

Commission on the 21ST Century Economy

Report
September 2009



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EXECUTIVE ORDER S-15-09

by the

Governor of the State of California

WHEREAS California is and should remain the best place in America to live, work and raise a family; and

WHEREAS California's long-term prosperity requires that employers and entrepreneurs invest, remain and grow in the state and that workers desire to live in the state; and

WHEREAS the quality of life for Californians benefits from essential and important services provided by state government directly and through funding for local government operated programs, and it is beneficial for those essential and important services to have a stable and predictable source of funding; and

WHEREAS General Fund revenue over the last several decades has fluctuated dramatically due to changes in the economy in general, but primarily as a result of the volatility that is inherent in California's current tax system; and

WHEREAS the volatility inherent in California's current tax system is reflected by fluctuations during the last decade, as exemplified by:

(a) a 28.1% increase in personal income tax revenue in Fiscal Year 1999/2000, followed by a 25.9% decrease in personal income tax revenue in Fiscal Year 2001/02;

(b) a 22.7% decrease in corporate income tax revenue in Fiscal Year 2001/02 and a 27.6% increase in corporate tax revenue in Fiscal Year 2002/03;

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(c) an 11.1% increase in sales and use tax revenue in Fiscal Year 1999/2000 and a currently estimated 1.4% decrease for Fiscal Year 2007/08; and

WHEREAS the volatility inherent in California's personal income tax is driven significantly by its reliance on capital gains tax revenues, which have experienced decreases in the last decade as great as 59.1% in tax year 2001, and an increase of 64.9% in tax year 2004; and

WHEREAS this fluctuation in General Fund revenues creates difficulty in funding the operations of government year-to-year, as the need for state services such as operating state parks, operating state prisons, overseeing elections and providing funding for healthcare and social services do not change in response to revenue, but in relation to population, demographics and service availability; and

WHEREAS this fluctuation in General Fund revenues makes it even more difficult to plan for those activities of government which, due to their magnitude, require funding over several decades, including projects for environmental remediation and infrastructure development; and

WHEREAS the California economy has changed significantly since our tax code was designed for the economy of the last century, shifting from a primarily manufacturing- and agriculturally-based economy to an information- and innovation-based economy; and

WHEREAS, California's current tax system could be improved to provide greater incentives for firms to increase employment in the state and invest more in entrepreneurial activities and research that lead to high paying jobs and more exports; and

WHEREAS an improved tax system would decrease the pressure for future tax increases to address revenue shortfalls that will continue to occur if the volatility of the current system is not reduced; and

WHEREAS Californians would benefit from an improved tax system that supports a strong economy and job climate and provides a more predictable revenue source for essential and important government services; and

WHEREAS elected officials could benefit from a study of tax system alternatives and information to develop strategies to improve the state's tax system; and

WHEREAS I established the Commission on the 21st Century Economy (Commission), and the Commission has made excellent progress in its review of the existing tax

structure and has identified reforms to make California's tax structure more aligned with the modern California economy; and

WHEREAS the complexity and far-reaching nature of tax reform necessitates time for thoughtful deliberation, careful analysis and public comment; and

WHEREAS, in consultation with the Legislative leaders, I will call a special session in September 2009 to consider the recommendations made by the Commission to improve California's state tax system.

NOW, THEREFORE, I, ARNOLD SCHWARZENEGGER, Governor of the State of California, by virtue of the power and authority vested in me by the Constitution and statutes of the State of California, do hereby issue this Order to supersede Executive Orders S-12-08, S-01-09 and S-03-09 and become effective immediately:

1. The Commission on the 21st Century Economy (Commission) is hereby established. It shall consist of fourteen members, seven of whom shall be appointed by the Governor, three of whom shall be appointed by the Speaker of the Assembly, three of whom shall be appointed by the Senate President pro Tem, and one of whom shall be appointed jointly by the Speaker of the Assembly and the Senate President pro Tem. The Governor shall designate one of the members as chairperson. The members of the Commission shall serve without compensation and at the pleasure of the official who appointed them.
2. On or before September 20, 2009, the Commission shall deliver a report to the Governor and to the Legislature with recommendations to change laws to achieve the following goals:
 - a. Establish 21st century tax structure that fits with state's 21st century economy;
 - b. Stabilize state revenues and reduce volatility;
 - c. Promote the long-term economic prosperity of the state and its citizens;
 - d. Improve California's ability to successfully compete with other states and nations for jobs and investments;
 - e. Reflect principles of sound tax policy including simplicity, competitiveness, efficiency, predictability, stability and ease of compliance and administration;
 - f. Ensure that tax structure is fair and equitable.

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3. The Commission shall be disbanded 30 days after delivery of their report unless the Commission’s service is extended by further Executive Order.

4. The Commission shall comply with applicable open meeting laws.

IT IS FURTHER ORDERED that State Agencies shall cooperate and provide support to the Commission in the implementation of this Order. Other entities of State government not under my direct executive authority, including constitutional officers, legislative branch, judicial branch, and local agencies, are requested to cooperate and provide support to the Commission.

This Order is not intended to create, and does not create, any rights or benefits, whether substantive or procedural, or enforceable at law or in equity, against the State of California or its agencies, departments, entities, officers, employees, or any other person.

I FURTHER ORDER that, as soon as hereafter possible, this Order be filed in the Office of the Secretary of State and that widespread publicity and notice be given to this Order.

IN WITNESS WHEREOF I have hereunto set my hand and caused the Great Seal of the State of California to be affixed this 29th day of July 2009.

ARNOLD SCHWARZENEGGER

/s/ Arnold Schwarzenegger

Governor of California

ATTEST:

DEBRA BOWEN

Secretary of State

COMMISSION MEMBERS

Governor's Appointments

Gerald Parsky, Chairman, Aurora Capital Group

Ruben Barrales, President and Chief Executive Officer, San Diego Regional Chamber of Commerce

Michael Boskin, Senior Fellow, Hoover Institution and T.M. Friedman Professor of Economics, Stanford University

John Cogan, Senior Fellow, Hoover Institution and Professor of Public Policy, Stanford University

William Hauck, President and Chief Executive, California Business Roundtable

Rebecca Morgan, President, Morgan Family Foundation

Curt Pringle, Mayor, City of Anaheim

Legislature's Appointments

Edward De La Rosa, Founder and President, De La Rosa & Company

Christopher Edley, Jr., Dean and Professor of Law, Boalt Hall School of Law, University of California, Berkeley

George Halvorson, Chairman and Chief Executive Officer, Kaiser Foundation Health Plan and Kaiser Foundation Hospitals

Jennifer Ito, Director of Research, Strategic Concepts in Organizing and Policy Education (SCOPE)

Fred Keeley, Treasurer of Santa Cruz County, Professor of Political Science, California State University, San Jose

Monica Lozano, Publisher and Chief Executive Officer, La Opinión

Richard Pomp, Alva P. Loiselle Professor of Law, University of Connecticut



Commission on the 21ST Century Economy

Members:

Gerald Parsky, Chair
Ruben Barrales
Michael Boskin
John Cogan
Edward De La Rosa
Christopher Edley, Jr.
George Halvorson

Bill Hauck
Jennifer Ito
Fred Keeley
Monica Lozano
Becky Morgan
Richard Pomp
Curt Pringle

Message from the Chairman

Over the past year, the state has experienced its worst economic recession since the tax system was first created in the 1930s. State tax revenues dropped precipitously, resulting in months of political struggle. Critical, publicly provided goods and services have been curtailed, and many Californians personally have experienced the negative effects of the state's budget predicament.

In this context, legislative leaders and the Governor formed the Commission on the 21st Century Economy to recommend reforms of the state's tax system. The Commission's goals were to suggest changes that would lead to more reliable and stable state revenues, encourage growth and job creation, and improve the state's ability to compete in the new economy. In crafting our recommendations, we have been mindful of how the economy has changed since the tax system was established. We have proposed reforms that fit within the context of these economic shifts and are aimed at establishing a system that is fair and equitable.

Although the Commission was asked to step back from the current crisis and consider improving the tax system over the long-term, the backdrop of the economic recession and continuing budgetary stress provided urgency to our endeavor. Clearly the state's tax system could benefit from more than just fine tuning.

Our recommendations would greatly lessen the volatility of California's revenue system. Much of this would result from decreasing our reliance on the personal and corporate income taxes, which are generally more sensitive to fluctuations in the economy than other taxes. Together with the proposed Rainy Day Reserve Fund, the package would significantly improve stability in state finances.

Our recommendations include significant restructuring of the personal income tax, as well as elimination of the corporation tax and removal of the state portion of the sales tax. In

order to institute these desirable reforms, our recommendations include a new tax called the Business Net Receipts Tax. This proposal would broaden the California tax base by levying a tax on all business activity. It is important to all Commissioners that the rate of this new tax be kept as low as possible and not exceed 4 percent.

Policy change of this magnitude must allow for a period of implementation and adjustment. The package includes an approach for implementing the transition to a reformed system over a five-year period, starting in 2012. It is important that the transition meet the requirements of revenue neutrality, fairness, and ease of administration. With boldness, there is unavoidable uncertainty, which we believe can be reduced to acceptable levels in an appropriately designed transition.

Tax policy requires making difficult choices and, naturally, Commissioners are of somewhat different views on elements of the recommendations. Various Commissioners remain concerned about individual aspects of the proposal. We urge the Legislature to undertake additional, detailed analyses of revenue forecasts, the incidence of various forms of taxes, and the impact of any changes on the distribution of tax burdens on Californians.

A majority of the Commissioners have come together in the spirit of compromise to move this report forward. These Commissioners believe that the recommendations include serious ideas that should be examined rigorously by the Legislature and the public.

On behalf of my fellow commissioners, we have tried to be of service to the people of our great state, and thank you for that opportunity.

Sincerely,

/s/ Gerald L. Parsky

Gerald L. Parsky
Chairman
Commission on the 21st Century Economy

SECTION ONE: OVERVIEW

The Commission on the 21st Century Economy (Commission) was created in the fall of 2008 during a period of fiscal crisis for the state. Beginning in January 2009, the bipartisan body of 14 people appointed by state leaders held public meetings over nine months to study and evaluate California's tax system.

The Commission's purpose, as set by Executive Order S-15-09, was to step back from the current fiscal situation and evaluate the state's tax structure. The Commission was asked to recommend ways to update the tax system in a manner that would improve the stability of the revenue stream, enhance California's ability to better compete economically, and adequately fund publicly provided goods and services.

While the Commission's goal was to look at the state revenue structure over the long term, California's immediate and ongoing fiscal crisis loomed, caused by some of the very issues the Commission considered. Tax revenues continued to plummet and state leaders struggled to close sudden budget gaps. One result was that Californians, already struggling with the effects of the national economic recession that hit the state hard, saw their taxes increase. Another result was that many services, such as state-provided health services, were cut. Parks were slated to be closed. Prisons looked to eliminate costs by the early release of inmates.

The state's worsening fiscal crisis added a sense of urgency to the Commission. The crisis contributed to a feeling among Commissioners that something must be done to end California's frequent and increasingly damaging periods of fiscal crisis, as well as improve the state's economic competitiveness. To that end, the Governor called for a special session of the state Legislature to address the recommendations from the Commission.

SECTION ONE: OVERVIEW

It is important for a healthy society to have an effective government funded at adequate levels from stable revenue sources. The state should have a reliable tax system that raises the revenues it needs to provide services and programs, to build highways and bridges, to educate students, and to assist the neediest. These taxes should raise the level of revenue the government can spend efficiently and effectively. In addition, the tax system should be designed to minimize deleterious impacts on economic decisions and be structured and administered fairly.

A tax system connects nearly all members of society in a variety of their roles: employee and employer; homeowner and renter; business owners, entrepreneurs, and consumers. All contribute to and use the goods and services provided by the state. It was with this understanding of the tax system that the Commission sought to make changes that would improve the system's competitiveness and stability for the benefit of all state residents.

The Commission's Focus

The Commission focused on California's three main taxes—the personal income tax (PIT), the sales and use tax (SUT), and the corporation tax (CT)—that constitute approximately 90 percent of the state's General Fund and have the greatest impact on the welfare of the state's residents. The Commission also examined the local Property Tax (PT), some other potential revenue sources such as a carbon tax and royalties on oil drilling, and certain budget management issues, such as the state's budget reserves. It also considered new forms of revenue.

California's tax system, in the more than 70 years since it was established, has generally provided revenue drawn from a broad base of income, wealth, and consumption. The system has grown with the economy over the long run. In recent years, however, the tax system's performance has been both increasingly volatile and less diverse in terms of its sources. These newer developments are largely related to how the state's economy has changed and its interaction with the state's tax system, especially its evolution towards high marginal rates on narrow bases. Economic shifts have not been matched with associated changes in the tax system and, as a result, the state is in an increasingly precarious fiscal position, both in the short and long run.

Economic Shifts

Since the tax system was first established in the 1930s, technology and services industries have become dominant in the state, while agricultural and manufacturing

sectors have waned in relative importance. Most significantly, how people earn and spend money has shifted as well, changes that reverberate through the tax system.

Income now stems from a variety of sources and is significantly more variable than it was in the past. In addition to salaries, there has been a dramatic expansion of variable and intermittent income such as bonuses, capital gains realizations, and the exercise of stock options. For example, in 2006 capital gains realizations alone, as a percent of personal income, was 12 percent, compared to just 4 percent in the early 1990s.

Consumers also spend their money differently than they did in the past: more on services, which are typically not taxed in the state, and less on taxable goods, which are taxed. Remote sales have become an important outlet for both consumers and businesses. As a consequence, the ratio of taxable sales to income is currently about 35 percent, compared to 55 percent in 1980.

Macro-economic forces are also at work. Technology and globalization allow easier movement of goods, services, labor, and capital across state and national borders than ever before in history. Given this mobility, California's many advantages—its work force, industry clusters, diversity, and weather—do not provide the state with the same edge in terms of attracting business and investment as they once did. Hence, the state must pay greater attention to the effects of public policy—including the effects of the tax system—on jobs and economic growth.

Deficiencies Of The Tax System

Lags Economic Changes

While California's economy has changed dramatically, the basic structure of its tax system has remained mostly the same, relying on three chief taxes for state funding. In some years, the state has seen its coffers overflow, but in periods of economic downturns, the state has struggled to raise sufficient revenues. Tax rates have been increased on steadily narrowing tax bases. That has led to significant shifts to the sources of revenue that do not necessarily reflect the overall economy of the state, and to higher marginal tax rates that impair the state's competitiveness and economic growth.

First, the state has switched from relying primarily on the revenue from the SUT to that of the PIT. For the fiscal year 2009-10, the PIT will provide about 54 percent of the state's General Fund revenue, up from 11 percent in the 1950-51. The SUT, which used to be the state's biggest General Fund revenue source, at nearly 60 percent in 1950-51, will supply about 31 percent in 2007-08.

SECTION ONE: OVERVIEW

Second, as income concentration has shifted, high income earners now pay a larger share of the PIT than they did in the past. In 2006, the top 1 percent of income earners paid 48 percent of the PIT, compared to 33 percent in 1993. The state's growing reliance on the PIT has occurred as the composition of personal income has shifted from being primarily wages to include more variable forms of pay such as capital gains realizations, bonuses, and stock options.

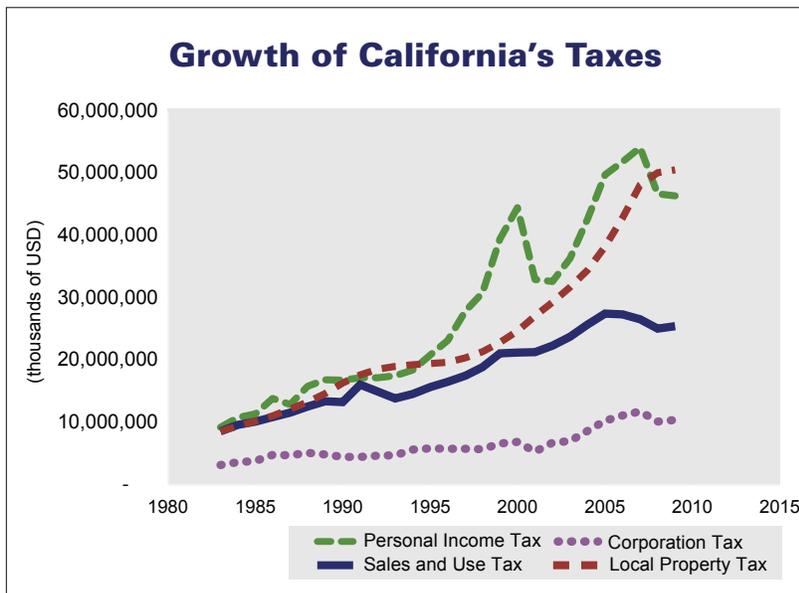
Generates Volatile Revenues

Economic changes and the lack of adjustments in the tax system have contributed to the increased volatility of the state's revenue system. Revenue from the PIT has grown more than the other taxes, as shown in Figure 1.1, but has done so while relying on a narrow band of taxpayers who have the most volatile sources of income.

As a result of this development, in the past ten years California has experienced periods of strong revenue growth followed by nearly symmetrical declines, a phenomenon outlined in the Governor's Executive Order:

- A 28.1 percent increase in PIT revenue in 1999-00, followed by a 25.9 percent decrease in PIT revenue in 2001-02.
- A 59.1 percent decrease in capital gains tax revenue experienced in tax year 2001 and a surge of 64.9 percent in tax year 2004.
- A 22.7 percent decrease in corporate income tax revenue in 2001-02 and a 27.6 percent increase in CT revenue in 2002-03.

Figure 1.1



Tax revenue volatility has become more volatile than the underlying economy. However, most of the operations of government are designed to reflect changes in population and demographics rather than fluctuating revenues. In fact, some programs are designed to be countercyclical, and experience increased spending demands during periods of revenue decline. Historically, it

has been difficult for the state to adjust spending to revenues; spending has surged with revenues on the upside of a business cycle and has been difficult and painful to adjust on the downside.

Discourages Growth and Investment

While all tax systems affect economic decisions to some degree, California's system, which has very high marginal rates, intrudes more than most. In key respects, California's taxes are out of step with the goal of economic growth and efficiency and are an impediment to the state's ability to compete with other states for jobs and investment.

High marginal tax rates have a disproportionate impact on decisions people make. When a tax is imposed on an activity or good, it changes or distorts the activity. Taxes on investments may have an effect on whether, and in what, people invest. Similarly, a sales tax changes how people shop. While weighing other important considerations, society should want its tax system to intrude as little as possible on people's choices so that the economy can flourish.

Among those states with a broad-based PIT, California stands out for its top marginal rate, which is the rate of tax paid on an additional dollar of income. At 9.55 percent, up from 9.30 percent after a tax increase in April 2009, the state's top marginal tax rate is the highest in the country. Taxpayers also pay an additional 1 percent on income in excess of \$1 million, putting their PIT rate at 10.55 percent. California's SUT rate is the highest in the nation, and its CT rate is among the highest nationally.

Results in an Uncompetitive Structure

California does not operate in a vacuum. It competes with other states and nations in providing an environment where the economy can thrive, businesses can grow, and employees can prosper. States help provide this environment by offering the proper level and structure of taxes and spending. While the level of taxes to finance spending matters, the manner in which the revenues are raised is also important.

As noted above, one of the tax system's noteworthy characteristics is that, except for the PT, the state's top marginal rates for all of its major taxes are high, and substantially higher than other large states and surrounding western states with which California competes. High rates can lessen the state's attractiveness among businesses considering relocating or expanding in California.

In addition, California's tax system levies taxes unevenly. Certain businesses selling services are not subject to SUT while other businesses selling goods are subject to the

tax. In other cases, some activities may be subject to multiple levels of taxation. For example, unlike in many states, businesses in California pay SUT on equipment purchases that are then used to make final taxable products, resulting in potential double taxation. Such equipment is also subject to local PT.

These interlocking problems with California's tax structure should be fixed for the state to maximize its economic potential.

A 21st Century Tax System

As the state looks to the future, the problems with its tax system threaten to become worse, not better, unless steps are taken. Improvements to the tax system, if made, can be an important factor in how quickly and strongly the state rebounds and grows.

The tax system should be designed to:

- **Improve Revenue Stability.** The state needs a tax system that is dependable and stable. The clearest path is to reduce reliance on its most volatile revenue source, the PIT, and its excessive dependence on a small pool of taxpayers with volatile income.
- **Tighten Link Between Taxes and Spending.** More people should pay taxes. This includes service providers, who currently do not pay sales tax, as well as those who may not pay PIT. This also includes remote sellers who benefit from the California marketplace but do not pay state sales tax. By bringing more people into the tax system, all residents and businesses will be invested in California's future.
- **Enhance Competitiveness and Growth.** The state needs a tax system that puts the state's economy in the best position possible to compete with other states and nations for jobs and investment.

As it addressed the system's problems, the Commission also looked at the issue of the tax system's fairness. A fair system takes into account the taxpayers' ability to pay, as well as the value of public goods and services the taxpayer receives. The Commission sought changes that would continue California's tradition of maintaining progressive elements in its overall taxing and spending system. Indeed, increasing the stability of the tax system would help people at the lowest end of the income spectrum, because a more stable system would work to fiscally 'safeguard' programs and services on which many rely on during economic downturns.

California has long been a place where people seek a brighter future. The changes the Commission recommends will be a step towards renewing that promise, creating a tax structure that more reliably supports the services that allow society to function. With these reforms, the Golden State, which previously outperformed the nation economically, will be better able to grow and compete in the 21st Century.

A Period of Fiscal Crisis

The genesis for the Commission on the 21st Century Economy came out of the budget impasse of 2008, which turned out to be prologue to one of the worst budget years on record.

In January 2008, Governor Arnold Schwarzenegger declared a fiscal state of emergency, as the state faced a \$14.5 billion deficit through June 2009. In the following nine months, state leaders twice closed growing budget gaps through borrowing, spending cuts, and delayed payments.

In the fall of 2008, the U.S. housing mortgage market unraveled with California particularly affected. Financial credit markets seized. A nationwide economic downturn hit the state hard.

Looking ahead to darkening revenue forecasts, the Governor and legislative leaders in October 2008 called for the creation of a group to step back from the crisis and address structural problems within the tax system that contribute to sharp budget shortfalls. As they began to put together the Commission in

December, the Governor declared a second fiscal emergency.

During the Commission's lifespan, the state's crisis worsened. In February 2009, state leaders, facing more than a \$40 billion budget shortfall over the combined 2008-09 and 2009-10 budget years, hammered out a deal that included spending cuts and temporary tax increases.

As part of that compromise, voters needed to approve \$6 billion worth of adjustments in a May special election. The measures failed and the economy continued to falter. Another budget gap opened; this time, a \$24 billion shortfall for 2009-10, as leaders could not agree on how to close it. By early July, the Governor declared a third fiscal emergency and the state began to preserve cash by issuing IOUs to vendors.

The state resolved the crisis by the end of July, with amendments to the 2009-10 budget that cut spending in nearly every state program that receives General Fund support. In all, the cumulative \$60 billion gap was the largest the state had ever experienced.

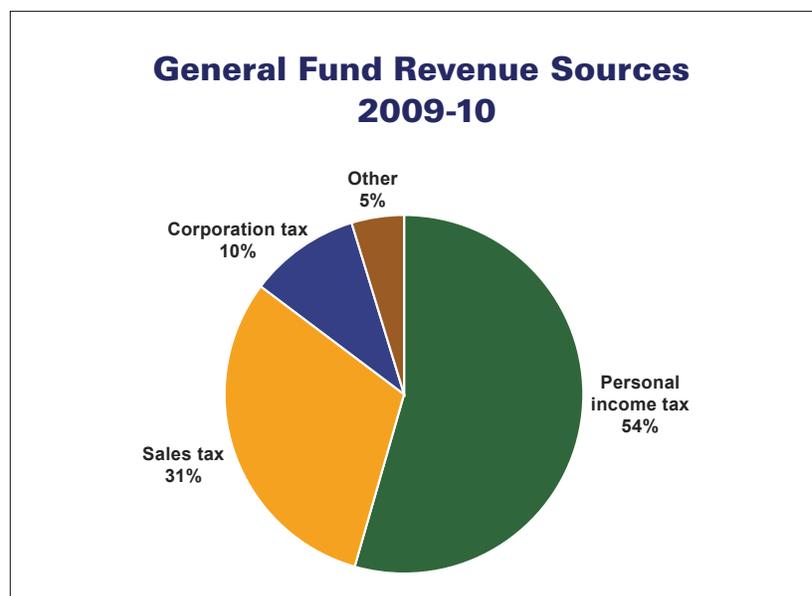
SECTION TWO: CALIFORNIA'S TAX SYSTEM

California's tax system was established in an era much different from today.

In the 1920s and 1930s, when the tax system's foundation was being set in place, manufacturing and agriculture dominated the state and residents mostly bought and sold tangible goods. Over the past 70 years, the forces of globalization and technological progress have transformed California into a state of not one but many economies. Californians are, on average, richer than other Americans due in part to technology firms originating in the state. Among the growing sectors, there are several service industries—business services, health care services, educational, and legal services. That transformation continues today, altering the kinds of goods created and consumed, the businesses built, and the workers needed. These changes in the economy directly affect the state's tax system and its ability to generate stable revenues that grow apace with the economy.

This section outlines the three principal state taxes in California—personal income tax (PIT), sales and use tax (SUT), and corporation tax (CT). These taxes together comprise about 95 percent of the General Fund's resources each year, as Figure 2.1 shows. We also

Figure 2.1



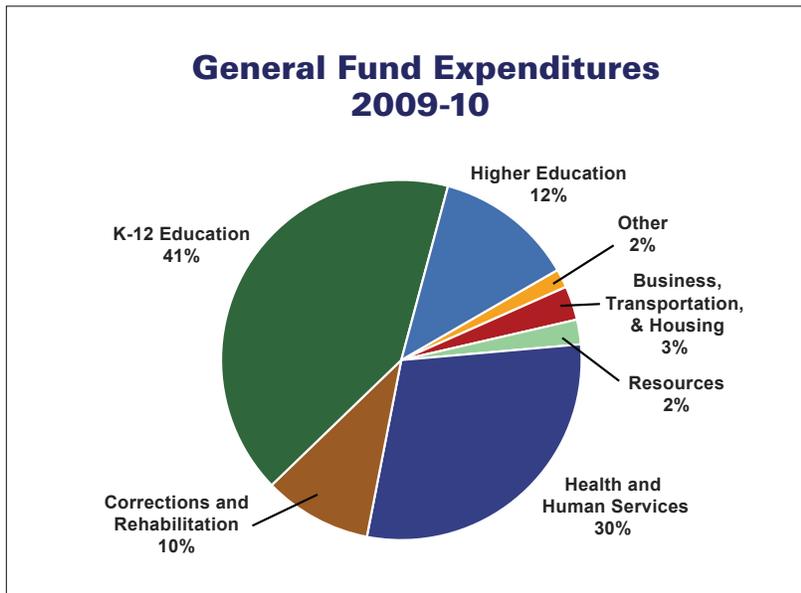
SECTION TWO: CALIFORNIA'S TAX SYSTEM

discuss the local property tax, the revenues from which are used for K-12 education, and other local purposes.

Tax revenues fund programs and services used by people around the state and in their communities. The General Fund supplies the money necessary for essential services and programs, as shown in Figure 2.2. The three biggest costs are K-12 education at 41.0 percent, health and human services at 30.0 percent and higher education at 12.0 percent. In fiscal year 2006, state and local spending was \$10,070 per capita, putting California fourth in the nation in spending after Alaska, New York, and Wyoming.

Although our focus is on the health of the state's General Fund, we note that state and local fiscal relationships in California are intertwined with varying types of funding and program responsibilities. In order for local governments to fund their operations, they

Figure 2.2



rely on local property taxes, local portions of the SUT, as well as various charges and fees for direct provision of services. In addition, some revenues collected by the state are directed to local governments, such as the vehicle license fee (VLF) and a portion of the statewide SUT. Some uses of these funds are restricted, such as the 1/2 cent sales tax rate dedicated to local public safety, while other local revenue transfers like the VLF are unrestricted.

Principal Taxes

The key elements of California's current state tax system were established in the late 1920s and early 1930s largely as a response to the fiscal crisis that accompanied the Depression.

The state adopted three taxes that have remained as the foundation of the state's tax system ever since: the PIT, the SUT, and the CT.

Since its establishment, the basic structure of the state's tax system has remained largely intact, but the role each tax plays has not. Economic shifts have had an impact on tax bases and rates resulting in changes over the decades in the portion of state revenue each tax collects. The most significant impact of this change on the tax system is a heavier reliance on revenue from the PIT. In large part, this reliance on the PIT has offset the relative decline in revenue from the SUT.

