2009 and 2010.

EXHIBIT C – REVENUE TABLES

Assumed Enactment after June 30, 2010

Table 1 - Children's Health Insurance Program Reauthorization Act of 2009 (CHIPRA) (Public Law 111-3)				
Act Section	**Provision**	**2010-11**	**2011-12**	**2012-13**
311	Special Enrollment Period Under Group Health Plans in Case of Termination of Medicaid or CHIP Coverage or Eligibility for Assistance in Purchase of Employment Based Coverage, Coordination of Coverage	Baseline	Baseline	Baseline
701	Increase in Excise Tax Rate on Tobacco Products	Defer to the BOE	Defer to the BOE	Defer to the BOE
702 & 703	Administrative Improvements & Treasury Study Concerning the Magnitude of Tobacco Smuggling in the United States	Defer to the BOE	Defer to the BOE	Defer to the BOE
704	Time for Payment of Corporate Estimated Taxes	N/A	N/A	N/A

Table 2 - American Recovery and Reinvestment Act of 2009 (ARRA) (Public Law 111-5)				
Act Section	**Provisions**	**2010-11**	**2011-12**	**2012-13**
Part I of Subtitle A of Title I - *General Tax Relief*				
1001	Making Work Pay Credit	N/A	N/A	N/A
1002	Temporary Increase in Earned Income Tax Credit	N/A	N/A	N/A
1003	Temporary Increase of Refundable Portion of Child Credit	N/A	N/A	N/A
1004	American Opportunity Tax Credit	N/A	N/A	N/A
1005	Computer Technology and Equipment Allowed as a Qualified Higher Education Expense for Section 529 Accounts in 2009 and 2010	-$20,000	$0	$0

Table 2 - American Recovery and Reinvestment Act of 2009 (ARRA) (Public Law 111-5)				
Act Section	**Provision**	**2010-11**	**2011-12**	**2012-13**
1006	Extension of and Increase in First-Time Homebuyer Credit; Waiver of Requirement to Repay	N/A	N/A	N/A
1007	Suspension of Tax on Portion of Unemployment Compensation	N/A	N/A	N/A
1008	Additional Deduction for State Sales Tax and Excise Tax on the Purchase of Certain Motor Vehicles	N/A	N/A	N/A
Part II of Subtitle A of Title I - *Alternative Minimum Tax Relief*				
1011	Extension of Alternative Minimum Tax Relief for Nonrefundable Personal Credits	N/A	N/A	N/A
1012	Extension of Increased Alternative Minimum Tax Exemption Amount	N/A	N/A	N/A
Part I of Subtitle B of Title I – *Renewable Energy Incentives*				
1101	Extension of Credit for Electricity Produced from Certain Renewable Resources	N/A	N/A	N/A
1102	Election of Investment Credit in Lieu of Production Credit	N/A	N/A	N/A
1103	Repeal of Certain Limitations on Credit for Renewable Energy Property	N/A	N/A	N/A
1104	Coordination with Renewable Energy Grants	-$36,000,000	-$23,000,000	-$16,000,000

Table 2 - American Recovery and Reinvestment Act of 2009 (ARRA) (Public Law 111-5)				
Act Section	**Provision**	**2010-11**	**2011-12**	**2012-13**
Part II of Subtitle B of Title I - *Increased Allocations of New Clean Renewable Energy Bonds and Qualified Energy Conservation Bonds*				
1111	Increased Limitation on Issuance of New Clean Renewable Energy Bonds	N/A	N/A	N/A
1112	Increased Limitation on Issuance of Qualified Energy Conservation Bonds	N/A	N/A	N/A
Part III of Subtitle B of Title I - *Energy Conservation Incentives*				
1121	Extension and Modification of Credit for Nonbusiness Energy Property	N/A	N/A	N/A
1122	Modification of Credit for Residential Energy Efficient Property	N/A	N/A	N/A
1123	Temporary Increase in Credit for Alternative Fuel Vehicle Refueling Property	N/A	N/A	N/A
Part IV of Subtitle B of Title I - *Modification of Credit for Carbon Dioxide Sequestration*				
1131	Application of Monitoring Requirements to Carbon Dioxide Used as a Tertiary Injectant	N/A	N/A	N/A
Part V of Subtitle B of Title I - *Plug-In Electric Drive Motor Vehicles*				
1141	Credit for New Qualified Plug-in Electric Drive Motor Vehicles	N/A	N/A	N/A
1142	Credit for Certain Plug-in Electric Vehicles	N/A	N/A	N/A
1143	Conversion Kits	N/A	N/A	N/A