The Property Tax (PT) was established in 1849, and has experienced significant structural changes, largely stemming from the passage of the state ballot initiative Proposition 13 in 1978. The PT is a local tax in both administration and use of revenues, and is governed by Constitutional provisions. All revenues are used within the county boundaries of the assessment site.

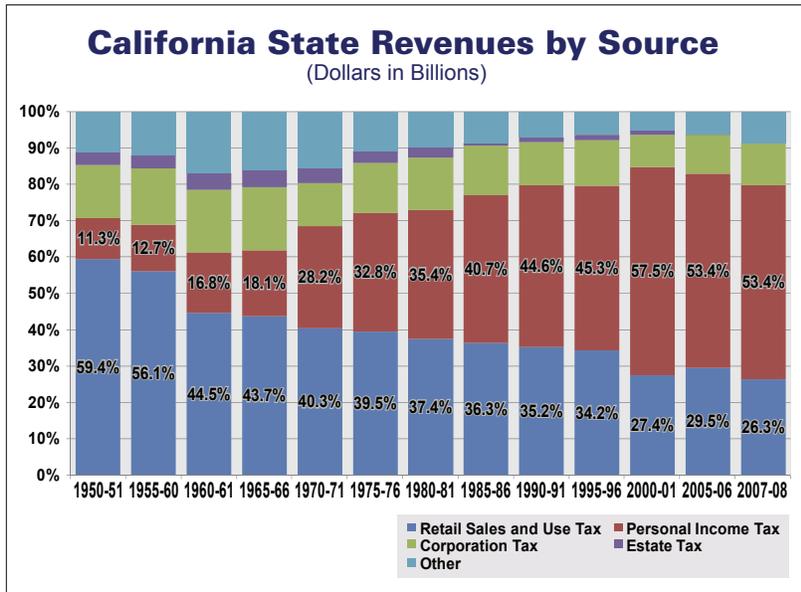
The Commission examined the PT because it has implications for state budgeting and is an integral component of educational and local government funding. Although the local PT is not a General Fund source, it is important in magnitude in its role in funding state mandated public education. Proposition 98, which passed in 1988, guarantees a minimum level of funding for education, generally about 40 percent of the state General Fund revenue. Thus, changes in PT revenues affect the General Fund.

States constantly assess where they stand with respect to other states in tax collections. California's top tax rates are among the highest—and for some taxes, the very highest—among all the states. Relative to personal income, California is somewhat above the median in its residents' tax burden, and clustered with many other states around the national average. Other measures—such as revenues per employee or per household—would place California among the highest tax burden states. These features, which can have an impact on the revenue stream and the state's economic performance, are discussed further below.

Personal Income Tax

Established in 1935, the PIT is currently the state's largest revenue source, providing the bulk of the revenue for state services and operations. In the fiscal year 2009-10, the tax will bring state coffers \$48.8 billion, representing about 54 percent of the General Fund portion of the budget. The PIT is levied on income earned by residents as well as California-sourced income earned by non-residents. It not only applies to individuals but also to certain corporations, sole proprietorships, partnerships, estates, and trusts. Over 15 million returns were filed in 2007, the most recent year for which data are available.

Figure 2.3



The state's reliance on the PIT has increased over time, averaging in recent years about 50 percent of the state's General Fund. This represents a significant increase from 11 percent in 1950-51 as shown in Figure 2.3. The PIT is one of the state's fastest growing sources of revenue, with an average annual rate of growth over the last decade of 4.2 percent. The tax is administered by the Franchise Tax Board (FTB), one of the state's three tax agencies.

Basic Tax Structure

The PIT is levied on a base of taxable income, including the following:

- Wages
- Salaries
- Interest, dividends
- Business-related income
- Capital gains realizations

The PIT is complex in design, with five different filing statuses, six tax brackets with permanent rates ranging from 1 percent to 9.3 percent, and an additional 1 percent levied on incomes of greater than \$1 million. (In April 2009, California temporarily raised its top rate 0.25 of a percentage point across the board, beginning with the current tax year and expiring after tax year 2010. As a consequence, the highest rate, levied on taxable income of more than \$1 million, rose to 10.55 percent from 10.3 percent.) The PIT also comes with numerous ways to reduce liabilities by means of a multitude of tax credits and itemized deductions. These provisions result in varying filing thresholds depending upon the filing status of the taxpayer. The PIT generally conforms to the federal income tax.

California's PIT is progressive. It has a relatively high income threshold for when a filer begins to pay. In tax year 2008, as shown in Figure 2.4, a household with two dependents

began paying PIT once its income exceeded approximately \$48,335; for individual filers with no dependents, the corresponding amount was \$12,243.

In addition, the average PIT tax rate rises with income. In tax year 2007, the most recent year for which data are available, the average rate of tax was 4.7 percent of adjusted gross income (AGI), defined as a taxpayer's gross income after adjustment

for specific deductions, such as contributions to retirement accounts. Figure 2.5 shows the tax rate schedule for married couples and domestic partners filing joint returns in 2008. The rates shown are applied to AGI after the application of the standard deduction or itemized deductions. The progressive schedule plateaus at a relatively low threshold with all income above that amount subject to a 9.3 percent tax rate. For example, for married couples and domestic partners filing joint returns, the 9.3 percent rate applies to taxable income of about \$94,000 and above. The federal marginal tax rate, in comparison, continues to increase above this level. Thus, taxpayers with taxable incomes above this point are all subject to the same marginal tax rate, until the additional 1 percent is applied to income in excess of \$1 million.

This structure results in higher income earners generally paying a proportionally larger share of their income in taxes than those with lower incomes. Put another

Figure 2.4

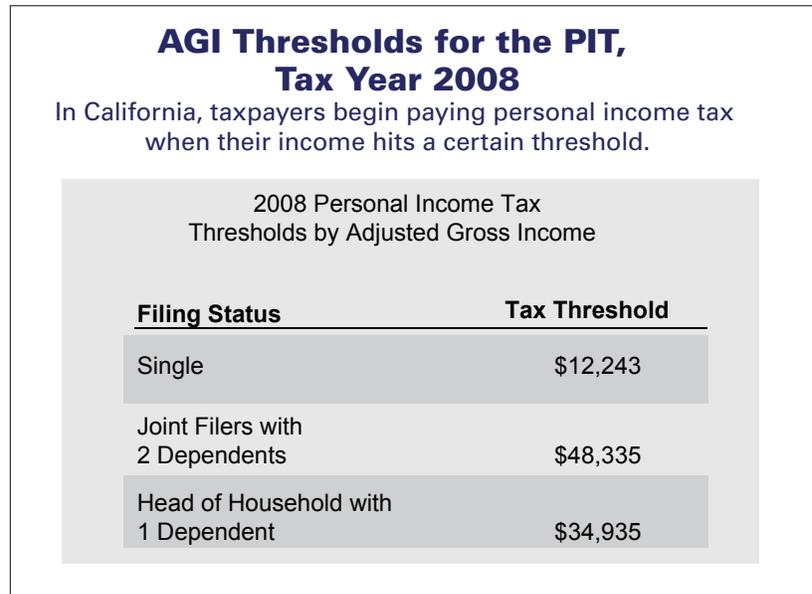
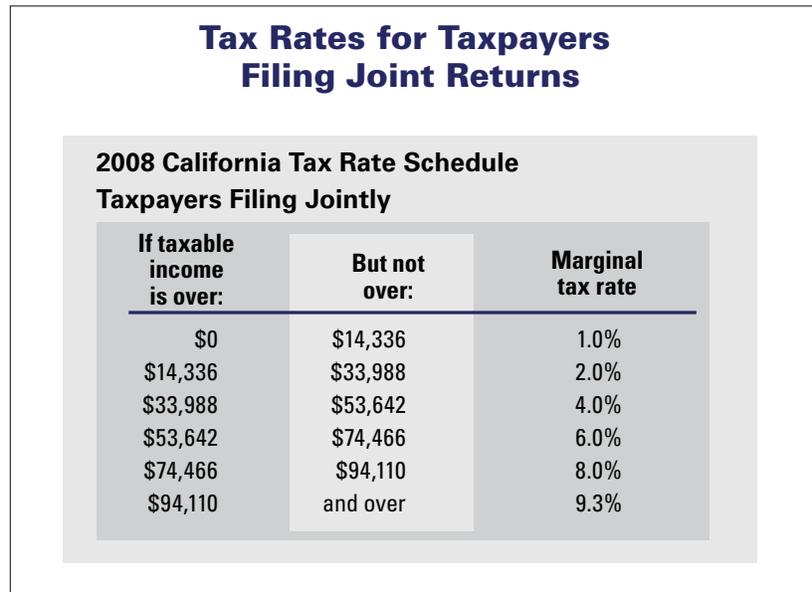


Figure 2.5



SECTION TWO: CALIFORNIA'S TAX SYSTEM

way, as taxpayers' incomes rise, the effective tax rate increases. In addition, because of the tax structure, many Californians do not pay PIT. In 2007 tax year, almost 6 million Californians, nearly 40 percent of the total filers, were below the filing threshold and paid no PIT. California has among the highest fraction of non-payers of income tax of any state.

Special Tax Provisions

Individuals and businesses often pay less PIT than the base tax rate would suggest because state law allows them to claim a wide variety of credits, deductions, exemptions, and exclusions. These provisions are commonly known as tax expenditures or special tax provisions, and represent programs the state pays for by forgoing revenue it otherwise would have collected. These special tax provisions have typically been enacted by the Legislature or initiative statute for one or more of the following reasons:

- Encourage certain economic behavior
- Achieve a desired distributional objective
- Conform to federal law or ease administration

For example, the state's many enterprise zone programs are an example of tax expenditures designed to influence economic behavior. The personal exemption credit and dependent exemption credit are examples of programs adopted to achieve distributional objectives. The state's allowance of deductions for contributions to qualified retirement programs such as individual retirement accounts (IRAs) are designed to both encourage saving and to conform to federal tax treatment. Tax expenditure programs can theoretically be replaced dollar for dollar by spending programs. In other words, money the state would have to spend for programs, it instead achieves through tax expenditures.

Tax expenditures are generally considered to be "exceptions" to the state's basic tax law, although there is no uniform agreement on the definition of the "basic" tax. There are about 85 tax expenditure programs that can be applied to the PIT. In 2008-09 the Home Mortgage Interest Deduction cost the State \$5.2 billion. In total, the PIT tax expenditures account for about 60 percent of PIT liabilities, meaning PIT revenue would swell by about 60 percent if there were no tax expenditures. The largest PIT tax expenditures and their revenue impacts are listed in Figure 2.6.

How the Tax Has Changed

The PIT's contribution to general state revenues has increased dramatically over time. In addition—and of equal importance—the sources of income subject to tax have undergone significant change. Although still dominated by wages and salaries, the make

up of the PIT includes other types of income that have become increasingly important. These sources include capital gains realizations, bonuses, stock option income, and other types of compensation. These income sources tend to be volatile. As shown in Figure 2.7, capital gains realizations as a percent of personal income have fluctuated greatly in the past fifteen years.

The second major change is the shift upwards in the share of the total tax paid by taxpayers in the higher income brackets. The increasing share of the PIT paid by taxpayers in the top 1-percent is depicted in Figure 2.8.

This shift in the PIT's tax burden to the upper income strata is due to changes in the tax base and top marginal rates. Nationwide, income has grown more rapidly at the upper end of the income spectrum, a situation that is also true in California. One stark result of this change has been that a

small number of top income earners supply a disproportionate share of the state's income from the PIT. These factors have important implications for tax policy.

Figure 2.6

**Largest Personal Income Tax Expenditures
2008-09 Revenue Loss**
(Dollars in Millions)

Provision	2008-09
Home mortgage interest deduction	5,200
Exclusion of employer pension contributions	3,900
Exclusion of employer contributions to health plans	3,700
Exclusion of Social Security benefits	2,100
Real estate deduction	1,660
Basis step-up on inherited property	1,600
Charitable contributions deduction	1,500
Exclusion of benefits provided under cafeteria plans	1,400
Exclusion of investment income on life insurance and annuity contracts	1,200
Exclusion of capital gains on sale of principal residence	1,000

Figure 2.7

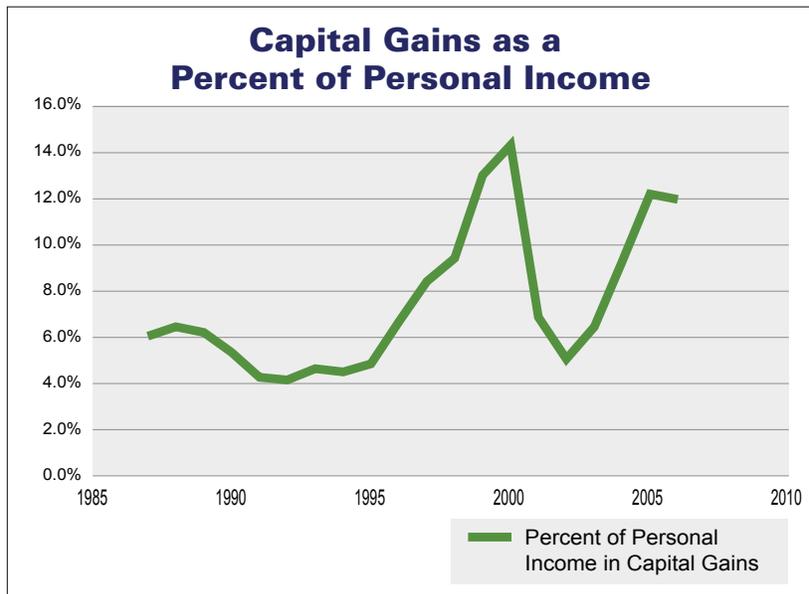
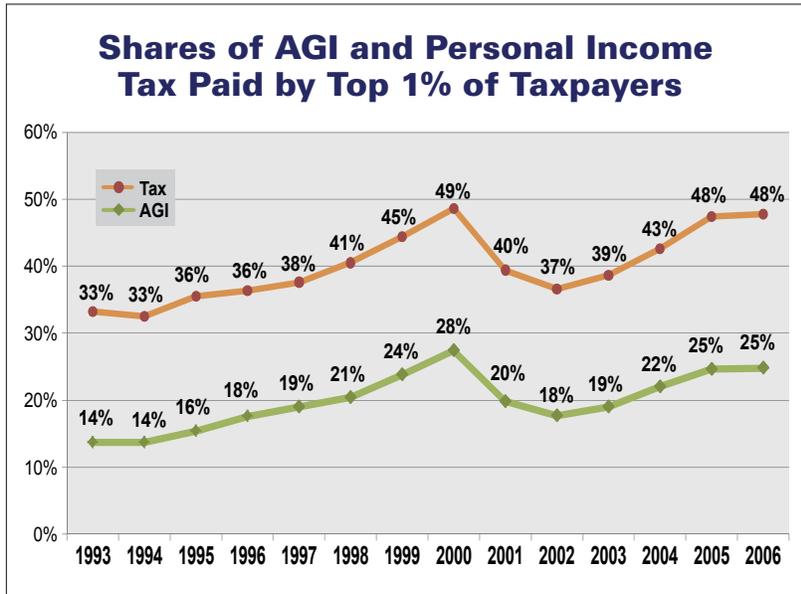


Figure 2.8



Issues and Concerns

California's PIT has significant strengths, but also some weaknesses. Due to its highly progressive nature, which taxes high-earners at a higher rate than lower or middle income taxpayers, revenues soar far beyond average income growth in good times and collapse in bad times. Over the long term, the PIT has grown with the economy, providing California a robust stream of income. On the other hand, California's PIT has key drawbacks:

- The PIT possesses the highest top marginal tax rates among all the states coupled with one of the lowest at the lower end of the income strata. The top marginal rate is often seen as an important influence on decisions about investment, work, and location.
- The PIT consists increasingly of proceeds from its most volatile sources, such as realizations from capital gains, variable pay, and one-time bonuses. California's reliance on these sources is enhanced because, for tax purposes, income from capital gains realizations is treated the same as all income.
- The PIT experiences significant swings in revenue as a result of the volatility of capital gains realizations, bonuses, and stock options. These gains are typically concentrated in the upper income levels and are subject to the highest marginal tax rate, exacerbating the revenue volatility.
- The PIT displays a vast gap between the state's income base and the actual amount of income subject to the tax. This gap is accounted for by the various exclusions, exemptions, deductions, and credits that have been enacted.

Sales and Use Tax

The second largest state tax in California is the SUT, which is administered by the Board of Equalization (BOE). Consumers directly pay about two-thirds of the SUT. Businesses

currently pay about one-third of the SUT when they are considered the final consumer, such as their purchases of supplies and equipment. In 2009-10, the SUT will generate \$27.6 billion in revenues representing 31.0 percent of the General Fund, down from 59 percent in 1950-51. Over time, this shift has been offset in relative terms by an increase in the PIT's contribution to the revenue portfolio.

Basic Tax Structure

The SUT is imposed on the sale of all tangible personal property, unless specifically exempted by state law. The tax has two components—the sales tax, established in 1933, which is applied to tangible goods sold in California, and the use tax, established in 1935, which is imposed on tangible goods purchased out of state but brought to California for use.

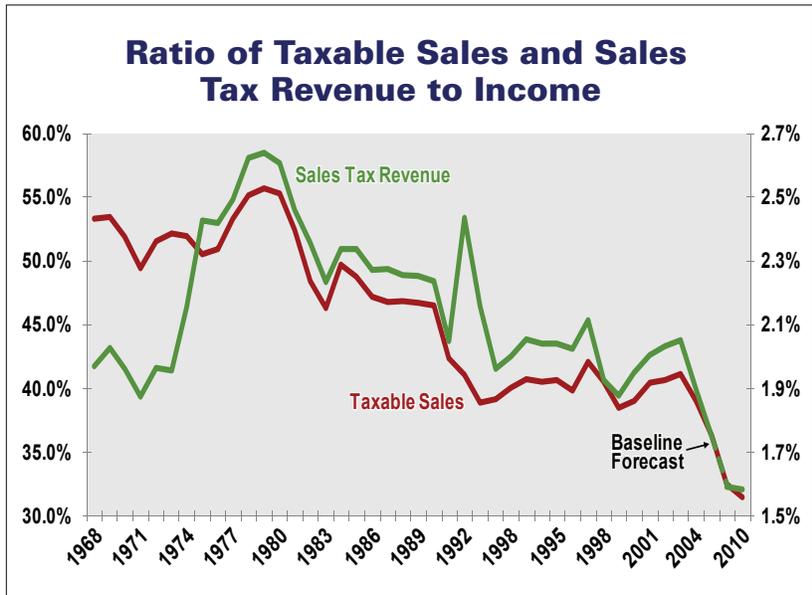
The sales tax portion of the SUT is collected and paid by businesses that are registered sellers with the state. The tax is assessed on sales to both individuals and businesses, although the tax is not applied to sales intended for resale. With the use tax, the purchaser—either a business or an individual—is required to pay. However, there are difficulties enforcing collection of the use tax unless the purchaser is also a business that is a registered seller or there exist registration requirements for the particular purchase, such as with vehicles and watercraft.

The state general revenue portion of the SUT is 6 percent, which includes a 1 percentage point temporary increase enacted in April 2009. This increase is scheduled to expire on June 30, 2011. Special fund and local revenue funds add an additional 2.25 percentage points bringing the basic statewide rate to 8.25 percent. In addition, cities, counties, and special districts are able to add up additional rates with voter approval. The average SUT rate for California is among the highest of any state in the nation.

Changes in the Tax Base

While the growth in SUT revenues has remained fairly steady—averaging about 2.87 percent over the last decade—the base of the tax has narrowed as consumer spending has changed. The economy has shifted away from the consumption of tangible goods and towards services and intangible goods. California has experienced the erosion of its SUT tax base relative to total spending and personal income. As shown in Figure 2.9, state tax data indicate that spending on taxable goods represented 34.6 percent of personal income in 2008, compared with 55.4 percent in 1980. Thus, relative to personal income, the tax base has become much narrower.

Figure 2.9



This decline in the share of income used for tangible goods reflects an underlying change in the economy. The SUT no longer captures the level of activity it formerly did. A portion of this relative decline is certainly the result of an increase in the purchase of business and personal services and entertainment, as well as increased consumption of intangible goods. California charges tax on 21 services, while some other states tax up to 168 services. Currently 41 states tax more services than

California. Hawaii and New Mexico impose sales tax on virtually all services. The growth of electronic (intangible) versions of books, recordings, movies, and software has also weakened the base of the tax.

A fairly minor, yet growing additional factor in the narrowing of the SUT base is the role of remote sales through telephone orders, mail order and increasingly, sales through the Internet. Sellers outside of the state with no physical presence in California are not required to pay the SUT when taking orders from California residents. This gives the advantage to out-of-state retailers and results in a substantial revenue loss to California. The U.S. Supreme Court has ruled, absent Congressional action, that states may not require retail businesses with no physical presence in the state to collect and remit sales tax.

Exclusions and Exemptions

Like the PIT, the base of the SUT is narrowed by excluding or exempting many goods. Programs were put into place when the taxes were first imposed to avoid taxing items considered to be necessities of life, goods such as food and prescription medications that constitute a larger percentage of purchases by lower income households. Yet purchases of these goods rises with income, so most of the benefit of the exclusions goes to middle and higher income households.

The various SUT exclusions and exemptions have an aggregate impact of roughly \$9 billion annually. The presence of these programs basically means that to raise a given level of revenue from the SUT, the rate of tax must be increased on the tax base that remains. The largest of the so-called tax expenditure programs for the SUT are listed in Figure 2.10.

Figure 2.10

Largest 2008-09 Tax Expenditure Programs for the Sales and Use Tax	
(Dollars in Billions)	
Food (other than hot prepared food) for human consumption	\$.4.2
Gas, electricity and water	\$.2.1
Prescription medicines and medical supplies	\$.1.6
Candy and snack food	\$.0.4
Farm equipment	\$.0.1

Issues and Concerns

The SUT, as with the PIT, has strengths and weaknesses.

With regular growth, the tax has

been a steady performer for the state. It is the least volatile of the state's general purpose taxes, but it is defective in several key ways:

- The SUT displays a very high rate structure, the highest of any state, which increased even further with the most recent budget agreement. High rates result in disproportionate increases in overall tax burdens and encourage non-compliance and out-of-state purchases.
- The SUT exhibits a narrowing of the tax base as the economy has shifted to services and intangible goods and away from tangible personal property. This has exacerbated the inconsistent treatment of purchases that are tangible goods (taxable) compared to intangible (non-taxable) versions.
- The SUT levies a tax on the purchase of business inputs, including capital equipment. Business inputs are incorporated either directly or indirectly in consumer products that are themselves taxed. This can result in the double taxation of goods.

Corporation Tax

The state's third largest revenue source, the CT, is a broad-based tax on corporate profits. First imposed in 1929, the CT will supply an estimate \$8.8 billion to the General Fund in 2009-10, 10 percent of its total. The CT includes the franchise tax, the corporate income tax, and the bank tax, all of which are based on a firm's net income. The largest of these

SECTION TWO: CALIFORNIA'S TAX SYSTEM

taxes is the franchise tax, paid by all California corporations and technically a franchise payment based on income for operating in the state. Non-California corporations pay the CT on their California income. Financial institutions pay the bank tax, levied at a somewhat higher rate in lieu of the local PT on personal property. The tax is administered by the FTB.

The regular tax rate for the CT is 8.84 percent, which is among the highest rates for all the states. The rate is the same for the corporate income tax and 10.84 percent for the bank tax. Subchapter S corporations (and other so-called “pass-through” entities) pay a reduced rate of tax at the corporate level of 1.5 percent. These businesses are allowed to pass the bulk of their income on to owners who pay the PIT on these receipts. The pass-through provision is restricted to businesses with limited owners and allows such operations to benefit from the legal protections of the corporate structure.

Because the CT is based on net income, not all businesses pay the tax during each tax year. Of the 600,000 corporations that file CT returns annually, only about 55 percent report profits and pay related CT taxes. The remaining corporations report zero income or less and are subject only to the state’s minimum CT of \$800. As a result, the tax tends to be generally influenced by business cycles as well as internal business operations—including tax planning—by the firm. Over the last decade, the CT has displayed growth averaging about 6 percent annually. In terms of stability, it is much more volatile than the SUT but less than the PIT.

Under the tax, California income is determined through a four factor apportionment

Figure 2.11

Largest Corporation Tax Expenditures 2008-09 Revenue Loss (Dollars in Millions)	
Provision	2008-09
Research and development credit	\$1,260
Water's edge election	750
Subchapter S corporations	420
Special treatment for economically depressed areas	370
Double-weighted sales factor	250
Accelerated depreciation of research and experimental cost	180
Like-kind Exchanges	160
Corporations exempt from minimum tax	120
Charitable contributions deduction	100
Low-income housing credit	65
Employee stock ownership plans	56
Percentage depletion of mineral and other natural resources	30

formula, based on sales (weighted twice), payroll, and property located in the state. This apportionment formula will change to a sales only factor beginning in 2011. This aspect of the CT, together with certain other characteristics of the tax, such as combined reporting of income and unitary groups and the increasing globalization of capital flows, makes the CT a tax that is relatively expensive to administer and enforce.

Issues and Concerns

Like other state taxes, the CT has a number of characteristics that are not in keeping with good tax policy. It is expensive to administer, susceptible to manipulation, cyclical in nature, and can result in double taxation of income. Sizeable tax expenditures result in a reduction in potential revenues. The biggest programs are shown in Figure 2.11.

Some or all of the special programs may be due for a review and analysis. As with the PIT, each expenditure program, at least historically, has its justification in terms of encouraging behavior or offsetting another perceived problem. Each program is a loss of potential revenue and thus leads to a higher tax rate and an increase in the overall tax burden for those entities that pay the tax.

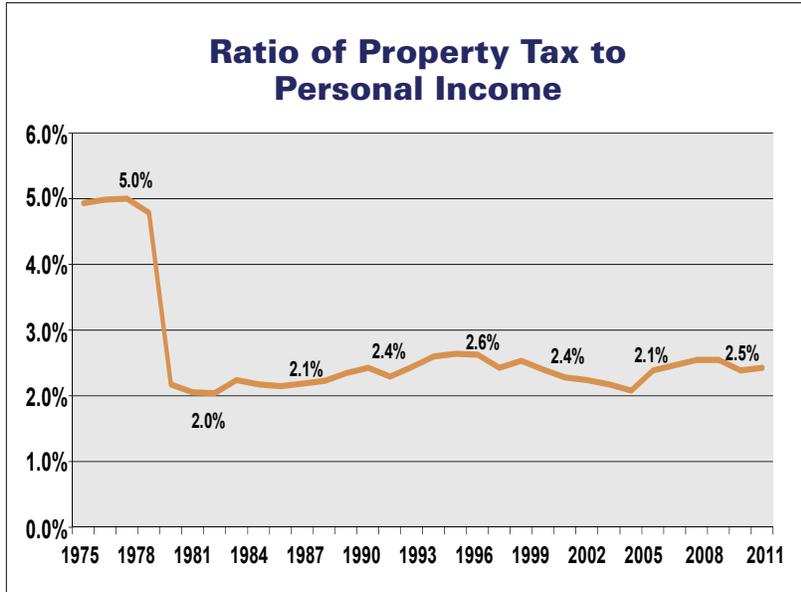
Property Tax

Since 1849, Californians have paid some kind of tax on the assessed value of their property. From its inception, the PT has been a local tax with resulting revenue used within the county of assessment. The state has played an active role in determining the allocation of PT revenues among the various local governmental entities—counties, cities, school districts, and special districts. The allocation of the PT is governed by complex interlocking formulas as determined by constitutional and statutory requirements. Statewide, about one-third of PT goes to local K-12 education and two-thirds to cities, counties, and special districts.

Prior to 1978, property was assessed at market value as determined by county assessors, with rates set by the various local governments. In 1978 voters passed Proposition 13, which dramatically changed the local PT. The initiative limited assessments to the property's acquisition value, plus an annual increase capped at the lesser of two-percent or the rate of inflation. The result of this change was a dramatic drop in the PT relative to personal income in the state. As shown in Figure 2.12, the PT—as a share of personal income—declined from 5.0 percent in 1977-78 to 2.4 percent in fiscal year 2005-06.

The tax is paid by owners of all real property—residential, commercial, industrial, and agricultural. In addition, the tax is levied on personal property owned by businesses, such as equipment, machinery, and aircraft. Property owned by governments and charities is exempt, as is personal household property; however, the VLF is considered an in-lieu property tax. Property is assessed and the tax collected at the local level, except for certain statewide properties—such as railroad property, whose unitary assessment is the responsibility of BOE. The BOE also provides guidance and regulations regarding the

Figure 2.12



assessment of all local property to county assessors.

The PT plays an important role in school funding. Under Proposition 98, schools are guaranteed a certain level of funding. Schools receive a portion of the PT, and the difference between what they receive from the PT and their guaranteed level is made up by the state General Fund.

Revenue generated by the PT tends to be the most stable of major state and local sources.

The tax is levied on a limited measure of wealth—largely real property, which tends not to fluctuate as much as other tax bases in response to business cycles. Nor does the tax exhibit the levels of volatility seen in certain other taxes, most notably the PIT. The passage of Proposition 13 likely increased the stability of the tax by limiting significant increases and decreases in the tax base. The recent housing boom fueled nearly a 9 percent annual rate of growth in PT revenues over the past 10 years, although this year saw the first decline in assessed value in several decades.

In addition to these taxes, taxpayers in California pay other taxes such as the insurance tax, alcoholic beverage tax, tobacco-related, and gambling related taxes. The state levies motor vehicle-related levies, such as a tax on gas fuels and diesel, which is the main source of transportation funding through a state special fund.

Legislative Voting Requirements

California is one of a few states that requires a two-thirds "supermajority" to both increase revenues and adopt a budget.

If the cumulative effect of a bill results in a net increase in state revenues over the first full year or over the entire period covered, a supermajority, or two-thirds in California's case, vote of the Legislature is required in order to pass. If a bill would result in a neutral or net decrease, it is subject to a majority vote.

These requirements are part of the state Constitution set in place as part of the 1978 passage of Proposition 13. The Legislative Counsel, the body that provides legal services for the legislative process to elected state officials, generally relies on revenue estimates provided by the FTB and the BOE to determine the voting requirements for a bill.

Counsel evaluates legislation based on the combined impact and duration of all changes

to the rate, base, or method of computation of state taxes. Factors such as behavioral changes, pending legislation, and possible future action by the Legislature are not considered.

The first full year cycle begins when the changes are enacted and ends at the close of the first full calendar, fiscal, or taxable year, during which all of the tax changes in the bill are operative. Revenue estimates provided by the FTB and the BOE for the lifetime of the bill typically extend for a period of three to five years.

Eleven states require that a so-called "supermajority" of the legislative body approve a bill that increases revenue. Eight states require a supermajority to pass a budget. In California the challenges of having both are apparent each year: in 20 of the last 30 years, the State Budget has been enacted after the constitutional deadline.

SECTION THREE: IMPROVING THE TAX SYSTEM

In performing its primary task—raising revenues for the purpose of funding publicly provided goods and services—California’s tax system has a mixed record.

On the positive side, California and local governments levy taxes on a broad range of activities: consumption, wealth, and income. The tax system has been robust, with revenues growing, on average, in line with the economy. On the negative side, the tax system has not been updated to take into account major economic changes that have occurred in recent decades:

- **Volatile.** California’s economy has boom and bust cycles, but its tax revenue is even more volatile. This trend has become more pronounced over the recent past and has created sudden and extreme revenue surges and budget shortfalls.
- **Narrow.** The tax system does not capture some of the economic activity of the state and has become increasingly reliant on a narrow segment of taxpayers.
- **Uncompetitive.** California’s high marginal tax rates hurt the economy and lead to lower levels of investment and job growth. Some economic activities are essentially “double-taxed.”
- **Complicated.** Some state taxes are complex and difficult to understand and the process for addressing and appealing disputes about one’s tax bill is neither clear nor fair.

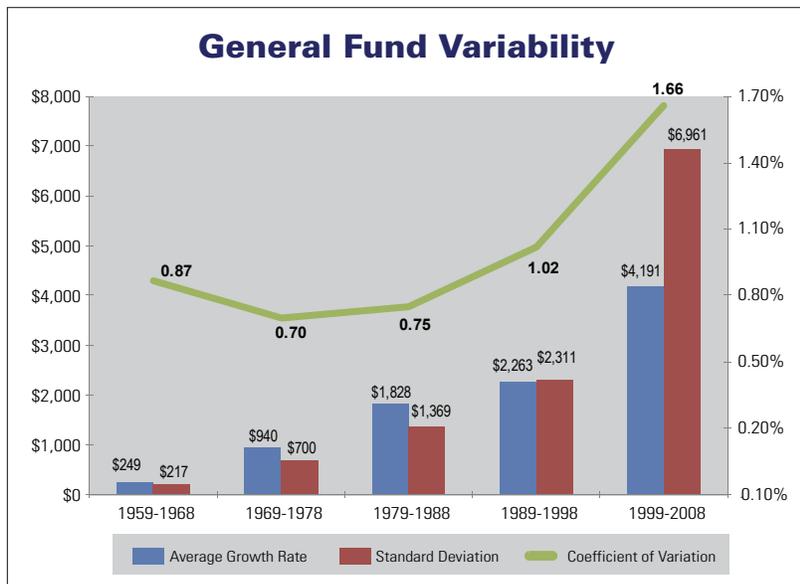
In evaluating California’s tax structure, the Commission took into account economic changes since the 1930s when the basics of the tax system were established, and considered solutions that would be in keeping with principles of good taxation. The Commission sought to fix California’s tax system in the following ways.

I. Improve Revenue Stability: California’s tax system should be restructured to alleviate revenue peaks and valleys.

Economic and institutional changes have led to increasing instability in California’s revenue stream:

- **Shift in the tax base.** The state has shifted from relatively stable revenue sources such as the property and sales taxes to the more inherently unstable, steeply progressive personal income tax (PIT). One cause of this shift is the relative decline of the sales tax base.
- **Changes in income.** Stock options, capital gains, bonuses and other types of one-time variable and sometimes volatile income are much more prevalent than in the past and tend to be concentrated among high income taxpayers. These types of income fluctuate substantially more than salaries and wages.
- **Shift in income distribution.** The proportion of income earned by high income taxpayers has increased. The change in nature of this income has meant that a greater proportion of revenue is generated by volatile sources taxed at the highest marginal rate.
- **Globalization and technological advances.** California’s economy is tied more than ever to economies around the world. Key state business sectors such as the technology and services industries benefit from this inter-connectedness with other economies, but these factors intensify competitive pressures as well.

Figure 3.1



Sweeping economic changes have had a steady and significant impact on the tax system over the past 70 years, contributing to years of robust revenue growth but also injecting extraordinary instability into the tax system. In recent years revenue fluctuations have become more dramatic, juxtaposing periods of steep growth with sudden shortfalls. Figure 3.1 indicates that the standard measure of volatility—the coefficient of

Principles of Taxation

There are basic principles that tax analysts and economists use in evaluating the quality of tax systems:

Economic Efficiency. Taxes should attempt to avoid influencing or “distorting” the decisions and actions of businesses and individuals. Taxes should also be “neutral,” treating all forms of income and consumption the same. An efficient tax system will maximize the economy’s ability to sustain growth and prosperity.

Fairness and Equity. Taxes should be fairly levied on all taxpayers. This means ensuring that similarly situated taxpayers are treated the same. Some believe tax rates should be progressive because lower income taxpayers have less ability to pay than those with higher incomes. Others tie fairness to the value of government services provided.

Administrative Ease. Taxes don’t exist only in theory. The taxes imposed should be cost-effective, minimizing administrative,

compliance and enforcement costs for taxpayers and the taxing authority. In addition, taxes should be simple, apparent, clear, and uniform across the tax base.

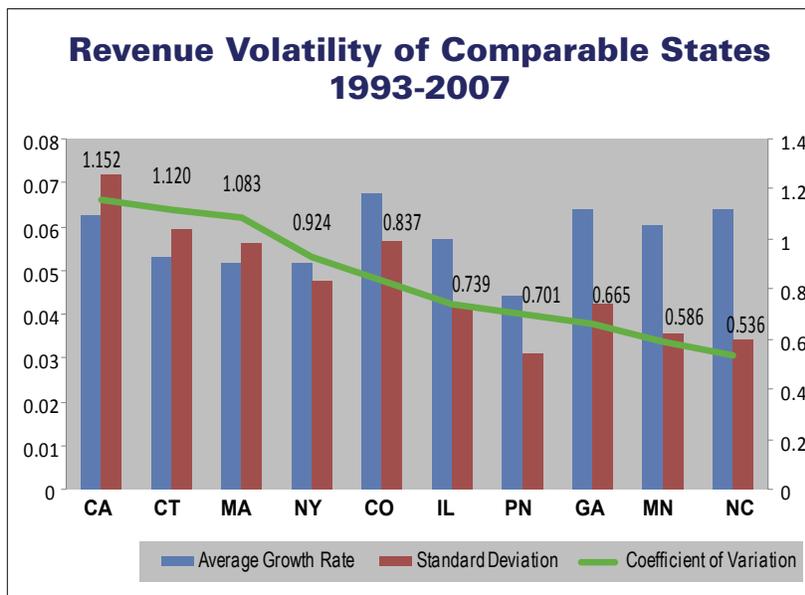
Revenue Generation. The principal reason for a tax system is to raise revenues to pay for publicly provided goods and services. The revenue stream should be adequate, reliable, and stable over time. The features of a tax system that ensure such revenue generation include the adequacy of the stream, the reliability of the revenues, and the stability of tax payments over time.

There can be a tension among some goals and taxation concepts. For example, efforts to create a system that improves a tax system’s ability to generate revenue may come into conflict with a system’s fairness and equity. Expanding a tax base to include more people, including those on the lower end of the income spectrum, may improve the overall revenue stream’s stability and reliability. Tax restructuring always entails this type of balancing of objectives.

variation—rose dramatically from 0.87 for the 1959-68 period to 1.66 for the 1999-2008 period. The coefficient of variation is defined as the standard deviation divided by average growth rate.

California is not alone in its revenue rollercoaster—other states experience volatility. Some are dependent on natural resource-based industries, such as Alaska and Wyoming, or tied to a cyclical business sector, such as Michigan’s reliance on the auto industry. Connecticut, Massachusetts, and New York experience tax revenue volatility for some of the same reasons as California—they have high concentrations of residents who work in

Figure 3.2



the financial industry and who have significant variable pay in the form of bonuses and capital gains. As shown in Figure 3.2, however, California stands out as having the most volatile revenue, adjusted for average growth rates, among the large industrial states examined.

Way Forward

In order to fund programs adequately and regularly, a reliable and stable revenue system is essential. With a reliable system, the expected level of revenues is received.

With a stable one, revenues do not fluctuate dramatically from one period to the next. A tax system possessing these qualities can allow government to operate smoothly and minimize disruption.

There are numerous ways to make the overall system more reliable and less volatile, both with better budget management and changes to the structure. On the budget side, reserve funds that are properly designed, established, and maintained can help address one of the major byproducts of tax revenue instability—the tendency to overspend in good times and to run short of funds during economic downturns.

However, the root causes of revenue volatility can be found in how the tax structure and the economy now interact. Therefore, it is necessary to change the revenue system. To that end, the state must find ways to reduce its dependence on the most volatile sources—the PIT and, within the PIT, the enormous reliance on a small segment of the population and the most volatile sources.

Reforming the PIT can be done in two ways. First, more income would be subject to tax if the structure of the PIT was changed by reducing the number of deductions and credits, and including more Californians as contributors to financing the state’s spending. In addition, the state can lessen the fluctuations in PIT revenue by reducing the PIT rates at the high end of the income spectrum. These changes, taken together, will contribute to a more predictable and stable revenue stream.

Would a Rainy Day Fund Solve the Volatility Problem?

Many states have established “rainy day funds” and have used them to sequester revenues in high growth periods. This practice has two important benefits.

First, it discourages states from making excessive, unsustainable budgetary commitments during periods of high revenue growth. Second, it provides funds to help buffer revenue drops during recessions.

There are, however, practical and political challenges in creating a reserve. In California, it has proven difficult to set the size of the fund and create strong enough restrictions for maintaining the fund during periods of increasing volatility.

In 2004, California voters passed Proposition 58 establishing the Budget Stabilization Account as part of the state’s General Fund. Among its budget-related requirements, the ballot initiative set the reserve fund target size at 5 percent of revenues. It also required that half of the

money transferred to the fund pay off debt and the rest go into a rainy day reserve.

The transfers occurred for two fiscal years, 2006-07 and again in 2007-08. But soon after, as the economy began to deteriorate, the entire reserve balance of \$1.4 billion was transferred to the General Fund and the Governor suspended transfers in 2008-09.

Given the central role that revenue volatility has played in establishing the state’s binge and purge budget cycle, the creation of a constitutionally-protected rainy day fund is essential.

However, as the volatility of the system has increased over time, the size of the rainy day fund necessary to “safeguard” the budgeting process has grown substantially.

Based on recent data, the reserve size required to cover a two year shortfall would approach almost \$30 billion. This would be unsustainable politically. It would also be bad policy to have tax revenues of this magnitude removed from the economy, potentially for years at a time.

Second, the state could reduce its reliance on the PIT by moving towards more stable, and more broad-based taxes. One way to do this is to expand the SUT to services and intangible goods. Alternatively, the state could introduce a new broad-based consumption tax based on the value of goods and services produced in the state.

II. Increase Scope of Taxes: California’s tax system should be broad-based and ensure that all residents contribute.

California residents and businesses benefit from many publicly provided goods and services. Some public services, such as the state highway system and courts, are provided directly by the state. Others may be provided by local governments and paid for by funds raised through state taxation or through taxes levied directly by the local jurisdiction. In other cases, the state provides funds directly to individuals or makes payments on their behalf. Directly or indirectly, California businesses and residents all have a stake in the tax system and the programs that it funds.

Changes in the economy have had a significant impact on the link between the tax and revenue system and the public expenditures that it funds. When the tax system was designed, it largely captured the economic activity in the state. For example, the sales tax was broad-based and levied taxes on a great majority of consumer spending and, as noted previously, contributed the bulk of state revenues. Other taxes were narrow, but contributed less than they do currently to the state’s operations. As the decades elapsed and the economy changed, tax bases have narrowed and become more reliant on particular sectors and taxpayers. The tax system currently in place mirrors this phenomenon.

The implications of a narrow tax base are many, including, as discussed above, increased volatility. Another is an increased proportion of the state’s economic activity is not included in the tax base. Thus, ever-larger tax burdens are placed on the sectors that are taxed. This has occurred with the state’s SUT. Similarly, as the state has shifted to the PIT, it has increasingly relied on a narrow band of taxpayers who contribute disproportionately to the state’s fiscal health.

When considering the fairness of a tax system, there are two general concepts that can be used as guideposts:

- **Benefits Principle.** The value of public goods and services the taxpayer receives
- **Ability to Pay Principle.** The ability to pay based on the taxpayer’s resources

As California’s economy has evolved, it has moved further away from reflecting the first principle. For example, the SUT is levied only on the sale of goods. An increasing share of consumption—that devoted to services—goes untaxed. The same is true with Internet purchases from out-of-state retailers. As a result, the untaxed sector is in some sense, being subsidized by higher taxes on the taxed sectors. Similarly, the corporation tax (CT),

which is based on income generated by business activities, only applies to profit-making concerns, even though all businesses benefit from publicly provided goods and services. This also involves an indirect subsidy.

The PIT has been designed to reflect in large part a concern with the ability to pay. The progressive nature of the rate structure, standard deduction, and various tax credits and deductions, reflect a concern with the ability of taxpayers to contribute directly to the state revenue stream. Over time, the basic structure of the tax (and the attendant economic changes) has resulted in the burden of the tax being placed on a relatively small pool of taxpayers. By moving increasingly towards an ability to pay principle of taxation—inadvertent or not—adherence to the benefits principle of taxation has been reduced.

This development strains the tax system in numerous ways. It leads to much higher tax rates for some than for others. It results in reducing the link between taxation and the types and levels of services the government provides to residents and businesses. It undercuts the level of support for publicly provided goods and services among highly taxed Californians. Finally, it creates the impression that such services are only worth having if the costs are imposed on someone else. None of these developments are healthy for the state.

The tax burden should be designed such that it achieves a proper balance based on both the ability to pay and the benefits received.

Way Forward

The state needs to expand the bases of income and consumption subject to tax. By working towards this goal, California can bring all residents and businesses into the system of taxing and spending. The reliance on the PIT, which structurally emphasizes the ability to pay principle, could be reduced. Instead, the state could rely more heavily on taxes that emphasize the benefits principle, while retaining the PIT to achieve a balanced degree of progressivity.

The state can do this in numerous ways but a few approaches stand out.

First, the state could bring the services sector, which uses public goods and services to operate its business, more fully into the tax system. This could be accomplished through expanding the existing system of sales and use taxation to include services. It could also be accomplished by imposing a new type of tax that would apply to all types of economic activity in the state.

SECTION THREE: IMPROVING THE TAX SYSTEM

In addition, in the case of the PIT, the reliance on a small pool of taxpayers for tax revenues might be reversed. While retaining the essential progressive nature of the PIT, the system could be changed to ensure that a greater number of Californians contribute to the PIT and a greater percentage of income received is actually taxed. This could be accomplished by reducing the number of deductions and credits and lowering the level at which Californians pay the tax.

III. Enhance the Economy: California's tax system should be competitive and minimize the negative impact on job creation and economic growth.

As part of the sweeping economic changes that have occurred, capital and labor have become vastly more mobile than they have been in the past. This has occurred mainly as a result of technological advances, the elimination of institutional barriers, and the globalization of markets. As a consequence, California faces more competition than ever from other states and nations at a time when it is easier than ever to shift investments and create jobs anywhere.

One of the Commission's primary goals is to improve California's tax system so that the state is better positioned to prosper economically in the future. While many factors affect any state's economic competitiveness, taxes can factor significantly in the decision-making of businesses and individuals. The tax system can also be directly affected by legislative action. One of the most effective means to improve California's tax system is to improve its efficiency and minimize its impact on economic behavior.

In this context, efficiency means that taxes should be designed to minimize influencing economic decisions and actions. Businesses and individuals should be allowed to respond to economic and marketplace incentives with minimum interference from taxation. While all taxes can interfere with economic decisions, higher marginal tax rates disproportionately affect efficient outcomes (relative to the revenue raised) and can impair economic growth. To that end, marginal tax rates should be as low as possible given revenue requirements.

One of the noteworthy characteristics of California's tax system is that, except for the property tax, the state's top marginal rates for all of its major taxes are very high. As shown in Figure 3.3, among those states with a broad based PIT, California stands out as having the highest top marginal rate at 10.30 percent. By comparison, Oregon's top marginal rate is 9.00 percent; New Jersey's is 8.97 percent; and Minnesota is 7.85 percent. Californian joint filers begin paying the 9.30 percent rate on taxable income over about \$90,000.

There are many ways to measure California's relative overall tax burden. As Figure 3.4 shows, when the PT is included, California ranks 14th nationally at 12.1 percent of income, modestly above the national average of 11.6 percent. On a per household basis, California is 4th. On a per capita basis, the rank falls between these two.

It may seem puzzling that California's average tax burden can be only somewhat higher than average, when comparing tax revenues as a percentage of income, while it has the highest tax rates in the country for its major state taxes. This is due to several factors. One is that in order to raise revenue, the state tends to raise rates on its existing base rather than expand the base, so certain groups of taxpayers pay considerably more than the average, while many others pay nothing—due to the fraction of households that pay no income tax. Other unique features of California's tax system work to lower the overall tax burden, such as the state's relatively low PT as a result of Proposition 13 and the tax expenditures allowed, which reduce individuals' and businesses' taxable income.

Figure 3.3

	Personal Income Tax	Corporation Tax	Statewide Sales Tax
Arizona	4.54%	6.97%	5.60%
California	10.30%	8.84%	7.25%
Colorado	4.63%	4.63%	2.90%
Illinois	3.00%	7.30%	6.25%
Minnesota	7.85%	9.80%	6.50%
Nevada	No income tax	No corporate tax	6.50%
New Jersey	8.97%	9.00%	7.00%
New York	6.85%	7.50%	4.00%
Ohio	6.24%	8.50%	5.50%
Oregon	9.00%	6.60%	No sales tax
Pennsylvania	3.07%	9.99%	6.00%
Texas	No income tax	1% of gross revenues	6.25%
Washington	No income tax	No corporate tax	6.50%

Note: California's statewide sales tax rate temporarily increased to 8.25% on April 1, 2009 and the personal tax top rate increased to 10.55%

Figure 3.4

State and Local Revenue Per Household*			2006 Tax Collections**		
	Revenue Per Household	Rank		% Personal Income	Rank
Alaska	55,273	1	New York	15.7%	2
Wyoming	37,442	2	Louisiana	14.0%	6
New York	36,474	3	New Mexico	12.9%	9
California	32,936	4	California	12.1%	14
Hawaii	27,144	5	Indiana	11.9%	17
New Jersey	26,855	6	Ohio	11.8%	18
Massachusetts	26,302	7	Utah	11.8%	19
Delaware	25,900	8	Minnesota	11.8%	20
New Mexico	25,249	9	Washington	11.2%	29
Washington	25,232	10	Michigan	10.9%	38
Utah	25,176	11	Oregon	10.8%	40
Oregon	24,688	12	South Carolina	10.3%	44
U.S.	24,051		U.S. Average	11.6%	

**Source: Tax Foundation, "2009 Facts & Figures, Mid-Year Update", 2009*
***Source: U.S. Bureau of the Census and Bureau of Economic Analysis*

SECTION THREE: IMPROVING THE TAX SYSTEM

In addition to concerns about the high marginal tax rates, there are other competitive issues that continue to affect investment in the state and its prospects for economic growth. In particular, taxes imposed on the purchase of capital equipment or other business inputs discourage investment and can result in double taxation. Unlike virtually all other states, California imposes the full sales tax on all types of business purchases (other than specific purchases for resale). This often can result in double taxation. Other states have various programs that provide some tax exemptions for business purchases.

Way Forward

A key to improving California's competitiveness is to find ways to lower tax rates, which will lessen the impact of taxes on the decisions of individuals and businesses. To do this, while raising the same amount of revenue, would require that the state capture more overall economic activity by expanding the scope of its existing consumption and income taxes.

In addition, the state should end its current practice of treating various businesses differently for tax purposes, as it does with businesses that sell tangible goods, which are taxed, compared to ones that provide services, which generally are not taxed. This would improve the neutrality of the tax system, subjecting all businesses to the same level of taxation and avoiding biasing economic-decision making by taxing different types of businesses differently.

Among the ways to improve the system competitively, expanding the sales tax to include services has serious shortcomings. Picking and choosing how to expand sales tax to services has been difficult for most states in a situation similar to California's. An expanded sales tax would still leave the state with its current system of requiring businesses to pay sales tax on inputs, such as supplies and capital equipment. In addition, imposing the sales tax at the existing high rate would cause a significant economic jolt for newly affected businesses.

Alternatively, the state could establish a new broad-based consumption tax that would be levied on all types of business. This would generate sufficient revenue to allow for a substantial reduction in the high marginal rates that pervade the system. It also has the advantage of including certain sectors that are not now subject to the sales and use tax, but avoid the impact of suddenly applying a high rate of tax to those businesses.

IV. Clarify and Simplify: California’s tax system should be easy to understand and fairly administered.

The administrative and compliance aspects of a tax system are often overlooked; however, these features are important to a well-functioning system. This is an area where tax policy meets the taxpayer.

California falls short in certain key respects. The PIT incorporates the complex aspects of federal law, and then adds some of its own. The CT is governed by a complicated set of rules governing what income is included in a tax return, how it is included, and then how that income is apportioned among the states.

The State’s Tax Appellate Process

When Californians wish to challenge their state income or sales and use tax bills, they face an appeals process in which the final decision is made by the same people who administer the tax. This raises issues about fairness.

The Franchise Tax Board (FTB) administers the personal income tax and corporation tax. It includes the Director of the Department of Finance, the State Controller and the chair of the Board of Equalization (BOE).

The BOE administers the sales and use tax, special tax and fee programs, property tax, and the tax appellate program. The Board is composed of the State Controller and four elected members.

Each agency has its own internal protest or appeals process for administrative tax disputes.

Once those avenues are exhausted, a taxpayer’s final, prepayment stop for administrative review—either to appeal a FTB action on an income or corporation tax protest or to appeal a BOE action on a sales and use,

special tax and fee, or property tax petition—is with a hearing with the elected members of the BOE.

To prepare for the hearing with the BOE, the parties provide written briefs detailing their factual contentions and legal arguments. Once the briefing is completed, the Appeals Division prepares a hearing summary or proposed decision in the matter.

The matter is then scheduled either for oral hearing before the BOE or for a decision based on the written record, at the taxpayer’s request. The actual hearing can be between 30 and 60 minutes long. The BOE mails written notifications of its determinations to the parties.

If a taxpayer wants to challenge the BOE’s determination on an appeal, the taxpayer must pay the tax liability and file a claim for refund with the assessing tax agency prior to filing a suit in court. Once the BOE makes its ruling in an income or corporation tax case, there is no clear statutory authority authorizing the FTB to file suit.

SECTION THREE: IMPROVING THE TAX SYSTEM

Both the PIT and the CT have many special tax programs that undercut the base of the tax. These tax expenditures result in certain activities being tax-favored over others, such as businesses operating in enterprise zones. While there may be sound policy reasons for these programs, they are not currently subject to an evaluation of either their policy value or their effectiveness.

Numerous tax expenditures in both the PIT and CT make it difficult for taxpayers to perceive what marginal rate they may be facing at a given level of income. The availability and then the phase-out of various credits and deductions have significant impacts on marginal rates.

Finally, the tax appeals process in California is complicated by the number of different tax agencies involved as well as the structure of the appellate process. It is fundamentally flawed for a democracy to allow the tax authorities to be the final adjudicators in tax disputes and to in effect act as prosecutors and jury. This is a system that needs to be replaced by an independent state tax court.

Way Forward

The state is faced with several key issues in the area of tax system simplification. Within the context of the existing system, the state could lessen the complexity in the PIT by reducing the number of rates and brackets and eliminating various tax expenditures that are ineffective or deemed unnecessary. With respect to the CT, ineffective tax expenditures could be eliminated as well.

There are inherent limitations to simplifying existing taxes. The CT is a complex tax with which to comply, and nothing short of a major restructuring would make it simpler. Similarly, while the PIT could be simplified, its linkage to the federal income tax places limitations here as well. An alternative—or complimentary approach—to simplifying existing taxes is to institute a new tax, with simpler rules, fewer special tax programs, and more clarity regarding liabilities. This could serve to reduce or eliminate the reliance on the state's more complicated taxes and ease the compliance burden on taxpayers.

In addition to these proposals, the state could enhance the fairness of the adjudicatory system by improving the tax appeals process. These changes will improve the state's ability to compete for jobs and investments and it will increase residents' trust in the state's tax system.

The Case for Reform

California needs to both bring more of the state's economic activity into the tax base and to lower marginal tax rates. By broadening the tax bases, the state will benefit from more stable tax revenues and a better link between taxes and spending. It will also be able to lower rates, reducing the negative impact of taxes on economic activity and encouraging potential job growth, investment, and consumer spending. By simplifying certain existing taxes or eliminating some taxes, the system will become less complex, easing compliance burdens and administrative costs.

This new tax system could retain some of its progressive aspects, while more stable tax revenues would greatly improve the state's ability to provide goods and services to the most vulnerable in society without episodic, wrenching interruptions.

SECTION FOUR: RECOMMENDATIONS

The Commission recommends to the Legislature for further examination and consideration a package of tax reforms that would dramatically change the State of California's revenue structure and improve its overall fiscal stability, competitiveness, and prospects for economic growth by significantly reducing tax rates and broadening the tax base.

The Commission's recommendations are part of a package that includes significant changes to the personal income tax (PIT), including a reduction in PIT rates, resulting in a lower PIT bill across all income groups.

The package recommends the elimination of the 8.84 percent corporation tax (CT) and the state general purpose portion of the sales and use tax (SUT), which will otherwise be at a rate of 5 percent when this proposed plan goes into effect in 2012.

A business net receipts tax (BNRT) would serve to replace these revenues. The BNRT represents a fundamental change in the state's tax system and would alter significantly the way California businesses would be taxed. Despite the Commission's work, the BNRT's far-reaching ramifications have not all been fully addressed and should be carefully analyzed and considered by the Governor and the Legislature.

The proposed BNRT would tax a broad range of economic activities at a relatively low rate. The BNRT would give the state a comparatively stable, reliable revenue stream that will grow with the economy in much the way that an income-related tax base would grow. It will allow the state to reduce its dependence on other more volatile taxes – specifically, the personal income tax and the corporate income tax.

The Commissioners came to their work holding decidedly different views as to whether the current distribution of tax burdens is too progressive or not progressive enough. In

SECTION FOUR: RECOMMENDATIONS

the spirit of compromise, our final recommendations retain the overall progressivity of California's tax system.

The Commission recommends implementing the proposed tax changes in 2012. This will give the Legislature time to evaluate the various components of the package, as well as address administrative issues that will arise.

In conjunction with the BNRT, the Commission is making specific suggestions on the transition from the current system of taxation to the new system. Among these is a mechanism that would act as a 'safety valve' to ensure that the transition from the old to the new tax system is revenue neutral, meaning that the revenue raised would be the same as would have been raised under current law.