Table 2 - American Recovery and Reinvestment Act of 2009 (ARRA) (Public Law 111-5)				
Act Section	**Provision**	**2010-11**	**2011-12**	**2012-13**
1144	Treatment of Alternative Motor Vehicle Credit as a Personal Credit Allowed Against AMT	N/A	N/A	N/A
Part VI of Subtitle B of Title I - *Parity for Transportation Fringe Benefits*				
1151	Increased Exclusion Amount for Commuter Transit Benefits and Transit Passes	Baseline	Baseline	Baseline
Part I of Subtitle C of Title I - *Temporary Investment Incentives*				
1201	Special Allowance for Certain Property Acquired During 2009	N/A	N/A	N/A
1202	Temporary Increase in Limitations on Expensing of Certain Depreciable Business Assets	N/A	N/A	N/A
Part II of Subtitle C of Title I - *Small Business Provisions*				
1211	5-Year Carryback of Operating Losses of Small Businesses	N/A	N/A	N/A
1212	Decreased Required Estimated Tax Payments in 2009 for Certain Small Businesses	N/A	N/A	N/A
Part III of Subtitle C of Title I - *Incentives for New Jobs*				
1221	Incentives to Hire Unemployed Veterans and Disconnected Youth	N/A	N/A	N/A

Table 2 - American Recovery and Reinvestment Act of 2009 (ARRA) (Public Law 111-5)				
Act Section	**Provision**	**2010-11**	**2011-12**	**2012-13**
Part IV of Subtitle C of Title I - *Rules Relating to Debt Instruments*				
1231	Deferral and Ratable Inclusion of Income Arising from Business Indebtedness Discharged by the Reacquisition of a Debt Instrument	-$351,000,000	-$16,000,000	$10,000,000
1232	Modifications of Rules for Original Issue Discount on Certain High Yield Obligations	Baseline	Baseline	Baseline
Part V of Subtitle C of Title I - *Qualified Small Business Stock*				
1241	Special Rules Applicable to Qualified Small Business Stock for 2009 and 2010	No Impact Until Fiscal Year 2014/2015	No Impact Until Fiscal Year 2014/2015	No Impact Until Fiscal Year 2014/2015
Part VI of Subtitle C of Title I - *S Corporations*				
1251	Temporary Reduction in Recognition Period for Built-in Gains Tax	-$4,700,000	-$1,000,000	-$700,000
Part VII of Subtitle C of Title I - *Rules Relating to Ownership Changes*				
1261	Clarification of Regulations Related to Limitations on Certain Built-in Losses Following an Ownership Change	N/A	N/A	N/A
1262	Treatment of Certain Ownership Changes for Purposes of Limitations on Net Operating Loss Carryforwards and Certain Built-in Losses	-$400,000	-$1,100,000	-$3,400,000

Table 2 - American Recovery and Reinvestment Act of 2009 (ARRA) (Public Law 111-5)				
Act Section	**Provision**	**2010-11**	**2011-12**	**2012-13**
Subtitle D of Title I - *Manufacturing Recovery Provisions*				
1301	Temporary Expansion of Availability of Industrial Development Bonds to Facilities Manufacturing Intangible Property	N/A	N/A	N/A
1302	Credit for Investment in Advanced Energy Facilities	N/A	N/A	N/A
Subtitle E of Title I - *Economic Recovery Tools*				
1401	Recovery Zone Bonds	N/A	N/A	N/A
1402	Tribal Economic Development Bonds	N/A	N/A	N/A
1403	Increase in New Markets Tax Credit	N/A	N/A	N/A
1404 & 1602	Coordination of Low-income Housing Credit and Low-income Housing Grants & Grants to States for Low-income Housing Projects in Lieu of Low-income Housing Credit Allocations for 2009	N/A	N/A	N/A
Part I of Subtitle F of Title I - *Improved Marketability for Tax-Exempt Bonds*				
1501 & 1502	De Minimis Safe Harbor Exception for Tax-Exempt Interest Expense of Financial Institutions & Modification of Small Issuer Exception to Tax-Exempt Interest Expense Allocation Rules for Financial Institutions	N/A	N/A	N/A
1503	Temporary Modification of Alternative Minimum Tax Limitations on Tax-Exempt Bonds	N/A	N/A	N/A
1504	Modification to High Speed Intercity Rail Facility Bonds	N/A	N/A	N/A

Table 2 - American Recovery and Reinvestment Act of 2009 (ARRA)
(Public Law 111-5)