A key component of the package is a proposal to establish a new Rainy Day Reserve Fund by raising the target amount and instituting stringent controls for transferring money out of the fund. This package of reforms also includes a recommendation to create an independent forum for hearing tax disputes, which will help improve the overall fairness of the state's tax system.

The following six recommendations have been divided into two sections depending on the legal requirements to enact the proposal. A third section lists several proposals deemed worthy of consideration by some Commissioners but did not command sufficient support to be included in the main recommendations.

SECTION ONE: The following recommendations require changes in statutory tax law. They have the consensus support of the Commission and may be enacted by the State Legislature.

Recommendation One: Reduce and restructure the personal income tax.

Recommendation Two: Eliminate the corporation tax and the franchise minimum tax.

Recommendation Three: Eliminate the state general purpose sales tax.

Recommendation Four: Establish the BNRT.

Recommendation Five: Create an independent tax dispute forum.

SECTION TWO: This recommendation requires a change in the State Constitution or a state ballot initiative in order to pass. It has the consensus support of the Commission.

Recommendation Six: Establish a new Rainy Day Reserve Fund.

SECTION ONE:

The following recommendations require changes in statutory tax law.

The Commission sought to achieve the goals laid out in the Governor's Executive Order with a package of reforms, which taken together, would provide the same revenue as would be raised under current law for the General Fund starting in year 2012. Draft legislation for this package of reforms can be found in Appendix I.

Recommendation One: Reduce and Restructure the Personal Income Tax

The PIT would significantly change in structure, and the state's reliance on this revenue source would diminish substantially. Under the proposal, the number of tax brackets would be reduced from six to two; credits would be eliminated (except for the other states' tax credit); deductions would be dramatically curtailed. After a phase-in period based on reductions in the current law PIT, the new tax structure beginning in year three of the plan would be as follows:

- Standard deduction of \$45,000 for joint filers (\$22,500 single filers).
- Itemized deductions limited to mortgage interest, property taxes and charitable contributions.
- Tax rate of 2.75 percent for taxable income up to \$56,000 for joint filers (\$28,000 single filers) and 6.50 percent for taxable incomes above that amount.

As under current law, taxpayers could choose to take the standard deduction or to itemize their deductions. For joint filers choosing the standard deduction, the first \$45,000 of adjusted gross income (AGI) would be exempt from personal income taxation. The 2.75 percent tax rate would be applied to AGI above this level, up to \$101,000. The 6.50 percent rate would apply to income above \$101,000.

These changes would retain the PIT's progressive nature but reduce all tax rates. Overall, the proposal would lower the PIT paid across income groups of taxpayers by an average of about 29 percent.

Recommendation Two: Eliminate the Corporation Tax and the Minimum Franchise Tax

In 2012, the first year of the implementation of the tax plan, the state should eliminate the CT, which is currently at 8.84 percent. It should also eliminate the \$800 minimum franchise tax.

Recommendation Three: Eliminate the State General Purpose Sales Tax

The state should eliminate the state General Fund portion of the SUT, which is currently at 5 percent, excluding the current temporary 1 percent increase. However, the state would retain the state portion of the SUT on gas and diesel fuels with revenue used for improvements to transportation as prescribed by Proposition 42.

The state portion of the SUT would be phased out beginning in the initial year of the tax plan, reduced by 1 percent during each of the five years of the plan's phase-in period.

Recommendation Four: Establish the Business Net Receipts Tax

The state should impose the BNRT, which would apply to all net receipts of almost all entities doing business in California. The BNRT is designed to tax the value a business adds in its production of products and services in California at a relatively low rate.

The base on which the tax is imposed is the net receipts of a business. In simple terms, net receipts is calculated first by aggregating the gross receipts, which is the gross amount the business receives from all sources, such as sale or exchange of property, performance of services or the use of property or capital in a trade or business. Next, all purchases, such as those from all other firms, are aggregated and then subtracted from gross receipts, resulting in the business's net receipts. This is then multiplied by the BNRT rate to calculate the tax liability of the business.

In general terms, the formula for the BNRT is:

$$(1) \text{ Gross Receipts} - \text{Purchases from Other Firms} = \text{Net Receipts}$$

$$(2) \text{ Net Receipts} * \text{BNRT Rate} = \text{BNRT Liability}$$

According to our preliminary calculations, the BNRT rate that would achieve revenue neutrality once the tax has been fully phased in is approximately 4 percent. The Commission recommends that the BNRT rate not exceed 4 percent. During the first year of the transition, our preliminary calculations indicate that the revenue neutral BNRT rate is 1.6 percent. A detailed description of the BNRT and a suggested five year phase-in period can be found in Appendix A and B.

Other BNRT Issues

The Commission recommends that the BNRT include an exemption for small businesses and a credit for research and development activities.

In addition, as the Legislature begins its examination of the Commission's central proposals, there are several key areas of the BNRT that the Legislature may want to explore with particular attention. In general, the Commission recommends more analysis and research on how the establishment of the BNRT will affect capital investment and job creation in the state.

Also, the Commission has suggested certain choices regarding the structure of the BNRT that warrant further examination. The Commission has identified the following specific issues for additional consideration by the Legislature:

- All employee compensation has been considered as a component of value-added in the computation of the tax base. Wages and salaries have been excluded as deductions from gross receipts, together with health benefits, pension contributions, other employee benefits and payroll taxes. Such treatment may warrant examination, especially with respect to health benefits if such coverage is mandated by future changes in federal law.
- Financial institutions have been included in the computation of the estimated BNRT revenues, based on a somewhat different method of calculation from non-financials. The differential rate for financial institutions that currently exists under the CT has also been retained. The tax treatment of financial institutions is complex and raises numerous computational and administrative issues. This may be an argument for the taxation of these institutions under a separate tax that would generate an equivalent amount of revenue as would have been generated by their inclusion in the BNRT.
- Under the current tax regime, businesses have substantial tax attributes "on the books," including net operating loss carry forwards, business activity credits—primarily for research and development and enterprise zone activities—depreciation, and deferred income and expenses. The treatment of these will have to be addressed as it will have a substantial impact on the BNRT base as well as the rate necessary to generate sufficient replacement revenues to offset the recommended changes to the sales, corporate, and personal income taxes.

A Note on the Transition to the BNRT

Instituting a new tax system and phasing out an old one needs careful oversight. There may be unforeseen consequences and dramatic shifts in the economy that could call into question the proposed pace of transition. Policy makers need a clear plan for evaluating the transition midstream.

SECTION FOUR: RECOMMENDATIONS

The Commission suggests a technical review panel and a method for evaluating the transition as it progresses. During the first three years of the transition, the panel would annually review the performance of the BNRT with respect to its estimated revenues relative to what revenues would have been raised under the old law. In each year, the panel would recalibrate the SUT transition process depending how the BNRT performs. For example, if in year three the BNRT produced less in revenues than necessary to replace the eliminated current law revenues, the SUT phase-in rate would be adjusted in order to make up the shortfall. For more information on a potential adjustment mechanism for the phase-in of the BNRT, see Appendix C.

Recommendation Five: Create an Independent Tax Forum

California should create an independent body with tax expertise to resolve disputes between the state and taxpayer. A taxpayer should be able to seek a ruling from the independent forum prior to having to pay the tax bill in question. A potential model for this proposal is presented in Appendix D.

SECTION TWO:

This recommendation requires a change in the State Constitution or a state ballot initiative in order to pass.

Recommendation Six: Establish a New Rainy Day Reserve Fund

The state should establish a new Rainy Day Reserve Fund by setting a higher target and improving how it sets aside and uses money in the fund, specifically:

- Increase the target for the reserve from 5 percent of revenues to 12.5 percent of revenues.
- Require revenues above a ten-year trend line be deposited in the reserve.
- Restrict the Governor's ability to suspend transfers into the fund. Transfers can be suspended only in periods when revenues are insufficient to provide spending at prior year's level adjusted for changes in population and inflation in the cost of providing state services.
- Create more stringent controls for the withdrawal of reserve funds. Reserve funds could be used to maintain spending at prior year's level adjusted for changes in population and inflation.

A more detailed description of the Rainy Day Reserve Fund can be found in Appendix E.

SECTION THREE:

In the course of the Commission deliberations, many ideas and proposals were discussed, debated, and analyzed. The following proposals were deemed worthy of the state's serious consideration by a sizeable number of Commissioners, including at least one each appointed by the Governor and by the Legislature. However, these proposals did not command sufficient support to be included in the Commission's main recommendations and, indeed, were opposed by some Commissioners.

Revenues from New Oil Leases

The state should permit additional offshore oil leases, under strict environmental safeguards. Royalty revenues should go to a reserve fund to be used for specific, limited purposes, such as paying off debt, lowering other taxes, one-time infrastructure spending, and building the state's Rainy Day Reserve Fund. Appendix F describes additional detail regarding this proposal.

Minimum Tax

To ensure that all California residents and businesses participate in the financing of the state's General Fund spending, a minimum tax on all adult residents and all businesses in the state is proposed. For more detail, please see Appendix G.

Merge Tax Agencies

The state should combine the Board of Equalization and the Franchise Tax Board. Appendix H describes additional detail regarding this proposal.

APPENDICES

- A.** Description of the Business Net Receipts Tax A-3
- B.** Potential Phase-in plan for the Business Net Receipts Tax A-13
- C.** Potential Adjustment Mechanism for the Business Net Receipts Tax A-15
- D.** Description of the Proposal for an Independent Tax Forum A-19
- E.** Description of the Proposal for a Rainy Day Reserve Fund. A-21
- F.** Description of the Proposal for Revenues from Oil Leases A-25
- G.** Description of the Proposal for a Minimum Tax A-27
- H.** Description of the Proposal to Merge Tax Agencies A-29
- I.** Draft Legislation for Commission’s Tax Package A-31

Additional information can be found at www.cotce.ca.gov.

APPENDIX A: DESCRIPTION OF THE BUSINESS NET RECEIPTS TAX

The following provides an overview of a tax the Commission on the 21st Century Economy is recommending as part of a package of tax reforms. The tax being recommended is based on the subtraction-method value-added concept of taxation and tentatively termed a Business Net Receipts Tax (BNRT). This report aims to provide guidance about the nature of the tax and its application.

- Introduction
- General
- Multi-State Businesses
- Gross Receipts and Purchases for Non-Financials
- Gross Receipts and Purchases for Financials
- Transition Issues
- Examples

Introduction

The BNRT is designed to tax the value a business adds to its production of products and services in California and thus attempts to approximate the benefits of services and programs utilized by the business. A value-added tax could accomplish several objectives as a component of the state's revenue system, including:

APPENDIX A: DESCRIPTION OF THE BUSINESS NET RECEIPTS TAX

Broaden the tax base. The BNRT is a business-level tax and would broaden the tax base of California. It would tax all types of business organizations, including corporations, pass-through entities and sole proprietorships. It would subject businesses that provide services to a tax on the consumption of these services. The tax would include businesses that make a market in California but may have no physical presence in the state, consistent with existing law.

Improve tax competitiveness. The BNRT would allow for the reduction in the rate of the existing sales tax, and thus reduce the degree of multiple taxation of certain business inputs. The BNRT would also allow for a reduction in the marginal rates of California personal income tax (PIT) and the elimination of the corporation income tax (CT) by imposing instead a low rate of tax on all productive activity in the state.

Stabilize tax revenue. The BNRT would be used to reduce the state's reliance on more volatile sources of revenues, such as the personal and corporation income taxes. In addition, the tax would grow along with state economic growth and is likely to be more stable and more reflective of the state's underlying economy than some existing sources of state revenue.

General

Calculation of Tax. The base on which the tax is imposed is the net receipts of a business. In simple terms, net receipts is calculated first by aggregating the gross receipts, which is the gross amount the business receives from all sources, such as sale or exchange of property, performance of services or the use of property or capital in a trade or business. Next, all purchases, such as those from all other firms, are aggregated and then subtracted from gross receipts, resulting in the business's net receipts. This would then be multiplied by the BNRT rate to calculate the tax liability of the business.

The general formula is:

$$(1) \text{ Gross Receipts} - \text{Purchases from Other Firms} = \text{Net Receipts}$$

$$(2) \text{ Net Receipts} * \text{BNRT Rate} = \text{BNRT Liability}$$

Examples of gross receipts would be the payment to a business for providing professional services or selling materials and equipment. Simple examples of purchases from other firms that would be deductible from gross receipts would include payment for professional services or the cost of capital equipment. Businesses would not be allowed to deduct employee compensation and non-financial businesses would not be allowed

to deduct interest payments. A research and development credit equal to x percent of qualified expenditures on research and development and y percent for basic research could be applied against the BNRT liability.

Entity Application. The BNRT would apply to all business entities that are considered to be “doing business” in California. Such businesses would include sole proprietorships, pass-through entities and corporations.¹ It would not include federal, state and local governments or non-profits, including health and education services. There would be a small business filing threshold set at \$500,000 in gross receipts. In addition, net receipts of \$250,000 or less would effectively be exempted from the BNRT base through a credit mechanism. This exclusion would be phased-out based on a graduated schedule. The BNRT would be an entity level tax, not a transaction-by-transaction tax, and would be paid by a business through quarterly estimated payments through the business’s tax year.

Economic Presence Test. Businesses subject to the BNRT would include all entities deemed to be “doing business” in California. A business entity would be deemed to be doing business in California if any of the following conditions hold:

- The business is organized or commercially domiciled in California.
- Sales of the business in California exceed the lesser of \$500,000 or 25 percent of a taxpayer’s total sales.
- The real property and tangible personal property of the business in California exceed the lesser of \$50,000 or 25 percent of a taxpayer’s total real property or tangible personal property.
- The amount paid in California by entity to the employee for compensation exceeds the lesser of \$50,000 or 25 percent of the total compensation paid by the taxpayer.
- This definition of “doing business” is consistent with California Revenue & Taxation Code (R&TC) section 23101, effective January 2011.

Tax Rate. The BNRT would be levied at the rate of **x** percent on the net receipts of all non-financial institutions and the rate of **y** percent on all financial institutions (as discussed below).

¹ The BNRT would apply to all forms of doing business, including sole proprietorships, pass-through entities (general partnerships, limited partnerships, S corporations, limited liability companies, limited liability partnerships and entities that check the box to be treated as partnerships for tax purposes), and corporations (C corps and business entities that check the corporations box for tax purposes). The tax would not apply to insurance companies, which would remain subject to the gross premiums tax. It would apply only to unrelated business activities of exempt organizations.

Multistate Businesses

Unitary Method. For single businesses operating inside and outside of California, the BNRT would rely on the unitary method. The unitary method would also apply to groups of affiliated businesses that effectively operate as a single integrated business. Business entities could operate one or more unitary businesses, and each of the unitary businesses would be accounted for separately. All types of business entities could be included in the unitary group, including pass-through entities and sole proprietorships. Estates, except to the extent that the estate continues to operate a business of a taxpayer, and trusts, other than business trusts, would not be subject to the tax and would not be included in a unitary group.

Combination. The business net receipts of a unitary group would be the sum of the net receipts of each entity that are included in the unitary business group. For purposes of the calculation of the net receipts for each of the members of the unitary group, transactions within the group would be eliminated using rules similar to those used under the existing Corporation Tax Law (CTL). The net receipts of each of the members of the unitary group would be calculated and aggregated.

Water's Edge. A unitary group would file on a water's-edge basis. Worldwide reporting would not be allowed. The water's-edge group would be similar to current law.² Thus, affiliated businesses organized in the U.S. are considered inside the water's edge, while businesses organized outside of the U.S. would generally be considered outside the water's-edge and not be included (except to the extent of their U.S. activities). Businesses with activities in tax haven jurisdictions would also include these activities in the water's edge return.

Business/Non-Business Receipts. As in the current corporate income tax system, business receipts and non-business receipts are considered differently for purposes of determining the BNRT. Business receipts are those receipts that arise from the conduct of a trade or business. This type of receipt would be apportioned based on the formula set forth below. Non-business receipts would not be apportioned, but rather allocated in full to a single location using the current non-business rules. All non-business net receipts would be added to the apportioned business net receipts to determine total net receipts from California subject to the tax. Non-business receipts would constitute a gross receipt but not be included in the sales factor.

² Sub-part F corporations would not be included in the water's-edge group.

Apportionment. Combined aggregate business net receipts of a unitary group (or a single business with multi-state operations) would be apportioned using single-factor sales.³ Non-business net receipts allocated to California would be combined with apportioned net receipts to determine aggregate net receipts subject to tax. If any member of the unitary group has nexus in California, all sales in this state by any of the members of the unitary group would be included in the numerator of the single factor sales (Finnigan Rule). For purposes of calculating the sales factor, the numerator would consist of sales in California and the denominator equal to sales everywhere. Occasional sales, as defined under current law, would be eliminated from the numerator and the denominator of the apportionment factor (but remain in the tax base).

Sales of tangible property would be assigned to California based on California R&TC section 25135, as it will read effective January 1, 2011. Sales of services and intangibles would be assigned to California according to revised California R&TC section 25136, as it will be effective January 1, 2011.

Calculated aggregate net receipts would then be multiplied by the BNRT rate to calculate the tax liability of the business.

The formula can be depicted as follows:

(1) Gross Receipts of X - Purchases from Other Firms by X = Net Receipts of X

(2) Gross Receipts of Y - Purchases from Other Firms by Y = Net Receipts of Y

(3) Net Receipts X + Net Receipts Y = Net Apportioned Receipts Total

*(4) Net Apportioned Receipts Total * (California Sales of X/Sales Everywhere) = California Apportioned Net Receipts of X*

*(5) Net Apportioned Receipts Total * (California Sales of Y/Sales Everywhere) = California Apportioned Net Receipts of Y*

(6) California Apportioned Net Receipts of X + Non-Business receipts of X = California Total Net Receipts of X

(7) California Apportioned Net Receipts + Non-Business receipts of Y = California Total Net Receipts of Y

³ Business receipts of the unitary group would be subject to apportionment. Non-business receipts would be allocated rather than apportioned.

APPENDIX A: DESCRIPTION OF THE BUSINESS NET RECEIPTS TAX

(8) *California Total Net Receipts for X * BNRT Rate = BNRT Liability for X*

(9) *California Total Net Receipts for Y * BNRT Rate = BNRT Liability for Y*

“Sales” will be defined consistent with the definition of gross receipts for the tax base discussed below, with certain exceptions, such as occasional sales and non-business items.

Gross Receipts and Purchases for Non-Financials

Gross Receipts. The definition of gross receipts is in general to be interpreted broadly, but within the context of goods and services sold by the taxpayer and consumed in the state. Thus, gross receipts for non-financial businesses would include amounts received on the sale or exchange of property, the performance of services, or the use of property or capital, including rents and royalties, in the trade or business of the taxpayer. Realization of gross receipts would be based on current law under the CT. Gross receipts would not include any receipts included in the measure of tax paid by any other taxpayer.

Gross receipts would exclude extraneous transactions that are not related to the sale of products or services, largely resulting from financial transactions. For example interest and dividends received would be excluded, as would principal received upon maturity of a bond, or the repayment of the principal of a loan. Specifically, the following would be excluded: interest income received; repayment, maturity, or redemption of the principal of a loan, bond, mutual fund, certificate of deposit, or marketable instrument; the amount of principal received under a repurchase agreement or other transaction properly characterized as a loan; proceeds from issuance of taxpayer’s own stock or from the sale of treasury stock; damages or other amounts received as the result of litigation; property acquired by an agent on behalf of another; tax refunds; pension reversions; contributions to capital (except for sales of securities by securities dealers); the price of commodities or other goods that are traded for similar or other goods, whether such trading is done for hedging or other purposes; amounts received from the maturity, redemption, sale, exchange, or other disposition of intangible assets held in connection with a treasury function of a taxpayer; amounts received from trading in stocks, bonds, derivative financial instruments including futures, forwards, and options; amounts received from selling accounts receivable if the sales that generated those accounts receivable are included in the taxpayer’s gross receipts; amounts received from selling land and other assets that are not subject to depreciation, amortization, or depletion except to the extent of the gain on the sale of these assets.

Purchases. The definition of purchases for non-financial businesses would include only rents, royalties, inventory purchased for resale, materials and supplies, services purchased during the year, and assets placed in service during the year. Each of these would be expensed and deducted from gross receipts.

Net Receipts. Net receipts are calculated by subtracting purchases and allowable asset expenses from gross receipts of the business. Purchases and allowable asset expenses in excess of gross receipts would result in zero net receipts. Purchases and allowable asset expenses in excess of gross receipts during the year could be carried forward and allowed as deductions from gross receipts in the ensuing period, not to exceed five years.

For pass-through entities, net receipts liabilities would be payable at the entity or partnership level. The BNRT liability would be deductible against the pass-through entity's income for purposes of calculating a partner's income tax liability. Thus, the PIT liability would be based on the pass-through income net of BNRT paid at the entity level. Similarly, for sole proprietorships, the BNRT liability would be deductible against the owner's income for purposes of calculating the owner's income tax liability.

Gross Receipts and Purchases for Financials

The BNRT is intended to reflect a value-added concept. Financial and investment companies buy and sell financial assets. To include financial and investment companies in the BNRT might require a different method of tax calculation than what other entities would use. The current plan is to include such financial institutions within the BNRT; however, the Commission recognizes the additional and complex issues that financials raise with respect to the design of the BNRT, some of which warrant further study. One alternative is to tax financials under a different tax that would raise an equivalent amount of revenue.

Definition of Financials. Financial institutions would include those businesses as set forth in California R&TC section 23183, plus other businesses acting as financial intermediaries such as brokers and dealers, and other businesses with financial transactions linked to their non-financial commercial activities.

Calculation of Tax. Taxation of financial institutions as defined above would be based on the following: gross receipts for financials would include all those amounts included for non-financials, such as amounts realized on the sale or exchange of property, the performance of services, or the use of property or capital, including rents and royalties, in the trade or business of the taxpayer. In addition, gross receipts would include interest

APPENDIX A: DESCRIPTION OF THE BUSINESS NET RECEIPTS TAX

amounts received pursuant to financial transactions. Purchases would include all those purchases set forth under non-financials, above, as well, and interest expenses on financial transactions.

Transition Issues

Phase-In Period. The BNRT would be phased-in over a five-year period beginning in 2012. In the initial fiscal year, the tax rate for the BNRT would be **x** (**z** for financial institutions) and increasing in increments until it reached the rate of **y** (**w** for financial institutions) in fiscal year 2016.

Personal Income Tax, Sales and Use Tax, and Corporation Tax. During the five-year phase-in period, the PIT rates would be reduced and then the tax restructured. The state SUT would have scheduled rate reductions during this period. By the end of the transition period, the state portion of the SUT would be eliminated. The CT would be eliminated in the initial year of the plan.

The following provisions represent policy suggestions by the Commission but have not been explicitly incorporated in the estimates and analysis of the BNRT.

Carry-over Credits and Net Operating Losses (NOLs). Existing credits and NOLs under the corporation franchise and income tax could be used on a limited basis to reduce BNRT tax liabilities. Annual utilization of used NOLs and carryover credits from the CTL could not exceed five percent of the BNRT liability for the reporting entity. In addition, any unused NOLs and carryover credits from the CTL would be allowed to carry forward for up to 20 years under the BNRT as transition NOLs and credit carryovers, until exhausted, and any such amounts not used would expire at the end of that period.

Depreciation. Taxpayers would continue to use current depreciation, amortization and depletion allowance schedules for property acquired prior to 2012 to calculate the annual purchase deduction with respect to those assets under the BNRT after 2011.

Deferrals. Items being deferred under the CTL as of its repeal date, including expenses, gains and income, would be recognized or deducted under the BNRT using the same methods and rules as under current law.

Capital Assets. In the case of capital assets acquired prior to the repeal date of the CTL, only the gain realized on the sale or other disposition of such assets will be includable in gross receipts, without regard to any non-recognition or other deferral rules under the existing CTL. Calculation of such gains shall be made using the basis rules under the existing CTL prior to its repeal.

APPENDIX A: DESCRIPTION OF THE BUSINESS NET RECEIPTS TAX

Examples

Example 1

Small Business
Landscaping and Supplies
Activities Only in California

	\$000	
Gross Receipts		
Landscaping Services Provided	2,500	
Sale of Supplies and Materials	1,000	
Consulting Services Provided	1,250	
Rental Income from Sublease	250	
Subtotal 1	5,000	
Purchases		
Building Rental	600	
Purchase of Supplies and Materials	1,500	
Utilities and Office Costs	120	
Purchased Services	60	
Subtotal 2	2,280	
Other Costs		
Employee Compensation		2,260
Interest Expense		60
Subtotal 3		2,320
Profit		400
Total Expenses and Profit	2,720	
Total Net Receipts (Subtotal 1 Less Subtotal 2)	2,720	
California Sales/Total Sales	100%	
Net Receipts Apportioned to California	2,720	
Net Receipts Tax Rate	4.0%	
Net Receipts Tax Liability	109	

APPENDIX A: DESCRIPTION OF THE BUSINESS NET RECEIPTS TAX

Example 2

Medium Business
Professional Engineering Services
Nationwide

	\$000	
Gross Receipts		
Direct Engineering Services	85,000	
Sales of Technical Manuals	25,000	
Lease from Technical Design Software	50,000	
Royalties from Proprietary Designs	40,000	
Subtotal 1	200,000	
Purchases		
Office Lease	6,000	
Utilities and Office Costs	3,000	
Equipment and Software Purchases	12,000	
Travel and Miscellaneous	15,000	
Professional Services	35,000	
Liability and Property Insurance	5,000	
Lease of Software	4,000	
Deductible Real Estate Purchases	12,000	
Subtotal 2	92,000	
Other Costs		
Employee Compensation		90,000
Interest Expense		8,000
Subtotal 3		98,000
Profit		10,000
Total Expenses and Profit	108,000	
Total Net Receipts (Subtotal 1 Less Subtotal 2)	108,000	
California Sales	25,000	
Total Sales	200,000	
California Sales/Total Sales	12.5%	
Net Receipts Apportioned to California	13,500	
Net Receipts Tax Rate	4.0%	
Net Receipts Tax Liability	540	

APPENDIX B: POTENTIAL PHASE-IN PLAN FOR THE BUSINESS NET RECEIPTS TAX

Year 1

- Elimination of the corporation tax
- Reduction in current law personal income tax
- Reduction of 1 percent in sales and use tax
- Establishment of the business net receipts tax

Year 2

- Reduction in current law personal income tax
- Additional reduction of 1 percent of sales and use tax
- Increase business net receipts tax rate

APPENDIX B: POTENTIAL PHASE-IN PLAN FOR THE BUSINESS NET RECEIPTS TAX

Year 3

Conversion to new personal income tax

Additional reduction of 1 percent in sales and use tax

Increase business net receipts tax rate

Year 4

Additional reduction of 1 percent in sales and use tax

Increase business net receipt tax rate

Year 5

Additional reduction of 1 percent in sales and use tax

Final increase of business net receipts tax rate

APPENDIX C: POTENTIAL ADJUSTMENT MECHANISM FOR THE BUSINESS NET RECEIPTS TAX

The tax plan would be phased in over a five-year period. During the first three years of the phase-in, a technical panel would review the performance of the business net receipts tax (BNRT) relative to its estimated revenues. Under this process, the technical panel will approve methodology and estimates of:

- (a) Revenues that would have been generated under old law (old system) through the three year period.
- (b) Revenue to be generated under current law (new system) through the three year period. These estimates would use common economic projections. The new system rates would be planned to be phased-in at rates that equalized these two estimates.
- (c) Updated revenues projected for the new system using the same model as in (b) with updated economic inputs and compared to the actual performance of the new system. Variances would then be deemed to be due to under or over performance of the system and not economics.

The results of this process would be incorporated in the budgeting process and used to potentially reconfigure the phase-in process. The reconfiguration could be used to account for unexpected revenues or shortfalls.

Technical Panel

The technical panel would consist of the State Controller, the State Treasurer, and the Director of the Department of Finance (Finance). The panel would rely on fiscal estimates from the Franchise Tax Board (FTB), the Board of Equalization (BOE), and Finance.

Estimation Process

Estimates of the current law will be provided to the technical panel by the relevant administrative agency for each of the taxes—the BOE for the sales and use tax (SUT) and the FTB for the Personal Income Tax (PIT), Corporation Tax (CT), and BNRT.

Budget Incorporation

Estimates conducted by the technical panel would be incorporated in the May Budget Revision by the Director of Finance in each of the first three years of the transition period.

2012-13

The scheduled phase-in of the BNRT would occur in conjunction with the scheduled reduction in the SUT.

2013-14

The May Revision would be based on the following: if estimated revenues under current law are equal to estimated revenues under old law (plus or minus revenues generated by a SUT rate of 1/8 percent), the state general purpose SUT rate would be reduced by the scheduled amount.

On December 1, if actual revenues for 2012-13 year are *less* than estimated old law revenues (plus or minus revenues generated by a SUT rate of 1/8 percent) the SUT rate would be recalibrated on January 1 to *generate* revenues sufficient to equal the difference.

On December 1, if actual revenues for 2012-13 year are *more* than estimated old law revenues (plus or minus revenues generated by a SUT rate of 1/8 percent) the SUT rate would be recalibrated on January 1 to *reduce* revenues sufficient to equal the difference.

2014-15

The May Revision would be based on the following: if estimated revenues under current law are equal to estimated revenues under old law (plus or minus revenues generated by a SUT rate of 1/8 percent), the state general purpose SUT rate would be reduced by the scheduled amount.

APPENDIX C: POTENTIAL ADJUSTMENT MECHANISM FOR THE BUSINESS NET RECEIPTS TAX

On December 1, if actual revenues for 2013-14 year are *less* than estimated old law revenues (plus or minus revenues generated by a SUT rate of 1/8 percent) the SUT rate would be recalibrated on January 1 to generate revenues sufficient to equal old law estimated revenues.

On December 1, if actual revenues for 2013-14 year are *more* than estimated old law revenues (plus or minus revenues generated by a SUT rate of 1/8 percent) the SUT rate would be recalibrated on January 1 to reduce revenues sufficient to equal old law estimated revenues.

2015-16

The May Revision would be based on the scheduled phase-in of the tax plan, after adjustments for prior year(s) actual revenues. The phase-in would continue in subsequent years until the SUT is fully eliminated or the BNRT ceiling rate is reached.

APPENDIX D: DESCRIPTION OF THE PROPOSAL FOR AN INDEPENDENT TAX FORUM

Proposal

California should create an independent body with tax expertise to resolve disputes between the state and taxpayer. A taxpayer should be able to appeal for a ruling from the independent tribunal prior to having to pay the tax bill in question.

Rationale

The current tax appeals process has some aspects that raise questions of fairness. A taxpayer's final prepayment stop for administrative review is a hearing with the elected members of the Board of Equalization (BOE), who are in general perceived to be the same people who administer the tax system. By creating an independent, experienced body to hear cases, the state will improve the fairness of the system. Allowing taxpayers to pay their tax bill after an independent body reviews their case will improve the appellate system's access to all taxpayers.

Background

The Franchise Tax Board (FTB), which administers the personal income tax (PIT) and corporation tax (CT), includes the Director of the Department of Finance, State Controller and the Chair of the BOE. The BOE administers the sales and use tax (SUT), special tax and fee programs, property tax (PT), and the tax appellate program. The BOE is composed of the State Controller and four elected members.

Each agency has its own internal protest or appeals process for administrative tax disputes.

APPENDIX D: DESCRIPTION OF THE PROPOSAL FOR AN INDEPENDENT TAX FORUM

A taxpayer's final prepayment stop for administrative review – either to appeal a FTB action on an income or corporation tax protest or to appeal a BOE action on a sales and use, special tax and fee, or property tax petition – is with a hearing with the elected members of the BOE. Members of the BOE are elected officials and not required to have any particular tax training or expertise.

To prepare for the hearing with the BOE, the parties provide written briefs detailing their factual contentions and legal arguments. Once the briefing is completed, the Appeals Division prepares a hearing summary or proposed decision in the matter.

The matter is then scheduled either for oral hearing before the BOE or for a decision based on the written record, at the taxpayer's request. The actual hearing can be between 30 and 60 minutes long. Given the complexity of tax cases, the short hearings lead some taxpayers to feel they must contact some BOE members in advance to try to explain their case. These informal meetings between taxpayers and BOE staff break from traditional legal practice and may be improper.

If a taxpayer wants to challenge the BOE's determination on an appeal, the taxpayer must pay the tax liability and file a claim for refund with the assessing tax agency prior to filing a suit in court. Some taxpayers cannot afford this option. In contrast, the U.S. Tax Court hears disputes about federal taxes without payment of tax.

The BOE mails written notifications of its determinations to the parties but does not make its decisions public, which would provide guidance to taxpayers. The U.S. Tax Court publishes all of its decisions.

Recommendation: Create an Independent, Administrative Tax Appeals Body

Following the guidelines as set by the American Bar Association's (ABA) "Model State Tax Tribunal Act," the state should create an independent administrative body with tax expertise to resolve disputes between state and taxpayer. The judges should be trained in tax issues. The body will be the prepayment court for challenges to PIT, SUT, payroll and excise taxes and the BNRT.

The ABA recommends that the Governor appoint the head of the body, such as a judge, and that the entire body would report to the Executive Branch. Decisions would be rendered in writing and made public. Both sides would be able to appeal to Superior Court. (The current situation permits only the taxpayer to appeal, not the state agency).

APPENDIX E: DESCRIPTION OF THE PROPOSAL FOR A RAINY DAY RESERVE FUND

Proposal

The state should strengthen the Rainy Day Reserve Fund by setting a higher target and improving how it sets aside and uses money in the fund. The state should fundamentally change its Rainy Day Reserve Fund in the following key ways:

- **Rainy Day Reserve Fund Target Level.** The state should increase the target for the rainy day reserve fund from the current 5 percent up to 12.5 percent of state revenues.
- **Transfers to the Rainy Day Reserve Fund.** Revenues over a long term average should be transferred into the Rainy Day Reserve Fund. The circumstances under which the Governor can suspend transfers into the reserve should be limited to periods when revenues are insufficient to provide spending at prior year's level adjusted for changes in population and inflation.
- **Transfers Out of the Rainy Day Reserve Fund.** The state should create more stringent controls on the circumstances for the withdrawals of money from the reserve fund, as well as, the purposes the money can be used. Reserve funds could only be used to maintain spending at the prior year's level adjusted for changes in population and inflation.

Rationale

It is critical for the state to maintain an adequate reserve in order to support government services through economic downturns. While the Commission has made proposals that would change the tax system in a way to reduce volatility in the state's income stream, normal economic cycles will continue to produce swings in revenue. As California's economy and fiscal structure have evolved, revenue volatility has emerged as a major budgeting problem. As a result, the need for a robust and well-protected reserve fund has increased.

The California Constitution already requires the establishment of a prudent state reserve fund, and the state has long contributed to a reserve. But the reserves and the restrictions that apply to them have proven to be inadequate to the task. The amounts in the reserves have been insufficient to compensate for the increasing volatility in California's revenues. Restrictions on withdrawals have not been stringent enough to maintain the reserve for the times when it is most needed. Finally, contribution requirements to the funds have been too easily skirted.

Background

Each year, the state sets aside a portion of revenues it estimates it will receive in the upcoming year in one of two reserve funds. The money can be used to pay for unexpected expenses, cover shortfalls in tax revenue and save for future years. The two funds are:

- **Special Fund for Economic Uncertainties (SFEU).** The SFEU is the state's traditional reserve fund, from which funds may be withdrawn and spent for any purpose with approval by the Legislature. Any unexpected funds received during a year are automatically deposited into the SFEU. Generally, the SFEU has not acted as a reserve that helps offset the effects of economic downturns and uncertainties; instead, it has been a source of cash to help with one-time emergencies.
- **Budget Stabilization Account (BSA).** In 2004, California voters passed Proposition 58 establishing the BSA as part of the state's General Fund. Among its budget-related requirements, the ballot initiative set a reserve fund target size at 5 percent of revenues. It also required that half of the money transferred to the fund pay off debt and the other half go into a rainy day reserve. Proposition 58 also set rules for transferring money into and out of the fund. The Governor can stop transfers into the BSA with an Executive Order. Once the reserve reaches its target, no further

transfers are required. By passing a law, the state can use the reserve funds for any purpose.

Recent history suggests the inadequacy of the state reserve fund approach. Transfers into the BSA occurred for two fiscal years, 2006-07 and again in 2007-08. But as the economy began to deteriorate, the entire reserve balance of \$1.4 billion was transferred back to the General Fund and used on spending programs. The Governor suspended transfers in 2008-09 and it is expected that the state will continue to suspend transfers for the next few years. The existing target amount is the higher of \$8 billion or 5 percent of revenues.

Recommendation: Establish a new Rainy Day Reserve Fund policy with increased funding levels and limitations on withdrawals.

Rainy Day Reserve Fund Target Level. The cap on the amount held in the Reserve Fund should be dramatically increased from the BSA cap. Specifically, the amount to be maintained in the fund would be equal to 12.5 percent of General Fund revenues. This percentage is currently equal to about \$10 billion, but would grow over time.

Revenues to the Rainy Day Reserve Fund. Transfers to the Reserve Fund should be based on a more aggressive schedule than is currently in place.

- In periods of higher than normal rates of revenue, the excess revenue would be transferred into the Rainy Day Reserve Fund. Specifically, a ten-year revenue trend would be established each year, based on a simple regression analysis of revenue growth in the previous ten years. If the revenue exceeds what would be expected if it had grown at the ten-year trend, the revenue above the trend would be deposited into the Rainy Day Reserve Fund.
- The Governor would be able to stop or reduce the transfers into the Reserve Fund only in years when the state does not have enough revenues to pay for state spending equal to the prior year's level of spending, adjusted for changes in the state's population (as estimated annually by the Department of Finance) and the California Consumer Price Index.

APPENDIX E: DESCRIPTION OF THE PROPOSAL FOR A RAINY DAY RESERVE FUND

Spending From the Rainy Day Reserve Fund. The ability to withdraw funds from the reserve should be restricted to specific situations.

- Rainy Day Reserve funds could be used if the state does not have revenues sufficient to cover state spending equal to the prior year's level of expenses, after adjusting for changes in population and inflation. Through this mechanism, the Rainy Day Reserve Fund would substantially stabilize spending over time, keeping it on average in line with revenues.
- Once the Rainy Day Reserve Fund reaches the targeted balance of 12.5 percent of General Fund revenues, any excess amounts in the fund could be used only for one-time expenses. Examples of allowable one-time expenses include capital spending for infrastructure projects, temporary tax cuts or rebates and defeasance of bonds.
- While some have argued for the Rainy Day Reserve Fund to be used in the case of major natural disasters, doing so would not be consistent with the Reserve Fund's main purpose, which is to provide backfill revenue at times when General Fund revenue is below trend.

APPENDIX F: DESCRIPTION OF THE PROPOSAL FOR REVENUES FROM OIL LEASES

Proposal

The state should permit new oil leases with royalty revenues going to a reserve fund.

There are several economic reasons for permitting new oil leases. Unlike all other revenue sources, those paying would be desirous of doing so. Revenues from this source would create no economic distortions, and the economic activity being taxed could not migrate elsewhere.

Environmental concerns are paramount. While technological advancements reduce the number of exploratory wells, produce smaller holes and use fewer chemicals, require fewer drilling sites or platforms, and can now recover oil onshore from as far as seven miles off-shore, strict environmental safeguards would need to be imposed. Britain and Norway provide examples of successful exploitation of energy resources while maintaining effective environmental controls.

The amount of revenue that could be generated is likely to vary from year to year because it depends upon the volatile price of oil. Therefore, revenues should be deposited in a reserve fund which would be restricted to such things as paying off debt, lowering other taxes, one-time infrastructure spending, and building the state's Rainy Day reserve.

Over time, the state could receive as much as \$30 billion to \$80 billion in royalty revenues from new leases in California waters, depending on the amount and price of oil and the royalty and federal sharing terms, based on government estimates of recoverable oil resources in state and federal waters.

APPENDIX G: DESCRIPTION OF THE PROPOSAL FOR A MINIMUM TAX

Proposal

To ensure that all California residents and businesses participate in the financing of the state's General Fund spending, a minimum tax on all adult residents and all businesses in the state is proposed.

- All adults would be required to pay a minimum tax of 1 percent of their adjusted gross income, or \$100, whichever is smaller, annually by the tax filing deadline of April 15.
- All businesses would be required to pay a minimum tax of 1 percent of income or \$100, whichever is smaller, annually by the date of each business's filing deadline.

Simple one-page state forms would be developed by the Franchise Tax Board and used for these purposes.

Currently, California excludes a larger share of its population from the state income tax than virtually any other state. The Commission's proposal to abolish the state's General Fund sales tax would further remove many millions of citizens from funding state general services. It is important for adults and businesses to contribute to the tax system to some degree. Paying taxes gives people a stake in how tax money is spent.

APPENDIX H: DESCRIPTION OF PROPOSAL TO MERGE TAX AGENCIES

Proposal

The state should merge the Board of Equalization and the Franchise Tax Board into a new Department of Revenue headed by a Secretary of Revenue appointed by the Governor.

By merging the two primary tax agencies, the state will save costs in the long term. A combined tax agency would make more efficient use of physical facilities and equipment, result in better coordination of administrative requirements of the various taxes, and facilitate more effective compliance efforts. This proposal would also contribute to simplifying the tax system for taxpayers.

APPENDIX I: DRAFT LEGISLATION FOR COMMISSION'S TAX PACKAGE

The following document provides a draft version of the tax law changes recommended by the Commission. This is a preliminary document and does not include the entire legislative proposal. It does not address the transitional issues associated with moving from one tax system to another. Further, all features and parameters of the business net receipts tax have not yet been fully defined and developed. In addition, certain components of the new tax have been addressed in the draft legislation but have not been incorporated in fiscal estimates.

The Legislative Counsel's digest is presented first, followed by the preliminary text of the tax proposal.

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Prepared By _____

Approved By _____

LEGISLATIVE COUNSEL'S DIGEST

Bill No.

as introduced, _____.

General Subject: Sales and use taxes: Business Net Receipts Tax Law: corporate tax
repeal: income taxes: rates: deductions: credits: AMT: annual tax.

Existing law imposes a sales tax on retailers measured by the gross receipts from the sale of tangible personal property sold at retail in this state, or a use tax on the storage, use, or other consumption in this state of tangible personal property purchased from a retailer for storage, use, or other consumption in this state. The state sales and use tax rate is 7.25%, with 6% of state sales and use tax revenues deposited in the General Fund, and 1.25% deposited in special funds. The state sales and use tax rate will decrease 1% on July 1, 2011, and thereafter 5% of state sales and use tax revenues will be deposited in the General Fund.

This bill would, beginning January 1, 2012, annually reduce the state sales and use tax rate from which revenues are deposited in the General Fund by 1%, and

beginning January 1, 2016, would only impose sales and use taxes from which revenues are deposited in special funds. However, the tax on the sale of, and the storage use, or other consumption of motor vehicle, diesel, and other fuel would not be reduced.

The Personal Income Tax Law imposes taxes on taxable income at specified rates based upon the amount of taxable income. That law allows various deductions and credits in computing income subject to taxation, and also imposes an alternative minimum tax in modified conformity with federal income tax laws.

This bill would, for taxable years beginning on or after January 1, 2012, and before January 1, 2014, reduce the existing income rates by unspecified amounts. This bill would, for taxable years beginning on or after January 1, 2014, establish 2 tax rates of 2.75% and 6.5%, as applicable, increase the standard deduction, allow itemized deductions only for specified items, disallow specified credits, and repeal the alternative minimum tax. This bill would, for taxable years beginning on or after January 1, 2012, eliminate a specified annual tax and fee imposed on limited partnerships, limited liability partnerships, and limited liability companies, as provided.

This bill would establish the Business Net Receipts Tax Law pursuant to which a tax would be imposed on specified business entities at a rate of an unspecified percentage of net receipts, as defined, for the taxable year. That law would provide specified exemptions, deductions, and credits in computing the tax.

This bill would also provide specified conforming administrative provisions and transfer of rules for certain business entities.

The California Constitution requires the state to reimburse local agencies and school districts for certain costs mandated by the state. Statutory provisions establish procedures for making that reimbursement.

This bill would provide that no reimbursement is required by this act for a specified reason.

This bill would take effect immediately as a tax levy.

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

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Prepared By _____

Approved By _____

An act to amend Section 1656.1 of the Civil Code, and to amend Sections 6051, 6051.2, 6051.5, 6201, 6201.2, 6201.5, 6359.2, 6480.1, 6596, 17073, 17073.5, 18401, 18402, 18403, 18405, 18413, 18414, 18417, 18510, 18535, 18621, 18622, 18633, 18662, 18666, 18668, 19001, 19007, 19009, 19041.5, 19043, 19043.5, 19054, 19057, 19063, 19066, 19066.5, 19071, 19101, 19132, 19141.5, 19142, 19144, 19145, 19147, 19164, 19164.5, 19169, 19173, 19179, 19184, 19195, 19201, 19202, 19221, 19222, 19254, 19255, 19280, 19290, 19301, 19313, 19314, 19340, 19371, 19374, 19377, 19441, 19443, 19501, 19503, 19504, 19504.5, 19512, 19521, 19525, 19533, 19542.1, 19547, 19549, 19563, 19565, 19566, 19570, 19591, 19604, 19701, 19702, 19705, 19706, 19712, 19772, 19777, and 19801 of, to amend and repeal Sections 6051.3, 6051.4, 6051.45, 6201.3, 6201.4, 6201.45, and 18407 of, to add and repeal Sections 17064, 17938, 17947.5, and 17948.5 of, to add Sections 17039.3, 17041.2, 17041.3, 18611, 18612, 18613, 19011.7, 19028, 19029, 19030, 19135.5, 19139, 19141.8, 19188, and 23005 to, to add Article 2.5 (commencing with Section 17100) to Chapter 3 of Part 10 of Division 2 of, to add Article 3 (commencing with Section 18421) to Chapter 1 of, Article 2.5 (commencing with Section 18611) to Chapter 2 of, and Article 2.5 (commencing with Section 19028)

to Chapter 4 of, Part 10.2 of Division 2 of, and to add Part 12 (commencing with Section 27001) to Division 2 of, to repeal Sections 6051.1, 6201.1, 17087.5, 18633.5, 19061, 19149, 19164.1, and 19365 of, and to repeal Chapter 2.1 (commencing with Section 17062), Chapter 10.5 (commencing with Section 17935), Chapter 10.6 (commencing with Section 17941), and Chapter 10.7 (commencing with Section 17948), of Part 10 of Division 2 of, the Revenue and Taxation Code, relating to taxation, to take effect immediately, tax levy.

THE PEOPLE OF THE STATE OF CALIFORNIA DO ENACT AS FOLLOWS:

SECTION 1. The Legislature finds and declares the following:

(a) California's long-term prosperity requires that employers and entrepreneurs invest, remain, and grow in the state and that workers desire to live in the state.

(b) The quality of life for Californians benefits from essential and important services provided by state government directly and through funding for local government-operated programs, and it is beneficial for those essential and important services to have a stable and predictable source of funding.

(c) General Fund revenue over the last several decades has fluctuated dramatically due to changes in the economy in general, but primarily as a result of the volatility that is inherent in California's current tax system.

(d) The volatility inherent in California's personal income tax is driven significantly by its reliance on capital gains tax revenues, which have experienced decreases in the last decade as great as 59.1 percent in 2001, and an increase of 64.9 percent in 2004.

(e) The fluctuation in General Fund revenues creates difficulty in funding the operations of government year-to-year, as the need for state services, such as operating state parks, operating state prisons, overseeing elections, and providing funding for health care and social services does not change in response to revenue, but in relation to population, demographics, and service availability.

(f) The fluctuation in General Fund revenues makes it even more difficult to plan for those activities of government which, due to their magnitude, require funding

over several decades, including projects for environmental remediation and infrastructure development.

(g) California's current tax system was designed for the economy of the last century. Meanwhile, California's economy has changed significantly, shifting from a primarily manufacturing- and agriculturally-based economy to an information- and innovation-based economy.

(h) California's current tax system could be improved to provide greater incentives for firms to increase employment in the state and invest more in entrepreneurial activities and research that lead to high paying jobs and more exports.

(i) An improved tax system would decrease the pressure for future tax increases to address revenue shortfalls that will continue to occur if the volatility of the current system is not reduced.

(j) Californians would benefit from an improved tax system that supports a strong economy and job climate and provides a more predictable revenue source for essential and important government services.

(k) The Governor created by Executive order the Commission on the 21st Century Economy to examine tax system alternatives and develop strategies to improve the state's tax system.

(l) On ____, 2009, the Commission on the 21st Century Economy delivered a report to the Governor and Legislature with recommendations that would change laws in order to do all of the following:

- (1) Establish a new tax structure that better fits with the state's economy.
- (2) Stabilize state revenues and reduce volatility.

(3) Promote the long-term economic prosperity of the state and its citizens.

(4) Improve California's ability to successfully compete with other states and nations for jobs and investments.

(5) Reflect principles of sound tax policy including simplicity, competitiveness, efficiency, predictability, stability, and ease of compliance and administration.

(6) Ensure that taxation is fair and equitable.

SEC. 2. Section 1656.1 of the Civil Code is amended to read:

1656.1. (a) Whether a retailer may add sales tax reimbursement to the sales price of the tangible personal property sold at retail to a purchaser depends solely upon the terms of the agreement of sale. It shall be presumed that the parties agreed to the addition of sales tax reimbursement to the sales price of tangible personal property sold at retail to a purchaser if:

(1) The agreement of sale expressly provides for such addition of sales tax reimbursement;

(2) Sales tax reimbursement is shown on the sales check or other proof of sale;
or

(3) The retailer posts in his or her premises in a location visible to purchasers, or includes on a price tag or in an advertisement or other printed material directed to purchasers, a notice to the effect that reimbursement for sales tax will be added to the sales price of all items or certain items, whichever is applicable.

(b) It shall be presumed that the property, the gross receipts from the sale of which is subject to the sales tax, is sold at a price which includes tax reimbursement

if the retailer posts in his or her premises, or includes on a price tag or in an advertisement (whichever is applicable) one of the following notices:

(1) "All prices of taxable items include sales tax reimbursement computed to the nearest mill."

(2) "The price of this item includes sales tax reimbursement computed to the nearest mill."

(c) (1) The State Board of Equalization shall prepare and make available for inspection and duplication or reproduction a sales tax reimbursement schedule which shall be identical with the following tables up to the amounts specified therein: set forth the various rates of tax then in effect, with price ranges from zero to at least one dollar (\$1.00) and the amount of tax imposed within those price ranges.

4³/₄ percent

Price	Tax
-.01-.10	..... .00
-.11-.31	..... .01
-.32-.52	..... .02
-.53-.73	..... .03
-.74-.94	..... .04
-.95-1.15	..... .05

5 percent

Price	Tax
-.01-.09	..... .00
-.10-.29	..... .01
-.30-.49	..... .02
-.50-.69	..... .03
-.70-.89	..... .04
-.90-1.09	..... .05

5¹/₄ percent

Price	Tax
-.01-.09	..... .00
-.10-.28	..... .01
-.29-.47	..... .02

-.48 -.66	.....	.03
-.67 -.85	.....	.04
-.86 -1.04	.....	.05

5^{-1/2} percent

Price		Tax
-.01 -.09	.....	.00
-.10 -.31	.....	.01
-.28 -.52	.....	.02
-.46 -.73	.....	.03
-.64 -.94	.....	.04
-.82 -.94	.....	.05
1.00-1.15	.....	.06

5^{-3/4} percent

Price		Tax
-.01 -.08	.....	.00
-.09 -.26	.....	.01
-.27 -.43	.....	.02
-.44 -.60	.....	.03
-.61 -.78	.....	.04
-.79 -.95	.....	.05
-.96 -1.13	.....	.06

6 percent

Price		Tax
-.01 -.08	.....	.00
-.09 -.24	.....	.01
-.25 -.41	.....	.02
-.42 -.58	.....	.03
-.59 -.74	.....	.04
-.75 -.91	.....	.05
-.92-	.....	.06

6^{-1/4} percent

Price		Tax
-.01 -.07	.....	.00
-.08 -.23	.....	.01
-.24 -.39	.....	.02
-.40 -.55	.....	.03
-.56 -.71	.....	.04
-.72 -.87	.....	.05
-.88 -1.03	.....	.06

6^{-1/2} percent

Price	Tax
.01 -.07	.....:00
.08 -.23	.....:01
.24 -.38	.....:02
.39 -.53	.....:03
.54 -.69	.....:04
.70 -.84	.....:05
.85 -.99	.....:06
1.00-1.15	.....:07

6³/₄ percent

Price	Tax
.01 -.07	.....:00
.08 -.22	.....:01
.23 -.37	.....:02
.38 -.51	.....:03
.52 -.66	.....:04
.67 -.81	.....:05
.82 -.96	.....:06
.97 -1.11	.....:07

7 percent

Price	Tax
.01 -.07	.....:00
.08 -.21	.....:01
.22 -.35	.....:02
.36 -.49	.....:03
.50 -.64	.....:04
.65 -.78	.....:05
.79 -.92	.....:06
.93 -1.07	.....:07

7¹/₄ percent

Price	Tax
.01 -.06	.....:00
.07 -.20:01
.21 -.34:02
.35 -.48:03
.49 -.62:04
.63 -.75:05
.76 -.89:06
.90 -1.03:07

7¹/₂ percent

Price	Tax
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-.01-.0600
-.07-.1901
-.20-.3302
-.34-.4603
-.47-.5904
-.60-.7305
-.74-.8606
-.87-.9907
1.00-1.1308

(2) Reimbursement on sales prices in excess of those shown in the schedules prepared pursuant to paragraph (1) may be computed by applying the applicable tax rate to the sales price, rounded off to the nearest cent by eliminating any fraction less than one-half cent and increasing any fraction of one-half cent or over to the next higher cent.

(3) If sales tax reimbursement is added to the sales price of tangible personal property sold at retail, the retailer shall use a schedule provided by the board, or a schedule approved by the board.

(d) The presumptions created by this section are rebuttable presumptions.

SEC. 3. Section 6051 of the Revenue and Taxation Code is amended to read:

6051. (a) For the privilege of selling tangible personal property at retail a tax is hereby imposed upon all retailers at the rate of 2 1/2 percent of the gross receipts of any retailer from the sale of all tangible personal property sold at retail in this state on or after August 1, 1933, and to and including June 30, 1935, and at the rate of 3 percent thereafter, and at the rate of 2 1/2 percent on and after July 1, 1943, and to and including June 30, 1949, and at the rate of 3 percent on and after July 1, 1949, and to and including July 31, 1967, and at the rate of 4 percent on and after August 1, 1967, and to and including June 30, 1972, and at the rate of ~~3 3/4 percent~~ 3 3/4 percent on and after July 1,

1972, and to and including June 30, 1973, and at the rate of $4\frac{3}{4}$ percent on and after July 1, 1973, and to and including September 30, 1973, and at the rate of $3\frac{3}{4}$ percent on and after October 1, 1973, and to and including March 31, 1974, and at the rate of $4\frac{3}{4}$ percent ~~thereafter~~ on and after April 1, 1974, and to and including December 31, 2011.

(b) Except as provided in subdivision (c), for the privilege of selling tangible personal property at retail a tax is hereby imposed upon all retailers at the rate of 4 percent of the gross receipts of any retailer from the sale of all tangible personal property sold at retail in this state on and after January 1, 2012, and to and including December 31, 2012, and at the rate of 3 percent on and after January 1, 2013, and to and including December 31, 2013, and at the rate of 2 percent on and after January 1, 2014, and to and including December 31, 2014, and at the rate of 1 percent on and after January 1, 2015, and to and including December 31, 2015.

(c) For the privilege of selling tangible personal property at retail a tax is hereby imposed upon all retailers at the rate of 5 percent of the gross receipts of any retailer from the sale of all tangible personal property that is motor vehicle fuel as defined for purposes of the Motor Vehicle Fuel Tax Law (Part 2 (commencing with Section 7301)), fuel as defined for purposes of the Use Fuel Tax Law (Part 3 (commencing with Section 8601)) and diesel fuel as defined for purposes of the Diesel Fuel Tax Law (Part 31 (commencing with Section 60001)) sold at retail in this state on and after January 1, 2012.

SEC. 4. Section 6051 is added to the Revenue and Taxation Code, to read:

6051. (a) For the privilege of selling tangible personal property at retail, this article imposes a tax upon all retailers measured by the gross receipts of a retailer from the sale of all tangible personal property sold at retail in this state.

(b) This section shall become operative on January 1, 2016.

SEC. 5. Section 6051.1 of the Revenue and Taxation Code is repealed.

~~6051.1. (a) Notwithstanding Section 6051, for the privilege of selling tangible personal property at retail a tax is hereby imposed upon all retailers at the rate of 5 percent of the gross receipts of any retailer from the sale of all tangible personal property sold at retail in this state on and after the operative date of this subdivision.~~

~~(b) Subdivision (a) shall become operative on December 1, 1989, and shall cease to be operative on January 1, 1991.~~

~~(c) The rate prescribed by Section 6051 shall be applicable on and after the first day following the date subdivision (a) ceases to be operative pursuant to subdivision (b).~~

SEC. 6. Section 6051.2 of the Revenue and Taxation Code is amended to read:

6051.2. (a) In addition to the taxes imposed by ~~Section 6051 and any other provision of this part~~, for the privilege of selling tangible personal property at retail, a tax is hereby imposed upon all retailers at the rate of $\frac{1}{2}$ percent of the gross receipts of any retailer from the sale of all tangible personal property sold at retail in this state on and after July 15, 1991.