Act Section	Provision	2010-11	2011-12	2012-13
Part II of Subtitle F of Title I - *Delay in Application of Withholding on Government Contractors*				
1511	Delay in Application of Withholding Tax on Government Contractors	N/A	$28,000,000	$300,000
Part III of Subtitle F of Title I - *Tax Credit Bonds for Schools*				
1521	Qualified School Construction Bonds	N/A	N/A	N/A
1522	Extension and Expansion of Qualified Zone Academy Bonds	N/A	N/A	N/A
Part IV of Subtitle F of Title I - *Build America Bonds*				
1531	Build America Bonds	N/A	N/A	N/A
Part V of Subtitle F of Title I - *Regulated Investment Companies Allowed to Pass-Thru Tax Credit Bond Credits*				
1541	Regulated Investment Companies Allowed to Pass-thru Tax Credit Bond Credits	N/A	N/A	N/A
Subtitle G of Title I - *Other Provisions*				
1601	Application of Certain Labor Standards to Projects Financed with Certain Tax-Favored Bonds	Defer to the EDD	Defer to the EDD	Defer to the EDD
1602	Grants to States for Low-Income Housing Projects in Lieu of Low-Income Housing Credits for 2009	N/A	N/A	N/A
1603	Grants for Specified Property in Lieu of Tax Credits	N/A	N/A	N/A

Table 2 - American Recovery and Reinvestment Act of 2009 (ARRA) (Public Law 111-5)				
Act Section	**Provision**	**2010-11**	**2011-12**	**2012-13**
Part VI of Subtitle I of Title I - *Health Coverage Improvement*				
1899A-1899L	Health Coverage Improvements	N/A	N/A	N/A
Subtitle A of Title II – *Unemployment Insurance*				
2001	Extension of Emergency Unemployment Compensation Program	Defer to the EDD	Defer to the EDD	Defer to the EDD
2002	Increase in Unemployment Compensation Benefits	Defer to the EDD	Defer to the EDD	Defer to the EDD
2005	Full Federal Funding of Extended Unemployment Compensation for a Limited Period	Defer to the EDD	Defer to the EDD	Defer to the EDD
Subtitle C of Title II - *Economic Recovery Payments To Certain Individuals*				
2201	Economic Recovery Payment to Recipients of Social Security, Supplemental Security Income, Railroad Retirement Benefits, and Veterans Disability Compensation or Pension Benefits	N/A	N/A	N/A
2202	Special Credit for Certain Government Retirees	N/A	N/A	N/A
Title III – *Premium Assistance for COBRA Benefits*				
3001	Premium Assistance for COBRA Benefits	Baseline / Defer to the EDD	Baseline / Defer to the EDD	Baseline / Defer to the EDD

Table 3 – Consumer Assistance to Recycle and Save Act of 2009 (Cash for Clunkers) (Title XIII of Public Law 111-32)				
Act Section	**Provision**	**2010-11**	**2011-12**	**2012-13**
1301	Consumer Assistance to Recycle and Save Program	-$150,000	-$150,000	-$150,000

Table 4 - Worker, Homeowner, and Business Assistance Act of 2009 (WHBAA) (Public Law 111-92)				
Act Section	**Provision**	**2010-11**	**2011-12**	**2012-13**
2 – 6	Emergency Unemployment Compensation	Defer to the EDD	Defer to the EDD	Defer to the EDD
8	Treatment of Additional Regular Compensation	Defer to the EDD	Defer to the EDD	Defer to the EDD
10	0.2 Percent Federal Unemployment Tax Act (FUTA) Surtax	Defer to the EDD	Defer to the EDD	Defer to the EDD
11 & 12	Extension and Modification of First-Time Homebuyer Tax Credit & Provisions to Enhance the Administration of the First-Time Homebuyer Tax Credit	N/A	N/A	N/A
13	5-Year Carryback of Operating Losses	N/A	N/A	N/A
14	Exclusion from Gross Income of Qualified Military Base Realignment and Closure Fringe	-$900,000	-$12,000	-$6,000
15	Delay in Application of Worldwide Allocation of Interest	N/A	N/A	N/A
16	Increase in Penalty for Failure to File a Partnership or S Corporation Return *Note*: There would also be a revenue impact of $70,000 for fiscal year 2009-10.	$2,500,000	$2,700,000	$5,100,000
17	Certain Tax Returns Preparers Required to File Returns Electronically	$0	$0	$0
18	Time for Payment of Corporate Estimated Taxes	N/A	N/A	N/A

Table 5 - Military Spouses Residency Relief Act of 2009 (Public Law 111-97)				
Act Section	**Provision**	**2010-11**	**2011-12**	**2012-13**
3	Determination for Tax Purposes of Residence of Spouses of Military Personnel	Baseline	Baseline	Baseline

Table 6 – Department of Defense Appropriations, 2010 (Public Law 111-118)				
Act Section	**Provision**	**2010-11**	**2011-12**	**2012-13**
1009	Untitled (Relates to Emergency Unemployment Compensation)	Defer to the EDD	Defer to the EDD	Defer to the EDD
1010	Extension of Eligibility Period	Baseline / Defer to the EDD	Baseline / Defer to the EDD	Baseline / Defer to the EDD

Table 7 – Addendum Fostering Connections to Success and Increasing Adoptions Act of 2008 (Public Law 110-351)				
Act Section	**Provision**	**2010-11**	**2011-12**	**2012-13**
501	Uniform Definition of a Child	$4,900,000	$2,900,000	$2,700,000