(b) All revenues received pursuant to this section shall be deposited in the State Treasury to the credit of the Local Revenue Fund, as established pursuant to Section 17600 of the Welfare and Institutions Code.

(c) This section shall cease to be operative on the first day of the first month of the calendar quarter following notification to the board by the Department of Finance of a final judicial determination by the California Supreme Court or any California court of appeal that the revenues collected pursuant to this section and Section 6201.2 that are deposited in the Local Revenue Fund are either of the following:

(1) "General Fund proceeds of taxes appropriated pursuant to Article XIII B of the California Constitution," as used in subdivision (b) of Section 8 of Article XVI of the California Constitution.

(2) "Allocated local proceeds of taxes," as used in subdivision (b) of Section 8 of Article XVI of the California Constitution.

SEC. 7. Section 6051.3 of the Revenue and Taxation Code is amended to read:

6051.3. (a) In addition to the taxes imposed by ~~Sections 6051, 6051.2, 6051.5,~~ and any other provision of this part, for the privilege of selling tangible personal property at retail, a tax is hereby imposed upon all retailers at the rate of $\frac{1}{4}$ percent of the gross receipts of any retailer from the sale of all tangible personal property sold at retail in this state on and after July 15, 1991, and during any period in which this section is operative pursuant to Section 6051.4.

(b) This section shall remain in effect only until January 1, 2012, and as of that date is repealed.

SEC. 8. Section 6051.4 of the Revenue and Taxation Code is amended to read:

6051.4. (a) Section 6051.3 shall be operative with respect to the sale of all tangible personal property sold at retail in this state on or after July 15, 1991, but shall cease to be operative during any period described in subdivision (c) or (d).

(b) On or before November 1, 1993, and on or before every November 1 thereafter, the Director of Finance shall determine and certify to the Governor, the Legislature, and the board both of the following:

(1) Whether the amount in the Special Fund for Economic Uncertainties, as established pursuant to Section 16418 of the Government Code, as of June 30 of the prior fiscal year exceeded 4 percent of General Fund revenues for that prior fiscal year.

(2) Whether the estimated amount in the Special Fund for Economic Uncertainties as of June 30 of the current fiscal year (without inclusion of any revenue derived pursuant to Section 6051.3 on and after January 1 of the current fiscal year) exceeds 4 percent of General Fund revenues for the current fiscal year.

(c) Section 6051.3 shall cease to be operative on and after January 1, 1994, if on or before November 1, 1993, the Director of Finance certifies pursuant to subdivision (b) that both amounts certified pursuant to paragraphs (1) and (2) of that subdivision exceed 4 percent of General Fund revenues for the respective fiscal year for which each amount is determined and certified.

(d) Section 6051.3 shall cease to be operative on and after January 1 following any November 1 in which Section 6051.3 is operative and the Director of Finance certifies pursuant to subdivision (b) that both amounts certified pursuant to paragraphs (1) and (2) of that subdivision exceed 4 percent of General Fund revenues for the respective fiscal year for which each amount is determined and certified.

(e) Section 6051.3 shall become operative on and after January 1 following any November 1 in which Section 6051.3 is inoperative and the Director of Finance certifies

pursuant to paragraph (2) of subdivision (b) that the estimated amount does not exceed 4 percent of the General Fund revenues as of June 30 of the current fiscal year.

(f) This section shall remain in effect only until January 1, 2012, and as of that date is repealed.

SEC. 9. Section 6051.45 of the Revenue and Taxation Code is amended to read:

6051.45. (a) Notwithstanding 6051.4 or any other provision of law, the state sales tax rate in Section 6051.3 shall not be operative in any calendar year beginning on or after January 1, 2002, if the Director of Finance determines both of the following:

(a)

(1) The General Fund reserve is 3 percent of revenues excluding the revenues derived from the $\frac{1}{4}$ cent sales and use tax rate.

(b)

(2) Actual General Fund revenues for the period May 1 through September 30 equal or exceed the May Revision forecast, prior to the November 1 determination.

~~The~~

(b) The Director of Finance shall make the determination on or before November 1 of each year.

~~The~~

(c) The $\frac{1}{4}$ cent reduction shall be operative for each calendar year commencing on the next January 1 after the determination is made.

(d) This section shall remain in effect only until January 1, 2012, and as of that date is repealed.

SEC. 10. Section 6051.5 of the Revenue and Taxation Code is amended to read:

6051.5. (a) In addition to the taxes imposed by ~~Section 6051 and any other provision of this part~~, for the privilege of selling tangible personal property at retail a tax is hereby imposed upon all retailers at the rate of ~~one-quarter of 1~~ 1 1/4 percent of the gross receipts of any retailer from the sale of all tangible personal property sold at retail in this state.

(b) All revenues, net of refunds, received pursuant to this section shall be deposited in the State Treasury to the credit of the Fiscal Recovery Fund, as established pursuant to Section 99008 of the Government Code.

(c) Revenues received pursuant to this section accruing to the Fiscal Recovery Fund shall not be considered to be "State General Fund proceeds of taxes appropriated pursuant to Article XIII B" within the meaning of either Section 8 of Article XVI of the California Constitution or Section 41202 of the Education Code.

(d) This section shall become operative on July 1, 2004, and shall cease to be operative on the first day of the first calendar quarter commencing more than 90 days following a notification to the board by the Director of Finance pursuant to subdivision (b) of Section 99006 of the Government Code.

SEC. 11. Section 6201 of the Revenue and Taxation Code is amended to read:

6201. (a) An excise tax is hereby imposed on the storage, use, or other consumption in this state of tangible personal property purchased from any retailer on or after July 1, 1935, for storage, use, or other consumption in this state at the rate of 3 percent of the sales price of the property, and at the rate of 2 1/2 percent on and after July 1, 1943, and to and including June 30, 1949, and at the rate of 3 percent on and after July 1, 1949, and to and including July 31, 1967, and at the rate of 4 percent on

and after August 1, 1967, and to and including June 30, 1972, and at the rate of $3\frac{3}{4}$ percent on and after July 1, 1972, and to and including June 30, 1973, and at the rate of $4\frac{3}{4}$ percent on and after July 1, 1973, and to and including September 30, 1973, and at the rate of $3\frac{3}{4}$ percent on and after October 1, 1973, and to and including March 31, 1974, and at the rate of $4\frac{3}{4}$ percent ~~thereafter~~ on and after April 1, 1974, and to and including December 31, 2011.

(b) Except as provided in subdivision (c), an excise tax is hereby imposed on the storage, use, or other consumption in this state of tangible personal property purchased from any retailer for storage, use, or other consumption in this state at the rate of 4 percent of the sales price of the property, on and after January 1, 2012, and to and including December 31, 2012, and at the rate of 3 percent on and after January 1, 2013, and to and including December 31, 2013, and at the rate of 2 percent on and after January 1, 2014, and to and including December 31, 2014, and at the rate of 1 percent on and after January 1, 2015, and to and including December 31, 2015.

(c) An excise tax is hereby imposed on the storage, use, or other consumption in this state of motor vehicle fuel as defined for purposes of the Motor Vehicle Fuel Tax Law (Part 2 (commencing with Section 7301)), fuel as defined for purposes of the Use Fuel Tax Law (Part 3 (commencing with Section 8601)), and diesel fuel as defined for purposes of the Diesel Fuel Tax Law (Part 31 (commencing with Section 60001)), purchased from any retailer for storage, use, or other consumption in this state at the rate of 5 percent of the sales price of the property, on and after January 1, 2012.

SEC. 12. Section 6201.1 of the Revenue and Taxation Code is repealed.

~~6201.1. (a) Notwithstanding Section 6201, an excise tax is hereby imposed on the storage, use, or other consumption in the state of tangible personal property purchased from any retailer on or after the operative date of this subdivision, for storage, use, or other consumption in this state at the rate of 5 percent of the sales price of the property on and after the operative date of this subdivision.~~

~~(b) Subdivision (a) shall become operative on December 1, 1989, and shall cease to be operative on January 1, 1991.~~

~~(c) The rate prescribed by Section 6201 shall be applicable on and after the first day following the date subdivision (a) ceases to be operative pursuant to subdivision (b).~~

SEC. 13. Section 6201.2 of the Revenue and Taxation Code is amended to read:

6201.2. (a) In addition to the taxes imposed by ~~Section 6201 and any other provision~~ of this part, an excise tax is hereby imposed on the storage, use, or other consumption in this state of tangible personal property purchased from any retailer on or after July 15, 1991, for storage, use, or other consumption in this state at the rate of $\frac{1}{2}$ percent of the sales price of the property.

(b) All revenues received pursuant to this section shall be deposited in the State Treasury to the credit of the Local Revenue Fund, as established pursuant to Section 17600 of the Welfare and Institutions Code.

(c) This section shall cease to be operative on the first day of the first month of the calendar quarter following notification to the board by the Department of Finance of a final judicial determination by the California Supreme Court or any California

court of appeal that the revenues collected pursuant to this section and Section 6051.2 and deposited in the Local Revenue Fund are either of the following:

(1) "General Fund proceeds of taxes appropriated pursuant to Article XIII B of the California Constitution," as used in subdivision (b) of Section 8 of Article XVI of the California Constitution.

(2) "Allocated local proceeds of taxes," as used in subdivision (b) of Section 8 of Article XVI of the California Constitution.

SEC. 14. Section 6201.3 of the Revenue and Taxation Code is amended to read:

6201.3. (a) In addition to the taxes imposed by ~~Sections 6201, 6201.2, 6201.5,~~ and any other provision of this part, an excise tax is hereby imposed on the storage, use, or other consumption in this state of tangible personal property purchased from any retailer on and after July 15, 1991, and purchased during any period in which this section is operative pursuant to Section 6201.4 at the rate of $\frac{1}{4}$ percent of the sales price of the property.

(b) This section shall remain in effect only until January 1, 2012, and as of that date is repealed.

SEC. 15. Section 6201.4 of the Revenue and Taxation Code is amended to read:

6201.4. (a) Section 6201.3 shall be operative with respect to the storage, use, or other consumption in this state of tangible personal property purchased from any retailer on and after July 15, 1991, but shall cease to be operative during any period described in subdivision (c) or (d).

(b) On or before November 1, 1993, and on or before every November 1 thereafter, the Director of Finance shall determine and certify to the Governor, the Legislature, and the board both of the following:

(1) Whether the amount in the Special Fund for Economic Uncertainties, as established pursuant to Section 16418 of the Government Code, as of June 30 of the prior fiscal year exceeded 4 percent of General Fund revenues for that prior fiscal year.

(2) Whether the estimated amount in the Special Fund for Economic Uncertainties as of June 30 of the current fiscal year (without inclusion of any revenue derived pursuant to Section 6201.3 on and after January 1 of the current fiscal year) exceeds 4 percent of General Fund revenues for the current fiscal year.

(c) Section 6201.3 shall cease to be operative on and after January 1, 1994, if on or before November 1, 1993, the Director of Finance certifies pursuant to subdivision (b) that both amounts certified pursuant to paragraphs (1) and (2) of that subdivision exceed 4 percent of General Fund revenues for the respective fiscal year for which each amount is determined and certified.

(d) Section 6201.3 shall cease to be operative on and after January 1 following any November 1 in which Section 6201.3 is operative and the Director of Finance certifies pursuant to subdivision (b) that both amounts certified pursuant to paragraphs (1) and (2) of that subdivision exceed 4 percent of General Fund revenues for the respective fiscal year for which each amount is determined and certified.

(e) Section 6201.3 shall become operative on and after January 1 following any November 1 in which Section 6201.3 is inoperative and the Director of Finance certifies

pursuant to paragraph (2) of subdivision (b) that the estimated amount does not exceed 4 percent of the General Fund revenues as of June 30 of the current fiscal year.

(f) This section shall remain in effect only until January 1, 2012, and as of that date is repealed.

SEC. 16. Section 6201.45 of the Revenue and Taxation Code is amended to read:

6201.45. (a) Notwithstanding 6201.4 or any other provision of law, the state use tax rate in Section 6201.3 shall not be operative in any calendar year beginning on or after January 1, 2002, if the Director of Finance determines both of the following:

(a)

(1) The General Fund reserve is 3 percent of revenues excluding the revenues derived from the $\frac{1}{4}$ cent sales and use tax rate.

(b)

(2) Actual General Fund revenues for the period May 1 through September 30 equal or exceed the May Revision forecast, prior to the November 1 determination.

The

(b) The Director of Finance shall make the determination on or before November 1 of each year.

The

(c) The $\frac{1}{4}$ cent reduction shall be operative for each calendar year commencing on the next January 1 after the determination is made.

(d) This section shall remain in effect only until January 1, 2012, and as of that date is repealed.

SEC. 17. Section 6201.5 of the Revenue and Taxation Code is amended to read:

6201.5. (a) In addition to the taxes imposed by ~~Section 6201 and any other provision~~ of this part, an excise tax is hereby imposed on the storage, use, or other consumption in this state of tangible personal property purchased from any retailer at the rate of ~~one-quarter of 1~~ 1/4 percent of the sales price of the property.

(b) All revenues, net of refunds, received pursuant to this section shall be deposited in the State Treasury to the credit of the Fiscal Recovery Fund, as established pursuant to Section 99008 of the Government Code.

(c) Revenues received pursuant to this section accruing to the Fiscal Recovery Fund shall not be considered to be "State General Fund proceeds of taxes appropriated pursuant to Article XIII B" within the meaning of either Section 8 of Article XVI of the California Constitution or Section 41202 of the Education Code.

(d) This section shall become operative on July 1, 2004, and shall cease to be operative on the first day of the first calendar quarter commencing more than 90 days following a notification to the board by the Director of Finance pursuant to subdivision (b) of Section 99006 of the Government Code.

SEC. 18. Section 6359.2 of the Revenue and Taxation Code is amended to read:

6359.2. (a) Except as otherwise provided in Sections 6359.4, 6359.45, 6363, and 6370, for the year beginning on January 1, 1988, and ending on December 31, 1988, 77 percent of the gross receipts of any retailer from the sale at retail of food products shall be subject to the tax imposed by ~~Section 6051~~ this part, when those food products are actually sold through a vending machine.

(b) Except as otherwise provided in Sections 6359.4, 6359.45, 6363, and 6370, for the year beginning on January 1, 1989, and ending on December 31, 1989, 55 percent of the gross receipts of any retailer from the sale at retail of food products shall be subject to the tax imposed by ~~Section 6051~~ this part, when those food products are actually sold through a vending machine.

(c) Except as otherwise provided in Sections 6359.4, 6359.45, 6363, and 6370, for the year beginning on January 1, 1990, and thereafter, 33 percent of the gross receipts of any retailer from the sale at retail of food products shall be subject to the tax imposed by ~~Section 6051~~ this part, when those food products are actually sold through a vending machine.

(d) (1) The Legislature finds that 33 percent represents the statewide average of food products sold through vending machines which are subject to the tax imposed under this part. Therefore, the Legislature establishes this average as the measure of the tax with respect to vending machine sales to simplify tax auditing procedures and to provide for uniformity in the taxation of gross receipts derived from the sale of food products through vending machines.

(2) The Legislature also finds that due to fiscal constraints, it is necessary to phase in the partial exemption for sales made through vending machines in the 1988 and 1989 calendar years.

(e) For purposes of this section, "food products" includes hot coffee, hot tea, and hot chocolate, when those hot beverages are actually sold through a vending machine for a separate price. "Food products" does not include other hot prepared food products, as defined in Section 6359.

SEC. 19. Section 6480.1 of the Revenue and Taxation Code is amended to read:

6480.1. (a) At any time that motor vehicle fuel tax or diesel fuel tax is imposed or would be imposed, but for the dyed diesel fuel exemption in paragraph (1) of subdivision (a) of Section 60100, or the train operator exemption in paragraph (7) of subdivision (a) of Section 60100 or paragraph (11) of subdivision (a) of Section 7401, or, pursuant to subdivision (f) of Section 6480, would be deemed to be imposed, on any removal, entry, or sale in this state of motor vehicle fuel, aircraft jet fuel, or diesel fuel, the supplier shall collect prepayment of retail sales tax from the person to whom the motor vehicle fuel, aircraft jet fuel, or diesel fuel is sold. However, if no sale occurs at the time of imposition of motor vehicle fuel tax or diesel fuel tax, the supplier shall prepay the retail sales tax on that motor vehicle fuel, aircraft jet fuel, or diesel fuel. The prepayment required to be collected by the supplier constitutes a debt owed by the supplier to this state until paid to the board, until satisfactory proof has been submitted to prove that the retailer of the fuel has paid the retail sales tax to the board, or until a supplier or wholesaler who has consumed the fuel has paid the use tax to the board. Each supplier shall report and pay the prepayment amounts to the board, in a form as prescribed by the board, in the period in which the fuel is sold. On each subsequent sale of that fuel, each seller, other than the retailer, shall collect from his or her purchaser a prepayment computed using the rate applicable at the time of sale. Each supplier shall provide his or her purchaser with an invoice for, or other evidence of, the collection of the prepayment amounts which shall be separately stated thereon.

(b) (1) A wholesaler shall collect prepayment of the retail sales tax from the person to whom the motor vehicle fuel, aircraft jet fuel, or diesel fuel is sold. Each

wholesaler shall provide his or her purchaser with an invoice for or other evidence of the collection of the prepayment amounts, which shall be separately stated thereon.

(2) Each wholesaler shall report to the board, in a form as prescribed by the board and for the period in which the motor vehicle fuel, aircraft jet fuel, or diesel fuel was sold, all of the following:

(A) The number of gallons of fuel sold and the amount of sales tax prepayments collected by the wholesaler.

(B) The number of tax-paid gallons purchased and the amount of sales tax prepayments made by the wholesaler.

(C) In the event that the amount of sales tax prepayments collected by the wholesaler is greater than the amount of sales tax prepayments made by the wholesaler, then the excess constitutes a debt owed by the wholesaler to the state until paid to the board, or until satisfactory proof has been submitted that the retailer of the fuel has paid the tax to the board.

(c) A supplier or wholesaler who pays the prepayment and issues a resale certificate to the seller, but subsequently consumes the motor vehicle fuel, aircraft jet fuel, or diesel fuel, shall be entitled to a credit against his or her sales and use taxes due and payable for the period in which the prepayment was made, provided that he or she reports and pays the use tax to the board on the consumption of that fuel.

(d) The amount of a prepayment paid by the retailer or a supplier or wholesaler who has consumed the motor vehicle fuel, aircraft jet fuel, or diesel fuel to the seller from whom he or she acquired the fuel shall constitute a credit against his or her sales and use taxes due and payable for the period in which the sale was made. Failure of

the supplier or wholesaler to report prepayments or the supplier's or wholesaler's failure to comply with any other duty under this article shall not constitute grounds for denial of the credit to the retailer, supplier, or wholesaler, either on a temporary or permanent basis or otherwise. To be entitled to the credit, the retailer, supplier, or wholesaler shall retain for inspection by the board any receipts, invoices, or other documents showing the amount of sales tax prepaid to his or her supplier, together with the evidence of payment.

(e) The rate of the prepayment required to be collected during the period from July 1, 1986, through March 31, 1987, shall be four cents (\$0.04) per gallon of motor vehicle fuel distributed or transferred.

(f) On April 1 of each succeeding year, the prepayment rate per gallon for motor vehicle fuel, rounded to the nearest one-half of one cent (\$0.005), of the required prepayment shall be established by the board based upon 80 percent of the combined state and local sales tax rate established by ~~Sections 6051, 6051.2, 6051.3, 6051.5, 7202, and 7203.1~~ this part, Sections 7202 and 7203.1, and Section 35 of Article XIII of the California Constitution on the arithmetic average selling price (excluding sales tax) as determined by the State Energy Resources Conservation and Development Commission, in its latest publication of the "Quarterly Oil Report," of all grades of gasoline sold through a self-service gasoline station. In the event the "Quarterly Oil Report" is delayed or discontinued, the board may base its determination on other sources of the arithmetic average selling price of gasoline. The board shall make its determination of the rate no later than November 1 of the year prior to the effective date of the new rate. Immediately upon making its determination and setting of the

rate, the board shall each year, no later than January 1, notify by mail every supplier, wholesaler, and retailer of motor vehicle fuel. In the event the price of fuel decreases or increases, and the established rate results in prepayments which consistently exceed or are significantly lower than the retailers' sales tax liability, the board may readjust the rate.

(g) On April 1 of each succeeding year, the prepayment rate per gallon for aircraft jet fuel, rounded to the nearest one-half of one cent (\$0.005), shall be established by the board based upon 80 percent of the combined state and local sales tax rate established by ~~Sections 6051, 6051.2, 6051.3, 6051.5, 7202, and 7203.1~~ this part, Sections 7202 and 7203.1, and Section 35 of Article XIII of the California Constitution on the arithmetic average selling price (excluding sales and state excise tax) as determined by the board. The board shall make its determination of the rate no later than November 1 of the year prior to the effective date of the new rate. The rate of the prepayment required to be collected for aircraft jet fuel shall be equal to 80 percent of the arithmetic average selling price of aircraft jet fuel as specified by industry publications. Immediately upon making its determination and setting of the rate, the board shall each year, no later than January 1, notify by mail every supplier, wholesaler, and retailer of aircraft jet fuel. In the event the price of aircraft jet fuel decreases or increases, and the established rate results in prepayments that consistently exceed or are significantly lower than the retailers' sales tax liability, the board may readjust the rate.

(h) On April 1 of each succeeding year, the prepayment rate per gallon for diesel fuel, rounded to the nearest one-half of one cent (\$0.005), shall be established by the

board based upon 80 percent of the combined state and local sales tax rate established by ~~Sections 6051, 6051.2, 6051.3, 6051.5, 7202, and 7203.1~~ this part, Sections 7202 and 7203.1, and Section 35 of Article XIII of the California Constitution on the arithmetic average selling price (excluding sales and state excise tax) as determined by the board. The board shall make its determination of the rate no later than November 1 of the year prior to the effective date of the new rate. The rate of the prepayment required to be collected for diesel fuel shall be equal to 80 percent of the arithmetic average selling price of diesel fuel as specified by industry publications. Immediately upon making its determination and setting of the rate, the board shall each year, no later than January 1, notify by mail every supplier, wholesaler, and retailer of diesel fuel. In the event the price of diesel fuel decreases or increases, and the established rate results in prepayments that consistently exceed or are significantly lower than the retailers' sales tax liability, the board may readjust the rate.

(i) (1) Notwithstanding any other provision of this section, motor vehicle fuel sold by a supplier or wholesaler to a qualified purchaser who, pursuant to a contract with the State of California or its instrumentalities, resells that fuel to the State of California or its instrumentalities shall be exempt from the prepayment requirements.

(2) A qualified purchaser who acquires motor vehicle fuel for subsequent resale to the State of California or its instrumentalities pursuant to this subdivision shall furnish to the supplier or wholesaler from whom the fuel is acquired an exemption certificate, completed in accordance with any instructions or regulations as the board may prescribe. The supplier or wholesaler shall retain the certificate in his or her records

in support of the exemption. To qualify for the prepayment exemption, both of the following conditions shall apply:

(A) The qualified purchaser does not take possession of the fuel at any time.

(B) The fuel is delivered into storage tanks owned or leased by the State of California or its instrumentalities via facilities of the supplier or wholesaler, or by common or contract carriers under contract with the supplier or wholesaler.

(3) For purposes of this subdivision, “qualified purchaser” means a wholesaler who does not have or maintain a storage facility or facilities for the purpose of selling motor vehicle fuel.

SEC. 20. Section 6596 of the Revenue and Taxation Code is amended to read:

6596. (a) If the board finds that a person’s failure to make a timely return or payment is due to the person’s reasonable reliance on written advice from the board, the person may be relieved of the taxes imposed by ~~Sections 6051 and 6201~~ this part and any penalty or interest added thereto.

(b) For the purpose of this section, a person’s failure to make a timely return or payment shall be considered to be due to reasonable reliance on written advice from the board, only if the board finds that all of the following conditions are satisfied:

(1) The person requested in writing that the board advise him or her whether a particular activity or transaction is subject to tax under this part. The specific facts and circumstances of the activity or transaction shall be fully described in the request.

(2) The board responded in writing to the person regarding the written request for advice, stating whether or not the described activity or transaction is subject to tax, or stating the conditions under which the activity or transaction is subject to tax.

(3) In reasonable reliance on the board's written advice, the person did not do either of the following:

(A) Charge or collect from his or her customers amounts designated as sales tax reimbursement or use tax for the described activity or transaction.

(B) Pay a use tax on the storage, use, or other consumption in this state of tangible personal property.

(4) The liability for taxes applied to a particular activity or transaction which occurred before either of the following:

(A) Before the board rescinded or modified the advice so given, by sending written notice to the person of the rescinded or modified advice.

(B) Before a change in statutory or constitutional law, a change in the board's regulations, or a final decision of a court, which renders the board's earlier written advice no longer valid.

(c) Any person seeking relief under this section shall file with the board:

(1) A copy of the person's written request to the board and a copy of the board's written advice.

(2) A statement under penalty of perjury setting forth the facts on which the claim for relief is based.

(3) Any other information which the board may require.

(d) Only the person making the written request shall be entitled to rely on the board's written advice to that person.

SEC. 21. Section 17039.3 is added to the Revenue and Taxation Code, to read:

17039.3. Notwithstanding this part or Part 10.2 (commencing with Section 18401), for each taxable year beginning on or after January 1, 2014, any credit otherwise allowable under Chapter 2 (commencing with Section 17041) or Section 17063, including the carryover of any credit under Chapter 2 (commencing with Section 17041) from a prior taxable year, any former provision of that chapter, or Section 17063, shall not be allowed against the “net tax,” as defined in Section 17039.

SEC. 22. Section 17041.2 is added to the Revenue and Taxation Code, to read:

17041.2. (a) For each taxable year beginning on or after January 1, 2012, and before January 1, 2013, Section 17041 is modified to provide that the percentages specified in paragraph (1) of subdivision (a) and paragraph (1) of subdivision (c) shall be reduced by ____ percent.

(b) For each taxable year beginning on or after January 1, 2013, and before January 1, 2014, Section 17041 is modified to provide that the percentages specified in paragraph (1) of subdivision (a) and paragraph (1) of subdivision (c) shall be reduced by ____ percent.

SEC. 23. Section 17041.3 is added to the Revenue and Taxation Code, to read:

17041.3. (a) (1) For each taxable year beginning on or after January 1, 2014, Section 17041 is modified to provide that the percentages and income tax brackets specified in paragraph (1) of subdivision (a) shall be the percentages and income tax brackets in paragraph (2) in lieu of each of the percentages and income tax brackets contained therein.

(2) If the taxable income is:	The tax is:
Not over \$27,500	2.75% of the taxable income
Over \$27,500	\$756 plus 6.5% of the

excess over \$27,500

(b) (1) For each taxable year beginning on or after January 1, 2014, Section 17041 is modified to provide that the percentages and income tax brackets specified in paragraph (1) of subdivision (c) shall be the percentages and income tax brackets in paragraph (2) in lieu of each of the percentages and income tax brackets contained therein.

(2) If the taxable income is:	The tax is:
Not over \$41,250	2.75% of the taxable income
Over \$41,250	\$1,134 plus 6.5% of the excess over \$41,250

(c) The income tax brackets in paragraph (2) of subdivision (a) and paragraph (2) of subdivision (b) shall be recomputed in accordance with subdivision (h) of Section 17041, modified by substituting “2015” for “1988.”

SEC. 24. Section 17064 is added to the Revenue and Taxation Code, to read:

17064. This chapter shall not apply to taxable years beginning on or after January 1, 2014, and shall remain in effect only until January 1, 2015, and as of that date is repealed.

SEC. 25. Section 17073 of the Revenue and Taxation Code is amended to read:

17073. (a) Section 63 of the Internal Revenue Code, relating to taxable income defined, shall apply, except as otherwise provided.

~~(b) The deduction allowed by Section 17208.1, relating to interest on loans or financed indebtedness obtained from a publicly owned utility for the purchase and installation of energy efficient products or equipment, may not be treated as a~~

~~miscellaneous itemized deduction under Section 67(a) of the Internal Revenue Code, relating to the 2-percent floor on miscellaneous deductions:~~

~~(e) For individuals who do not itemize deductions, the standard deduction computed in accordance with Section 17073.5 shall be allowed as a deduction in computing taxable income.~~

(b) For each taxable year beginning on or after January 1, 2014, Section 63(a) of the Internal Revenue Code is modified to provide that the term “taxable income” means adjusted gross income (as defined in Section 17072), minus either “itemized deductions” (as defined in subdivision (c)) or the standard deduction computed in accordance with Section 17073.5.

(c) For each taxable year beginning on or after January 1, 2014, Section 63(d) of the Internal Revenue Code, relating to itemized deductions, is modified to provide that the term “itemized deductions” means only the deduction for each of the following:

(1) The deduction for qualified residence interest under Section 163(h)(2)(D) of the Internal Revenue Code.

(2) The deduction for real property taxes under Section 164(a)(1) of the Internal Revenue Code.

(3) The deduction under Section 170 of the Internal Revenue Code, relating to charitable, etc., contributions and gifts.

(d) Section 17077 of this code, and Section 68 of the Internal Revenue Code, relating to overall limitation on itemized deductions, shall not apply to taxable years beginning on or after January 1, 2014.

SEC. 26. Section 17073.5 of the Revenue and Taxation Code is amended to read:

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

(1) In the case of a taxpayer, other than a head of a household or a surviving spouse (as defined in Section 17046) or a married couple filing a joint return, the standard deduction shall be ~~one thousand eight hundred eighty dollars (\$1,880)~~ twenty-two thousand five hundred dollars (\$22,500).

(2) In the case of a head of household or a surviving spouse (as defined in Section 17046) or a married couple filing a joint return, the standard deduction shall be ~~three thousand seven hundred sixty dollars (\$3,760)~~ forty-five thousand dollars (\$45,000).

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

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

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

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

(a). That computation shall be made as follows:

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

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

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

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

(e) The amendments to this section by the act adding this subdivision shall apply to taxable years beginning on or after January 1, 2014.

SEC. 27. Section 17087.5 of the Revenue and Taxation Code is repealed.

~~17087.5. Subchapter S of Chapter 1 of Subtitle A of the Internal Revenue Code, relating to tax treatment of "S corporations" and their shareholders, shall apply, except as otherwise provided under this part or Part 11 (commencing with Section 23001).~~

SEC. 28. Article 2.5 (commencing with Section 17100) is added to Chapter 3 of Part 10 of Division 2 of the Revenue and Taxation Code, to read:

Article 2.5. Tax Treatment of "S" Corporations and their Shareholders

17100. Subchapter S of Chapter 1 of Subtitle A of the Internal Revenue Code, relating to the tax treatment of "S" corporations and their shareholders, shall apply, except as otherwise provided.

17101. (a) A corporation that has in effect for federal income tax purposes a valid election under Section 1362(a) of the Internal Revenue Code shall be an "S" corporation for purposes of this part and Part 10.2 (commencing with Section 18401).

(b) A corporation that is an "S" corporation for federal income tax purposes shall be an "S" corporation for purposes of this part, Part 10.2 (commencing with Section 18401), and its shareholders shall be shareholders of an "S" corporation without regard to whether the corporation is qualified to do business or is incorporated in this state.

(c) (1) A termination of a federal election pursuant to Section 1362(d) of the Internal Revenue Code that is not an inadvertent termination pursuant to Section 1362(f) of the Internal Revenue Code shall simultaneously terminate the "S" corporation election for purposes of this part and Part 10.2 (commencing with Section 18401).

(2) A federal termination by revocation shall be effective for purposes of this part and shall be reported to the Franchise Tax Board in the form and manner prescribed by the Franchise Tax Board no later than the last date allowed for filing federal termination for that year under Section 1362(d) of the Internal Revenue Code.

(d) Section 1362(d)(3) of the Internal Revenue Code, relating to circumstances where passive investment income exceeds 25 percent of gross receipts for three consecutive taxable years and the corporation has accumulated earnings and profits, shall not apply unless the “S” election is terminated for federal income tax purposes.

(e) (1) The provisions of Section 1362(b)(5) of the Internal Revenue Code, relating to authority to treat late elections, etc., as timely, shall apply only for taxable years beginning on or after January 1, 1997, with respect to elections under Section 1362(a) of the Internal Revenue Code for taxable years beginning on or after January 1, 1997.

(2) Notwithstanding paragraph (1), if for any taxable year beginning on or after January 1, 2003, a corporation fails to qualify as an “S” corporation for federal income tax purposes solely because the federal Form 2553 (Election by a Small Business Corporation) was not filed timely, the corporation shall be treated for purposes of this part as an “S” corporation for the taxable year the “S” corporation election should have been made, and for each subsequent year until terminated, if the corporation and its shareholders have filed with the Internal Revenue Service a federal Form 2553 requesting automatic relief with respect to the late “S” corporation election, in full compliance with the federal Revenue Procedure 1997-48, I.R.B. 1997-43, and have received notification of the acceptance of the untimely filed “S” corporation election from the Internal Revenue Service. A copy of the notification shall be provided to the Franchise Tax Board upon request.

(f) The provisions of Section 1362(f) of the Internal Revenue Code, relating to inadvertent invalid elections or terminations, shall apply only for taxable years beginning

on or after January 1, 1997, with respect to elections under Section 1362(a) of the Internal Revenue Code for taxable years beginning on or after January 1, 1997.

17102. (a) For purposes of this part, Part 10.2 (commencing with Section 18401), and Part 12 (commencing with Section 27001):

(1) (A) Section 1361(b)(3)(A)(ii) of the Internal Revenue Code shall not apply and, in lieu thereof, subparagraph (B) shall apply and all references to Section 1361(b)(3)(A)(ii) of the Internal Revenue Code shall be treated as a reference to subparagraph (B).

(B) All activities, assets, liabilities, receipts, purchases, and items of income, deduction, and credit of a qualified Subchapter S subsidiary shall be treated as activities (including activities for purposes of Part 12), assets, liabilities, receipts, purchases, and those items, as the case may be, of the "S" corporation.

(2) Section 1361(b)(3)(B) of the Internal Revenue Code is modified to include the following requirements in addition to the requirements contained therein:

(A) The "S" corporation has in effect a valid election to treat the corporation as a qualified Subchapter S subsidiary for federal income tax purposes.

(B) An election made by the "S" corporation under Section 1361(b)(3)(B)(ii) of the Internal Revenue Code to treat the corporation as a qualified Subchapter S subsidiary for federal income tax purposes shall be treated for purposes of this part as an election made by the "S" corporation under this subdivision and a separate election under paragraph (3) of subdivision (e) of Section 17024.5 shall not be allowed.

(C) No election under this subdivision shall be allowed unless the "S" corporation has made the election under Section 1361(b)(3)(B)(ii) of the Internal Revenue Code

to treat the corporation as a qualified Subchapter S subsidiary for federal income tax purposes.

(b) Section 1361(c)(6) of the Internal Revenue Code, relating to certain exempt organizations permitted as shareholders, is modified by substituting a reference to Section 17631 or Section 27701d in lieu of the reference to Section 501(c)(3) of the Internal Revenue Code and by substituting a reference to Section 17631 or Section 27701 in lieu of the reference to Section 501(a) of the Internal Revenue Code.

(c) Section 1361(e)(1)(B)(ii) of the Internal Revenue Code, relating to certain trusts not eligible, is modified by substituting “under this part” in lieu of “under this subtitle.”

(d) Section 1361(e)(3) of the Internal Revenue Code, relating to election, is modified to include the following provisions:

(1) An election made by the trustee under Section 1361(e) of the Internal Revenue Code to be an electing small business trust for federal income tax purposes shall be treated for purposes of this part as an election made by the trustee under this subdivision and a separate election under paragraph (3) of subdivision (e) of Section 17024.5 shall not be allowed. Any election made shall apply to the taxable year of the trust for which that election is made and to all subsequent taxable years of that trust, unless revoked with the consent of the Franchise Tax Board.

(2) No election under this subdivision shall be allowed unless the trustee has made the election under Section 1361(e) of the Internal Revenue Code to be an electing small business trust for federal income tax purposes.

17103. For purposes of subdivision (b) of Section 17276, relating to limitations on loss carryovers, losses passed through to shareholders of an “S” corporation, to the extent otherwise allowable without application of that subdivision, shall be fully included in the net operating loss of that shareholder and then that subdivision shall be applied to the entire net operating loss.

17104. (a) Section 1366(a)(1) of the Internal Revenue Code, relating to determination of shareholder’s tax liability, is modified to apply to the final taxable year of a trust or estate that terminates before the end of the corporation’s taxable year.

(b) Section 1366(d)(1)(A) of the Internal Revenue Code, relating to losses and deductions that cannot exceed shareholder’s basis in stock and debt, is modified to additionally provide that the adjusted basis of a shareholder’s stock in the “S” corporation is to be decreased by distributions by the corporation that were not includable in the income of the shareholder by reason of Section 1368 of the Internal Revenue Code.

(c) Section 1366(d)(3) of the Internal Revenue Code, relating to carryover of disallowed losses and deductions to post-termination transition period, is modified to provide that to the extent that any increase in adjusted basis described in Section 1366(d)(3)(B) of the Internal Revenue Code would have increased the shareholder’s amount at risk under Section 465 if the increase had occurred on the day preceding the commencement of the post-termination transition period, rules similar to the rules described in Section 1366(d)(3)(A) to (C), inclusive, of the Internal Revenue Code shall apply to any losses disallowed by reason of Section 465(a) of the Internal Revenue Code.

17105. (a) Section 1366(f) of the Internal Revenue Code, relating to special rules, shall be modified as follows:

(1) The amount of tax used to compute the loss allowed by Section 1366(f)(2) of the Internal Revenue Code shall be the amount of tax imposed on built-in gains under former Part 11 (commencing with Section 23001).

(2) The amount of tax used to compute the reduction allowed by Section 1366(f)(3) of the Internal Revenue Code shall be the amount of tax imposed on excess net passive income under former Part 11 (commencing with Section 23001).

17106. Section 1367(b)(4) of the Internal Revenue Code, relating to adjustments in case of inherited stock, shall apply for decedents dying after December 31, 1996.

17107. (a) Section 1371(a) of the Internal Revenue Code, relating to application of Subchapter C rules, is modified to provide that, notwithstanding subdivisions (a) and (e) of Section 17024.5, any election by an "S" corporation or its shareholders under Section 338 of the Internal Revenue Code, relating to certain stock purchases treated as asset acquisitions, for federal purposes shall be treated as an election for purposes of this part and a separate election under paragraph (3) of subdivision (e) of Section 17024.5 shall not be allowed.

(b) No election under Section 338 of the Internal Revenue Code, relating to certain stock purchases treated as asset acquisitions, shall be allowed for state purposes unless the "S" corporation or its shareholders made a valid election for federal purposes under Section 338 of the Internal Revenue Code.

(c) Section 1371(d) of the Internal Revenue Code shall not apply.

17108. Section 1372 of the Internal Revenue Code shall be modified so that references to partnership treatment shall be to Internal Revenue Code partnership provisions, as modified by this part.

17109. Sections 1373 and 1379 of the Internal Revenue Code shall not apply.

17110. Section 1374 of the Internal Revenue Code, relating to tax imposed on certain built-in gains, shall not apply.

17111. Section 1375 of the Internal Revenue Code, relating to tax imposed on passive investment income, shall not apply.

17112. Section 1377(b)(2) of the Internal Revenue Code, relating to determination defined, is modified to include, in addition to the items specified therein, the following:

(a) A decision by the State Board of Equalization that has become final.

(b) A closing agreement made under Article 6 (commencing with Section 19441) of Chapter 6 of Part 10.2.

(c) A final disposition by the Franchise Tax Board of a claim for refund.

17113. Any reference to Chapter 4.5 (commencing with Section 23800) of Part 11 or any provision thereof shall also be a reference to this article or a provision of this article which is substantially the same as the provision referenced in Chapter 4.5 (commencing with Section 23800) of Part 11.

17114. This article shall be operative for taxable years beginning on or after January 1, 2012.

SEC. 29. Section 17938 is added to the Revenue and Taxation Code, to read:

17938. This chapter shall not apply to taxable years beginning on or after January 1, 2012, and shall remain in effect only until January 1, 2013, and as of that date is repealed.

SEC. 30. Section 17947.5 is added to the Revenue and Taxation Code, to read:

17947.5. This chapter shall not apply to taxable years beginning on or after January 1, 2012, and shall remain in effect only until January 1, 2013, and as of that date is repealed.

SEC. 31. Section 17948.5 is added to the Revenue and Taxation Code, to read:

17948.5. This chapter shall not apply to taxable years beginning on or after January 1, 2012, and shall remain in effect only until January 1, 2013, and as of that date is repealed.

SEC. 32. Section 18401 of the Revenue and Taxation Code is amended to read:

18401. Each provision of this part shall apply to Part 10 (commencing with Section 17001) ~~and~~, Part 11 (commencing with Section 23001), and Part 12 (commencing with Section 27001), unless otherwise provided.

SEC. 33. Section 18402 of the Revenue and Taxation Code is amended to read:

18402. (a) Except where the context otherwise requires, the general provisions and definitions provided in Chapter 1 (commencing with Section 17001) of Part 10 ~~and in~~, Chapter 1 (commencing with Section 23001) of Part 11, and Chapter 1 (commencing with Section 27001) of Part 12 shall apply to this part.

(b) For purposes of this part, "person" includes an individual, fiduciary, partnership, limited liability company, corporation, or organization exempt from taxation under Section 23701.

(c) (1) Whenever provisions of this part are applied in connection with Part 10 (commencing with Section 17001), the terms “taxpayer,” “corporation” and “taxable year” have the same meaning as defined in Chapter 1 (commencing with Section 17001) of Part 10.

(2) Whenever provisions of this part are applied in connection with Part 11 (commencing with Section 23001), the terms “taxpayer,” “corporation,” “income year,” and “taxable year” have the same meaning as defined in Article 2 (commencing with Section 23030) of Chapter 1 of Part 11.

(3) Whenever provisions of this part are applied in connection with Part 12 (commencing with Section 27001), the terms “taxpayer,” “business entity,” and “taxable year” shall have the same meaning as defined in Chapter 1 (commencing with Section 27001) of part 12.

SEC. 34. Section 18403 of the Revenue and Taxation Code is amended to read:

18403. For purposes of this part, any return, declaration, report, statement, or other document required to be made or filed under Part 10 (commencing with Section 17001)~~, Part 11 (commencing with Section 23001), or Part 12 (commencing with Section 27001)~~ shall be deemed to have been required to be made or filed under this part.

SEC. 35. Section 18405 of the Revenue and Taxation Code is amended to read:

18405. (a) In the case of a new statutory provision in Part 7.5 (commencing with Section 13201), Part 10 (commencing with Section 17001), Part 10.2 (commencing with Section 18401), ~~Part 11 (commencing with Section 23001), or Part 12 (commencing with Section 27001)~~, or the addition of a new part, the Franchise Tax

Board itself is authorized to grant relief as set forth in subdivision (b) from the requirements of the new statutory provision in a manner as provided in subdivision (c).

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

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

(d) For purposes of this section:

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

(2) "Perfecting elections" includes correcting omissions or errors only when substantial evidence is present with the filed return that the taxpayer intended to make

the election and does not include making an election where one was not previously attempted to be made.

(3) "Substantial unintentional noncompliance," for purposes of Part 11 (commencing with Section 23001), includes any case in which the taxpayer filed a water's-edge contract with a timely filed original return and timely paid all taxes and other required amounts shown on the return consistent with the water's-edge election, but where the taxpayer's election is or might be invalidated by reason of the act or omission of an affiliated corporation that is not the parent or a subsidiary of the taxpayer. In that case, notwithstanding anything to the contrary in this section, relief shall be deemed granted to validate the taxpayer's water's-edge election, conditioned only upon an agreement by the affiliated corporation to either (A) file a water's-edge contract and pay all taxes and other required amounts consistent with that election, or (B) waive any right, with respect to any taxable year for which the corporation did not make a water's-edge election on its own timely filed return, to determine its income derived from or attributable to sources within this state pursuant to that election, whichever measure produces the greater amount of tax.

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

SEC. 36. Section 18407 of the Revenue and Taxation Code, as amended by Section 326 of Chapter 183 of the Statutes of 2004, is repealed.

~~18407. Section 6011 of the Internal Revenue Code, relating to general requirement of return, statement, or list, shall apply, except as otherwise provided.~~

(a) ~~Section 6011(a) of the Internal Revenue Code, relating to general rule, is modified as follows:~~

(1) ~~The phrase “any person liable for any tax imposed by Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23001), or this part,” shall be substituted for the phrase “when required by regulations prescribed by the Secretary any person made liable for any tax imposed by this title,” contained therein.~~

(2) ~~“Secretary of the Treasury under Section 6011 of the Internal Revenue Code for federal income tax purposes or by the Franchise Tax Board” shall be substituted for “Secretary.”~~

(3) ~~To additionally provide that “reportable transaction” includes any transaction of a type that the Secretary of the Treasury under Section 6011 of the Internal Revenue Code for federal income tax purposes or the Franchise Tax Board under this section for California income or franchise tax purposes determines as having a potential for tax avoidance or evasion including deductions, basis, credits, entity classification, dividend elimination, or omission of income, and shall be reported on the return or the statement required to be made.~~

(4) ~~To additionally provide that “listed transaction” includes any transaction that is the same as, or substantially similar to, a transaction specifically identified by the Secretary of the Treasury under Section 6011 of the Internal Revenue Code for federal income tax purposes or by the Franchise Tax Board under this section for California income or franchise tax purposes, as a tax avoidance transaction including deductions, basis, credits, entity classification, dividend elimination, or omission of income and shall be reported on the return or statement required to be made.~~

~~(A) The Franchise Tax Board shall identify and publish “listed transactions” (whether identified by the Secretary of the Treasury under Section 6011 of the Internal Revenue Code for federal income tax purposes or by the Franchise Tax Board) through the use of Franchise Tax Board Notices or other published positions. In addition, the “listed transactions” identified and published pursuant to the preceding sentence shall be published on the Web site of the Franchise Tax Board.~~

~~(B) The Franchise Tax Board shall conduct a public outreach program to make taxpayers aware of the new and increased penalties associated with the use of tax avoidance transactions including deductions, basis, credits, entity classification, dividend elimination, or omission of income.~~

~~(5) Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code does not apply to any standard, criterion, procedure, determination, rule, notice, or guideline established or issued by the Franchise Tax Board pursuant to paragraph (4).~~

~~(b) Section 6011(b) of the Internal Revenue Code, relating to identification of taxpayer, does not apply and, in lieu thereof, Section 18408 shall apply.~~

~~(c) Section 6011(c) of the Internal Revenue Code, relating to returns, etc., of DISCs and former DISCs and FSCs and former FSCs, does not apply.~~

~~(d) Section 6011(d) of the Internal Revenue Code, relating to authority to require information concerning Section 912 allowances, does not apply.~~

~~(e) Section 6011(e) of the Internal Revenue Code, relating to regulations requiring returns on magnetic media, etc., shall take into account Section 18408 and shall also~~

~~include the modifications made to Section 6011(e) of the Internal Revenue Code by Section 18408.~~

~~(f) Section 6011(f)(2) of the Internal Revenue Code, relating to incentives, does not apply.~~

SEC. 37. Section 18407 of the Revenue and Taxation Code, as amended by Section 327 of Chapter 183 of the Statutes of 2004, is amended to read:

18407. Section 6011 of the Internal Revenue Code, relating to general requirement of return, statement, or list, shall apply, except as otherwise provided.

(a) Section 6011(a) of the Internal Revenue Code, relating to general rule, is modified as follows:

(1) The phrase “any person liable for any tax imposed by Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23001), Part 12 (commencing with Section 27001), or this part,” shall be substituted for the phrase “when required by regulations prescribed by the Secretary any person made liable for any tax imposed by this title,” contained therein.

(2) “Secretary of the Treasury under Section 6011 of the Internal Revenue Code for federal income tax purposes or by the Franchise Tax Board” shall be substituted for “Secretary.”

(3) To additionally provide that “reportable transaction” includes any transaction of a type that the Secretary of the Treasury under Section 6011 of the Internal Revenue Code for federal income tax purposes or the Franchise Tax Board under this section for California income or franchise tax purposes determines as having a potential for tax avoidance or evasion including deductions, basis, credits, entity classification,

dividend elimination, or omission of income, and shall be reported on the return or the statement required to be made.

(4) To additionally provide that “listed transaction” includes any transaction that is the same as, or substantially similar to, a transaction specifically identified by the Secretary of the Treasury under Section 6011 of the Internal Revenue Code for federal income tax purposes or by the Franchise Tax Board under this section for California income or franchise tax purposes, as a tax avoidance transaction including deductions, basis, credits, entity classification, dividend elimination, or omission of income and shall be reported on the return or statement required to be made.

(A) The Franchise Tax Board shall identify and publish “listed transactions” (whether identified by the Secretary of the Treasury under Section 6011 of the Internal Revenue Code for federal income tax purposes or by the Franchise Tax Board) through the use of Franchise Tax Board Notices or other published positions. In addition, the “listed transactions” identified and published pursuant to the preceding sentence shall be published on the Web site of the Franchise Tax Board.

(B) The Franchise Tax Board shall conduct a public outreach program to make taxpayers aware of the new and increased penalties associated with the use of tax avoidance transactions including deductions, basis, credits, entity classification, dividend elimination, or omission of income.

(5) Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code does not apply to any standard, criterion, procedure, determination, rule, notice, or guideline established or issued by the Franchise Tax Board pursuant to paragraph (4).

(b) Section 6011(b) of the Internal Revenue Code, relating to identification of taxpayer, does not apply and, in lieu thereof, Section 18408 shall apply.

(c) Section 6011(c) of the Internal Revenue Code, relating to returns, etc., of DISCs and former DISCs and FSCs and former FSCs, does not apply.

(d) Section 6011(d) of the Internal Revenue Code, relating to authority to require information concerning Section 912 allowances, does not apply.

(e) Section 6011(e) of the Internal Revenue Code, relating to regulations requiring returns on magnetic media, etc., shall take into account Section 18408 and shall also include the modifications made to Section 6011(e) of the Internal Revenue Code by Section 18408.

(f) Section 6011(f)(2) of the Internal Revenue Code, relating to incentives, does not apply.

SEC. 38. Section 18413 of the Revenue and Taxation Code is amended to read:

18413. The repeal of any provision in Part 10 (commencing with Section 17001) or Part 11 (commencing with Section 23001) made by the act adding or amending this section shall not affect any act done or any right accruing or accrued, or any suit, appeal, or other proceeding having commenced under Part 10 (commencing with Section 17001) or Part 11 (commencing with Section 23001), before that repeal; but all rights and liabilities under that law shall continue, and may be enforced in the same manner, as if that repeal had not been made.

SEC. 39. Section 18414 of the Revenue and Taxation Code is amended to read:

18414. Any provision of this part that refers to the application of any portion of this part to a prior period (or which depends upon the application to a prior period

of any portion of this part) shall, when appropriate and consistent with the purpose of that provision, be deemed to refer to (or depend upon the application of) the corresponding provision of Part 10 (commencing with Section 17001)~~or~~, Part 11 (commencing with Section 23001), or Part 12 (commencing with Section 27001), as was applicable to the prior period.

SEC. 40. Section 18417 of the Revenue and Taxation Code is amended to read:

18417. Provisions in other codes or general law statutes that are related to this part include all of the following:

(a) Chapter 20.6 (commencing with Section 9891) of Division 3 of the Business and Professions Code, relating to tax preparers.

(b) Sections 1502, 2204 to 2206, inclusive, 6210, 6810, 8210, and 8810 of the Corporations Code, relating to the corporation officer statement penalty.

(c) Section 2104 of the Corporations Code, which prevents the application of any provision of this part against any foreign lending institution whose activities in this state are limited to those described in subdivision (d) of Section 191 of the Corporations Code.

(d) Sections 15700 to 15702.1, inclusive, of the Government Code, relating to the Franchise Tax Board.

(e) Part 10 (commencing with Section 17001) of this division, relating to the Personal Income Tax Law.

(f) Part 10.5 (commencing with Section 20501) of this division, relating to the Senior Citizens Property Tax Assistance and Postponement Law.

(g) Part 10.7 (commencing with Section 21001) of this division, relating to the Taxpayers' Bill of Rights.

(h) Part 11 (commencing with Section 23001) of this division, relating to the Corporation Tax Law.

(i) Part 12 (commencing with Section 27001) of this division, relating to the Business Net Receipts Tax Law.

SEC. 41. Article 3 (commencing with Section 18421) is added to Chapter 1 of Part 10.2 of Division 2 of the Revenue and Taxation Code, to read:

Article 3. Other Matters

18421. (a) Notwithstanding any statute, ordinance, regulation, rule or decision to the contrary, no city, county, city and county, governmental subdivision, district, public and quasi-public corporation, municipal corporation, whether incorporated or not or whether chartered or not, shall levy or collect or cause to be levied or collected any tax upon income which is excludable from gross income and exempt from state taxes pursuant to Section 24320.

(b) This section shall not be construed to authorize any such entity to levy a tax on, according to, or measured by, income or profits paid or accrued.

SEC. 42. Section 18510 of the Revenue and Taxation Code is amended to read:

18510. (a) (1) The Franchise Tax Board shall revise the returns required to be filed pursuant to this article, Article 2 (commencing with Section 18601), Section 18633, Section 18633.5, and Article 3 (commencing with Section 23771) of Chapter

4 of Part 11, and Article 3 (commencing with Section 27771) of Chapter 4 of Part 12 in a form and manner approved by the State Board of Equalization, to allow a person to report and pay qualified use tax in accordance with the provisions of Section 6452.1.

(2) Within 10 working days of receiving from the Franchise Tax Board the returns described in paragraph (1), the State Board of Equalization shall do either of the following:

(A) Approve the form and manner of the returns and notify the Franchise Tax Board of this approval.

(B) Submit comments to the Franchise Tax Board regarding changes to the returns that shall be incorporated before the State Board of Equalization approves the form and manner of the returns.

(b) Any payments and credits shown on the return, together with any other credits associated with that person's account, of a person that elects to report qualified use tax on an acceptable tax return shall be applied in the following order:

(1) Taxes imposed under Part 10 (commencing with Section 17001) or Part 11 (commencing with Section 23001), including penalties and interest, if any, imposed under this part.

(2) Qualified use tax as reported on the acceptable tax return, in accordance with Section 6452.1.

(c) The Franchise Tax Board shall transfer the qualified use tax received pursuant to Section 6452.1, and any information the State Board of Equalization deems necessary for its administration of the use tax, to the State Board of Equalization within 60 days

from the date the use tax is received or the acceptable tax return is processed, whichever is later.

(d) This section shall be operative for returns filed for taxable years on and after January 1, 2003, and ending on or before December 31, 2009, and as of that date becomes inoperative, unless a later enacted statute extends the operation of this section.

SEC. 43. Section 18535 of the Revenue and Taxation Code is amended to read:

18535. (a) In lieu of electing nonresident partners filing a return pursuant to Section 18501, the Franchise Tax Board may, pursuant to requirements and conditions set forth in forms and instructions, provide for the filing of a group return for one or more electing nonresident partners by a partnership doing business in, or deriving income from, sources in California. The tax rate or rates applicable to each electing partner's distributive share shall consist of the highest marginal rate or rates provided by Part 10 (commencing with Section 17001) plus, in the case of any electing nonresident partner included on the group return who would be subject to Section 17043 when filing individually, an additional tax rate of 1 percent. Except as provided in subdivision (b), no deductions shall be allowed except those necessary to determine each partner's distributive share, and no credits shall be allowed except those directly attributable to the partnership. As required by the Franchise Tax Board, the partnership as agent for the electing partners shall make the payments of tax, additions to tax, interest, and penalties otherwise required to be paid by the electing partners.

(b) Deductions provided by Chapter 5 (commencing with Section 17501) of Part 10, attributable to earned income of a partner derived from a partnership filing a group return on behalf of electing nonresident partners under subdivision (a), shall be allowed

if the partner certifies, in the form and manner as the Franchise Tax Board may prescribe, that he or she has no earned income from any other source.

(c) This section shall also be applicable to a nonresident shareholder of a corporation which is treated as an "S" corporation under ~~Chapter 4.5 (commencing with Section 23800) of Part 11~~ Article 2.5 (commencing with Section 17100) of Chapter 3 of Part 10. In that case, the provisions of subdivisions (a) and (b) are modified to refer to "shareholder or shareholders" in lieu of "partners" and to "S" corporation in lieu of "partnership."

(d) This section shall also be applicable to a nonresident individual with a membership or economic interest in a limited liability company, registered limited liability partnership, or foreign limited liability partnership, which is classified as a partnership for California tax purposes. In that case, the provisions of subdivisions (a) and (b) are modified to refer to "holders of a membership or economic interest" in lieu of "partners" and to "limited liability companies" in lieu of "partnerships," and "partnerships" shall include registered limited liability partnerships and foreign limited liability partnerships.

(e) The Franchise Tax Board may adjust the income of an electing nonresident taxpayer included in a group return filed under this section to properly reflect income under Part 10 (commencing with Section 17001), including Chapter 11 thereof (commencing with Section 17951), this part (commencing with Section 18401), and Part 11 (commencing with Section 23001), including Chapter 17 thereof (commencing with Section 25101).

SEC. 44. Article 2.5 (commencing with Section 18611) is added to Chapter 2 of Part 10.2 of Division 2 of the Revenue and Taxation Code, to read:

Article 2.5. Business Entities

18611. (a) Except as provided in subdivision (b), every taxpayer subject to the tax imposed by Part 12 (commencing with Section 27001) shall, on or before the 15th day of the third month following the close of its taxable year, transmit to the Franchise Tax Board a return in a form prescribed by it, specifying for the taxable year, all the facts as it may by rule, or otherwise, require in order to carry out that part of this part.

(b) In the case of any taxpayer that has gross receipts (as defined in Article 3 (commencing with Section 27521) of Chapter 3 of Part 12) of less than \$500,000 during the taxable year, including for this purpose any gross receipts that are part of the unitary business of the taxpayer, no return is required to be filed for that taxable year under this article.

SEC. 45. Section 18612 is added to the Revenue and Taxation Code, to read:

18612. (a) The Franchise Tax Board may grant a reasonable extension of time for filing any return, declaration, statement, or other document required by Part 12 (commencing with Section 27001), in the manner and form as the Franchise Tax Board may determine. No extension or extensions shall aggregate more than seven months from the due date for filing the return.

(b) An extension of time granted pursuant to this section is not an extension of time for payment of tax required to be paid on or before the due date of the return

without regard to extension. Underpayment of tax penalties shall be imposed as provided by law without regard to any extension granted under this section.

SEC. 46. Section 18613 is added to the Revenue and Taxation Code, to read:

18613. (a) In cases where receivers, trustees in a case under Title 11 of the United States Code, or assignees are operating the property or business of a business entity those receivers, trustees, or assignees shall make returns for that business entity in the same manner and form as that business entity is required to make a return.

(b) Any tax due on the basis of returns made by receivers, trustees, or assignees shall be collected in the same manner as if collected from the business entity of whose business or property they have custody and control.

SEC. 47. Section 18621 of the Revenue and Taxation Code is amended to read:

18621. Except as otherwise provided by the Franchise Tax Board and in Section 18621.5, any return, declaration, statement, or other document required to be made under any provision of Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23001), Part 12 (commencing with Section 27001), this part, or any applicable regulation shall contain, or be verified by, a written declaration that it is made under the penalties of perjury. Those returns, and all other returns, declarations, statements, or other documents or copies thereof required, shall be in any form as the Franchise Tax Board may from time to time prescribe, including, but not limited to, on paper, on magnetic media pursuant to Section 19524, or by electronic technology or electronic imaging technology pursuant to Section 18621.5, and shall be filed with the Franchise Tax Board. The Franchise Tax Board shall prepare blank forms for the returns, declarations, statements, or other documents and shall distribute them

throughout the state and furnish them upon application. Failure to receive or secure the form does not relieve any taxpayer from making any return, declaration, statement, or other document required.

SEC. 48. Section 18622 of the Revenue and Taxation Code is amended to read:

18622. (a) If any item required to be shown on a federal tax return, including any gross income, deduction, penalty, credit, or tax for any year of any taxpayer is changed or corrected by the Commissioner of Internal Revenue or other officer of the United States or other competent authority, or where a renegotiation of a contract or subcontract with the United States results in a change in gross income or deductions, or gross receipts or purchases, that taxpayer shall report each change or correction, or the results of the renegotiation, within six months after the date of each final federal determination of the change or correction or renegotiation, or as required by the Franchise Tax Board, and shall concede the accuracy of the determination or state wherein it is erroneous. For any individual subject to tax under Part 10 (commencing with Section 17001), changes or corrections need not be reported unless they increase the amount of tax payable under Part 10 (commencing with Section 17001) for any year.

(b) Any taxpayer filing an amended return with the Commissioner of Internal Revenue shall also file within six months thereafter an amended return with the Franchise Tax Board which shall contain any information as it shall require. For any individual subject to tax under Part 10 (commencing with Section 17001), an amended return need not be filed unless the change therein would increase the amount of tax payable under Part 10 (commencing with Section 17001) for any year.

(c) Notification of a change or correction by the Commissioner of Internal Revenue or other officer of the United States or other competent authority, or renegotiation of a contract or subcontract with the United States that results in a change in any item or the filing of an amended return must be sufficiently detailed to allow computation of the resulting California tax change and shall be reported in the form and manner as prescribed by the Franchise Tax Board.

(d) For purposes of this part, the date of each final federal determination shall be the date on which each adjustment or resolution resulting from an Internal Revenue Service examination is assessed pursuant to Section 6203 of the Internal Revenue Code.

SEC. 49. Section 18633 of the Revenue and Taxation Code is amended to read:

18633. (a) ~~(1)~~ Every partnership, on or before the 15th day of the fourth month following the close of its taxable year, shall make a return for that taxable year, stating specifically the items of gross income and the deductions allowed by Part 10 (commencing with Section 17001). Except as otherwise provided in Section 18621.5, the return shall include the names, addresses, and taxpayer identification numbers of the persons, whether residents or nonresidents, who would be entitled to share in the net income if distributed and the amount of the distributive share of each person. The return shall contain or be verified by a written declaration that it is made under penalty of perjury, signed by one of the partners.

~~(2) In addition to returns required by paragraph (1), every limited partnership subject to the tax imposed by subdivision (b) of Section 17935, on or before the 15th day of the fourth month following the close of its taxable year, shall make a return for~~

~~that taxable year, containing the information identified in paragraph (1). In the case of a limited partnership not doing business in this state, the Franchise Tax Board shall prescribe the manner and extent to which the information identified in paragraph (1) shall be included with the return required by this paragraph.~~

(b) Each partnership required to file a return under subdivision (a) for any taxable year shall (on or before the day on which the return for that taxable year was required to be filed) furnish to each person who is a partner or who holds an interest in that partnership as a nominee for another person at any time during that taxable year a copy of the information required to be shown on that return as may be required by regulations.

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

(1) Furnish to the partnership, in the manner prescribed by the Franchise Tax Board, the name, address, and taxpayer identification number of that other person, and any other information for that taxable year as the Franchise Tax Board may by form and regulation prescribe.

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

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

(e) The provisions of Section 6031(f) of the Internal Revenue Code, relating to electing investment partnerships, shall apply, except as otherwise provided.

SEC. 50. Section 18633.5 of the Revenue and Taxation Code is repealed.

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

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

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

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

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

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

~~(e) (1) A limited liability company shall file with its return required under subdivision (a), in the form required by the Franchise Tax Board, the agreement of each nonresident member to file a return pursuant to Section 18501, to make timely payment of all taxes imposed on the member by this state with respect to the income of the limited liability company, and to be subject to personal jurisdiction in this state for purposes of the collection of income taxes, together with related interest and penalties, imposed on the member by this state with respect to the income of the limited liability company. If the limited liability company fails to timely file the agreements on behalf of each of its nonresident members, then the limited liability company shall, at the time set forth in subdivision (f), pay to this state on behalf of each nonresident member of whom an agreement has not been timely filed an amount equal to the highest marginal tax rate in effect under Section 17041, in the case of members which are individuals, estates, or trusts, and Section 23151, in the case of members that are corporations, multiplied by the amount of the member's distributive share of the income~~

source to the state reflected on the limited liability company's return for the taxable period, reduced by the amount of tax previously withheld and paid by the limited liability company pursuant to Section 18662 and the regulations thereunder with respect to each nonresident member. A limited liability company shall be entitled to recover the payment made from the member on whose behalf the payment was made.

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

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

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

(1) The time the annual return is required to be filed pursuant to this section for the first taxable period for which the limited liability company became subject to tax pursuant to Chapter 10.6 (commencing with Section 17941).

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

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

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

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

~~(2) If the owner's consent required under paragraph (1) is not included, the limited liability company shall pay on behalf of its owner an amount consistent with, and treated the same as, the amount to be paid under subdivision (c) by a limited liability~~

company on behalf of a nonresident member for whom an agreement required by subdivision (c) is not attached to the return of the limited liability company.

~~(3) The return required under paragraph (1) shall be filed on or before the fifteenth day of the fourth month after the close of the taxable year of the owner subject to tax under Part 10 (commencing with Section 17001) of Division 2 or on or before the fifteenth day of the third month after the close of the taxable year of the owner subject to tax under Chapter 2 (commencing with Section 23101) of Part 11 of Division 2, whichever is applicable.~~

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

~~(j) The amendments made by the act adding this subdivision apply to taxable years beginning on or after January 1, 2005.~~

SEC. 51. Section 18662 of the Revenue and Taxation Code is amended to read:

18662. (a) The Franchise Tax Board may, by regulation, require any person, in whatever capacity acting, including lessees or mortgagors of real or personal property, fiduciaries, employers, and any officer or department of the state, or any political subdivision or agency of the state, or any city organized under a freeholder's charter, or any political body not a subdivision or agency of the state, having the control, receipt, custody, disposal, or payment of items of income specified in subdivision (b), to withhold an amount, determined by the Franchise Tax Board to reasonably represent the amount of tax due when the items of income are included with other income of the

taxpayer, and to transmit the amount withheld to the Franchise Tax Board at the time as it may designate.

(b) The items of income referred to in subdivision (a) are interest, dividends, rents, prizes and winnings, premiums, annuities, emoluments, compensation for services, including bonuses, partnership income or gains, and other fixed or determinable annual or periodical gains, profits, and income.

(c) The Franchise Tax Board may authorize the tax under subdivision (a) to be deducted and withheld from the interest upon any securities the owners of which are not known to the withholding agent.

(d) Any person that fails to withhold from any payments any amounts required to be withheld by this section or fails to remit the taxes withheld is liable for the amount specified in Section 18668.

(e) (1) This subdivision applies to any disposition of a California real property interest by:

(A) Any person, ~~other than either of the following:~~ subject to tax under Part 10 (commencing with Section 17001).

~~(i) Except as otherwise provided in this subdivision, a corporation, including an entity classified for tax purposes as a corporation under Part 11 (commencing with Section 23001):~~

~~(ii) Except as otherwise provided in this subdivision, a partnership, as determined in accordance with Subchapter K of Chapter 1 of Subtitle A of the Internal Revenue Code, including an entity classified as a partnership for tax purposes under Part 10 (commencing with Section 17001):~~

~~(B) A corporation or partnership passthrough entity, if that corporation or partnership immediately after the transfer of the title to the California real property has no permanent place of business in California. For purposes of this subdivision, a corporation or partnership has no permanent place of business in California if all of the following apply: any income resulting from the disposition of California real property, when distributed, is subject to tax under Part 10 (commencing with Section 17001). For purposes of this subparagraph, “passthrough entity” means a partnership or an “S” corporation.~~

~~(i) It is not organized and existing under the laws of California.~~

~~(ii) It does not qualify with the office of the Secretary of State to transact business in California.~~

~~(iii) It does not maintain and staff a permanent office in California.~~

(2) (A) Except as provided in subparagraph (B), in the case of any disposition of a California real property interest by a transferor described in paragraph (1), the transferee, including for this purpose any intermediary or accommodator in a deferred exchange, is required to withhold an amount equal to $3\frac{1}{3}$ percent of the sales price of the California real property conveyed.

(B) If the transferor makes an election under this subparagraph, the transferee, including any intermediary or accommodator in a deferred exchange, is required to withhold an amount equal to an amount certified by the transferor in writing under penalty of perjury. The amount certified shall not be less than the gain required to be recognized under Part 10 (commencing with Section 17001) and Part 11 (commencing with Section 23001) on the disposition of the California real property multiplied by

~~the rate specified in either Section 23151 or Section 23186, as applicable, for transferors that are corporations, or the highest rate specified in Section 17041 for transferors other than corporations. For purposes of applying the previous sentence, the following shall apply:~~

(i) ~~The highest rate specified in Section 17041 is determined without regard to any other tax rate specified under Part 10 (commencing with Section 17001) irrespective of whether the applicable statute provides that tax shall be treated as if imposed under Section 17041.~~

(ii) ~~For corporations that are "S" corporations subject to the modified tax rate specified in Section 23802, the rate shall be the sum of the rate specified in subdivision (b) of Section 23802 and the highest rate specified in Section 17041, as described in clause (i).~~

(C) (i) The written certification required by subparagraph (B) shall be in a form, as prescribed by the Franchise Tax Board. The form shall provide as follows:

"Title and escrow persons and exchange accommodators are not authorized to provide legal or accounting advice for purposes of determining withholding amounts. Transferors are strongly encouraged to consult with a competent tax professional for this purpose."

(ii) The Franchise Tax Board shall make this form available electronically on its Web site in a format that allows a transferor to complete and print the form. The Franchise Tax Board shall also provide electronic means to enable the transferor to estimate the amount of gain required to be recognized by the transferor in the

transaction. Any form or worksheet, electronic or otherwise, developed for this purpose shall provide as follows:

“Title and escrow persons and exchange accommodators are not authorized to provide legal or accounting advice for purposes of determining withholding amounts. Transferors are strongly encouraged to consult with a competent tax professional for this purpose.”

(3) Notwithstanding any other provision of this subdivision, all of the following shall apply:

(A) No transferee is required to withhold any amount under this subdivision unless the sales price of the California real property conveyed exceeds one hundred thousand dollars (\$100,000).

(B) No transferee, other than an intermediary or an accommodator in a deferred exchange, is required to withhold any amount under this subdivision unless written notification of the withholding requirements of this subdivision has been provided by the real estate escrow person.

(C) (i) No transferee, trustee under a deed of trust, or mortgagee under a mortgage with a power of sale is required to withhold under this subdivision when the transferee has acquired California real property at a sale pursuant to a power of sale under a mortgage or deed of trust or a sale pursuant to a decree of foreclosure or has acquired the property by a deed in lieu of foreclosure.

(ii) No transferee is required to withhold under this subdivision when the transferor is a bank acting as trustee other than a trustee of a deed of trust.

(D) No transferee, including for this purpose any intermediary or accommodator in a deferred exchange, is required to withhold any amount under this subdivision if the transferee, in good faith and based on all the information of which he or she has knowledge, relies on a written certificate executed by the transferor, certifying, under penalty of perjury, one of the following:

(i) (I) The California real property being conveyed is the seller's or decedent's principal residence, within the meaning of Section 121 of the Internal Revenue Code.

(II) The last use of the property being conveyed was use by the transferor as the transferor's principal residence within the meaning of Section 121 of the Internal Revenue Code.

(ii) (I) The California real property being conveyed is being exchanged, or will be exchanged, for property of like kind, within the meaning of Section 1031 of the Internal Revenue Code, but only to the extent of the amount of the gain not required to be recognized for California income or franchise tax purposes under Section 1031 of the Internal Revenue Code.

(II) Subclause (I) may not apply if an exchange does not qualify for nonrecognition treatment for California income or franchise tax purposes under Section 1031 of the Internal Revenue Code, in whole or in part, due to the failure of the transaction to comply with the provisions of Section 1031(a)(3) of the Internal Revenue Code, relating to the requirement that property be identified and that the exchange be completed not more than 180 days after the transfer of the exchanged property.

(III) In any case where clause (ii) applies, the transferee, including for this purpose any intermediary or accommodator in a deferred exchange, is required to notify the

Franchise Tax Board in writing within 10 days of the expiration of the statutory periods specified in Section 1031(a)(3) of the Internal Revenue Code and thereafter remit the applicable withholding amounts determined under this subdivision in accordance with paragraph (4).

(iii) The California real property has been compulsorily or involuntarily converted, within the meaning of Section 1033 of the Internal Revenue Code, and the transferor intends to acquire property similar or related in service or use so as to be eligible for nonrecognition of gain for California income tax purposes under Section 1033 of the Internal Revenue Code.

(iv) The transaction will result in either a net loss or a net gain not required to be recognized for California income or franchise tax purposes.

~~(v) The transferor is a corporation with a permanent place of business in California.~~

(E) (i) In the case of any transaction otherwise subject to this subdivision that qualifies as an “installment sale,” within the meaning of Section 453(b) of the Internal Revenue Code, for California income tax purposes, the provisions of this subdivision shall be separately applied to each principal payment to be made under the terms of the installment sale agreement between the parties.

(ii) For purposes of clause (i), subparagraph (A) of paragraph (3) does not apply to each individual payment to be received under the terms of the installment sale agreement.

(4) (A) Amounts withheld and payments made in accordance with this subdivision shall be reported and remitted to the Franchise Tax Board in the form and manner and

at the time specified by the Franchise Tax Board. Notwithstanding the foregoing, funds withheld on individual transactions by real estate escrow persons may, at the option of the real estate escrow person, be remitted by the 20th day of the month following the close of escrow for the individual transaction, or may be remitted on a monthly basis in combination with other transactions closed during that month.

(B) The transferor shall submit a copy of the written certificate and supporting documentation for the reduced withholding specified in subparagraph (B) of paragraph (2) or subparagraph (D) of paragraph (3), executed by the transferor, to the Franchise Tax Board upon request.

(5) For purposes of this subdivision, "California real property interest" means an interest in real property located in California and defined in Section 897(c)(1)(A)(i) of the Internal Revenue Code.

(6) For purposes of this subdivision, "real estate escrow person" means any of the following persons involved in the real estate transaction:

(A) The person, including any attorney, escrow company, or title company, responsible for closing the transaction.

(B) If no person described in subparagraph (A) is responsible for closing the transaction, then any other person who receives and disburses the consideration or value for the interest or property conveyed.

(7) (A) Unless the real estate escrow person provides "assistance," it shall be unlawful for any real estate escrow person to charge any customer for complying with the requirements of this subdivision.

(B) For purposes of this paragraph, “assistance” includes, but is not limited to, helping the parties clarify with the Franchise Tax Board the issue of whether withholding is required under this subdivision or, upon request of the parties, withholding an amount under this subdivision and remitting that amount to the Franchise Tax Board.

(C) For purposes of this paragraph, “assistance” does not include providing the written notification of the withholding requirements of this subdivision.

(D) In a case where the real estate escrow person provides “assistance” in complying with the withholding requirements of this subdivision, it shall be unlawful for the real estate escrow person to charge any customer a fee that exceeds forty-five dollars (\$45).

(8) For purposes of this subdivision, “sales price” means the sum of all of the following:

(A) The cash paid, or to be paid, but excluding for this purpose any stated or unstated interest or original issue discount, as determined under Sections 1271 through 1275, inclusive, of the Internal Revenue Code.

(B) The fair market value of other property transferred, or to be transferred.

(C) The outstanding amount of any liability assumed by the transferee or to which the California real property interest is subject immediately before and after the transfer.

(9) The Franchise Tax Board may prescribe, by forms, instructions, published notices, or regulations, any requirements necessary for the efficient administration of this subdivision relating to the treatment of “de minimis” amounts otherwise required under this section.

(f) Withholding is not required under this section with respect to wages, salaries, fees, or other compensation paid by a corporation for services performed in California for that corporation to a nonresident corporate director for director services, including attendance at a board of directors' meeting.

(g) In the case of any payment described in subdivision (f), the person making the payment shall do each of the following:

(1) File a return with the Franchise Tax Board at the time and in the form and manner specified by the Franchise Tax Board.

(2) Provide the payee with a statement at the time and in the form and manner specified by the Franchise Tax Board.

(h) (1) The amendments to this section made by Chapter 488 of the Statutes of 2002 apply to dispositions of California real property interests that occur on or after January 1, 2003.

(2) In the case of any payments received on or after January 1, 2003, pursuant to an installment sale agreement relating to a disposition occurring before January 1, 2003, the amendments to this section made by Chapter 488 of the Statutes of 2002 do not apply to those payments.

(i) (1) The amendments made to this section by the act adding this subdivision shall apply to dispositions of California real property interests that occur on or after January 1, 2009.

(2) In the case of any payments received on or after January 1, 2009, pursuant to an installment sale agreement relating to a disposition occurring before January 1,

2009, the amendments made to this section by the act adding this subdivision do not apply to those payments.

SEC. 52. Section 18666 of the Revenue and Taxation Code is amended to read:

18666. (a) Section 1446 of the Internal Revenue Code shall apply to the extent that the amounts represent income from California sources, except as otherwise provided.

(b) (1) The rate of tax referred to in Section 1446(b)(2)(A) of the Internal Revenue Code shall be the maximum tax rate specified in Section 17041, rather than the rate specified in Section 1 of the Internal Revenue Code.

(2) ~~The rate of tax referred to in Section 1446(b)(2)(B) of the Internal Revenue Code shall be the rate specified in Section 23151, 23181, or 23183, as applicable, rather than the rate specified in Section 11 of the Internal Revenue Code not apply.~~

SEC. 53. Section 18668 of the Revenue and Taxation Code is amended to read:

18668. (a) Every person required under this article to deduct and withhold any tax is hereby made liable for that tax, to the extent provided by this section. Any amount required to be deducted and paid to the Franchise Tax Board under this article shall be considered the tax of that person. Unless it is shown that the failure is due to reasonable cause, any person who fails to withhold from any payments any amount required to be withheld under this article or who fails to transmit the withheld amounts to the Franchise Tax Board on or before the due date required by regulations is liable for the amount actually withheld, or the amount of taxes due from the taxpayer to whom the payments are made, whichever is greater, but not in excess of the amount required to be withheld.

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

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

(d) In lieu of the amount provided for in subdivision (a), unless it is shown that the failure to withhold is due to reasonable cause, whenever any transferee is required to withhold any amount pursuant to subdivision (e) of Section 18662, the transferee is liable for the greater of the following amounts for failure to withhold only after the transferee, as specified, is notified in writing of the requirements under subdivision (e) of Section 18662:

(1) Five hundred dollars (\$500).

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

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

(2) The real estate escrow person shall provide written notification to the transferee (other than a transferee that is an intermediary or accommodator in a deferred exchange) in substantially the same form as follows:

“In accordance with Section 18662 of the Revenue and Taxation Code, a buyer may be required to withhold an amount equal to $3\frac{1}{3}$ percent of the sales price or the amount that is specified in a written certificate executed by the transferor in the case of a disposition of California real property interest by either:

1. A seller who is an individual, trust, or estate or when the disbursement instructions authorize the proceeds to be sent to a financial intermediary of the seller,
OR

2. ~~A corporate or partnership seller that has no permanent place of business in California immediately after the transfer of title to the California real property.~~
passthrough entity, if any income resulting from the disposition of California real property, when distributed, is subject to tax under Part 10 (commencing with Section 17001). For purposes of this subparagraph, “passthrough entity” means a partnership or an “S” corporation.

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

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

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

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

3. The seller, who is an individual, trust, estate, ~~partnership, or a corporation~~ without a permanent place of business in California passthrough entity, if any income resulting from the disposition of California real property by the passthrough entity, when distributed, is subject to tax under Part 10 (commencing with Section 17001), executes a written certificate, under the penalty of perjury, of any of the following:

A. The California real property being conveyed is the seller's or decedent's principal residence, within the meaning of Section 121 of the Internal Revenue Code.

B. The last use of the property being conveyed was use by the transferor as the transferor's principal residence within the meaning of Section 121 of the Internal Revenue Code.

C. The California real property being conveyed is or will be exchanged for property of like kind, within the meaning of Section 1031 of the Internal Revenue Code, but only to the extent of the amount of gain not required to be recognized for California income tax purposes under Section 1031 of the Internal Revenue Code.

D. The California real property has been compulsorily or involuntarily converted, within the meaning of Section 1033 of the Internal Revenue Code, and that the seller intends to acquire property similar or related in service or use so as to be eligible for

nonrecognition of gain for California income tax purposes under Section 1033 of the Internal Revenue Code.

E. The California real property transaction will result in a loss or a net gain not required to be recognized for California income tax purposes.

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

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

(4) The real estate escrow person or transferee is not liable under paragraph (1) or subdivision (d), if the failure to withhold is the result of his or her reliance, based on good faith and on all the information of which he or she has knowledge, upon a written certificate executed by the transferor under penalty of perjury pursuant to subparagraph (D) of paragraph (3) of subdivision (e) of Section 18662.

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

(f) The amount of tax required to be deducted, withheld, and remitted under this article shall be assessed, collected, and paid upon notice and demand. Article 3 (commencing with Section 19031), relating to deficiency assessments, shall not apply with respect to the assessment or collection of any amount due under this article.

SEC. 54. Section 19001 of the Revenue and Taxation Code is amended to read:

19001. Except as provided by Article 2 (commencing with Section 19021), the tax imposed under Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23001), and ~~Part 11~~ Part 12 (commencing with ~~Section 23001~~ Section 27001) shall be paid at the time and place fixed for filing the return (determined without regard to any extension of time for filing the return).

SEC. 55. Section 19007 of the Revenue and Taxation Code is amended to read:

19007. Payment of the estimated tax, or any installment thereof, shall be considered payment on account of the taxes imposed under Part 10 (commencing with Section 17001) ~~or~~, Part 11 (commencing with Section 23001), ~~or Part 12 (commencing with Section 27001)~~ for the taxable year.

SEC. 56. Section 19009 of the Revenue and Taxation Code is amended to read:

19009. (a) Whenever any person or employer who is required to collect, account for, and pay over any tax —

(1) At the time and in the manner prescribed by law or regulations (A) fails to collect, truthfully account for, or pay over the tax, or (B) fails to make deposits, payments, or returns of the tax, and

(2) Is notified, by notice delivered in hand or by registered mail of the failure, then all the requirements of subdivision (b) shall be complied with. In the case of a corporation, partnership, limited liability company, or trust, notice to an officer, partner, manager, member, or trustee, shall, for purposes of this section, be deemed to be sufficient notice to the corporation, partnership, limited liability company, or trust and to all officers, partners, managers, members, trustees, and employees thereof.

(b) Any person or employer who is required to collect, account for, and pay over any tax imposed by Part 10 (commencing with Section 17001) ~~or~~, Part 11 (commencing with Section 23001), or Part 12 (commencing with Section 27001), if notice has been delivered to that person or employer in accordance with subdivision (a), shall collect the taxes, which become collectible after delivery of the notice, shall (not later than the end of the second banking day after any amount of the taxes is collected) deposit that amount in a separate account in a bank located within the limits of this state, and shall keep the amount of those taxes in that account until payment over to the Franchise Tax Board. The account shall be designated as a special fund in trust for the Franchise Tax Board, payable to the Franchise Tax Board by that person or employer as trustee.

(c) Whenever the Franchise Tax Board is satisfied, with respect to any notification made under subdivision (a), that all requirements of law and regulations with respect to the taxes, will henceforth be complied with, it may cancel the notification. The cancellation shall take effect at the time as is specified in the notice of the cancellation.

SEC. 57. Section 19011.7 is added to the Revenue and Taxation Code, to read:

19011.7. 19011.7. (a) All payments required under this part, regardless of the taxable year to which the payments apply, shall be remitted to the Franchise Tax Board by electronic funds transfer pursuant to Division 11 (commencing with Section 11101) of the Commercial Code, once any of the following conditions are met:

(1) With respect to any business entity subject to tax under Part 12 (commencing with Section 27001), any installment payment of estimated tax made pursuant to Section 19028 or the payment made pursuant to Section 18612 with regard to an extension of time to file exceeds twenty thousand dollars (\$20,000) in any taxable year.

(2) With respect to any business entity subject to tax under Part 12 (commencing with Section 27001), the total tax liability exceeds eighty thousand dollars (\$80,000) in any taxable year. For purposes of this section, total tax liability shall be the total tax liability as shown on the original return, after any adjustment made pursuant to Section 19051.

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

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

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

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

(e) Electronic funds transfer procedures, in addition to those described in subdivision (f), shall be as prescribed by the Franchise Tax Board. Payment is deemed complete on the date the electronic funds transfer is initiated, if settlement to the state's demand account occurs on or before the banking day following the date the transfer is initiated. If settlement to the state's demand account does not occur on or before the banking day following the date the transfer is initiated, payment is deemed to occur on the date settlement occurs.

(f) For purposes of this section:

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

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

(3) "Automated clearinghouse debit" means a transaction in which any department of the state, through its designated depository bank, originates an automated clearinghouse transaction debiting the taxpayer's bank account and crediting the state's

bank account for the amount of tax. Banking costs incurred for the automated clearinghouse debit transaction by the taxpayer shall be paid by the state.

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

(5) “Fedwire” means any transaction originated by the taxpayer and utilizing the national electronic payment system to transfer funds through federal reserve banks, pursuant to which the taxpayer debits its own bank account and credits the state’s bank account. Electronic funds transfers may be made by Fedwire only if prior approval is obtained from the Franchise Tax Board and the taxpayer is unable, for reasonable cause, to make payments pursuant to paragraph (3) or (4). Banking costs charged to the taxpayer and to the state may be charged to the taxpayer.

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

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

SEC. 58. Article 2.5 (commencing with Section 19028) is added to Chapter 4 of Part 10.2 of Division 2 of the Revenue and Taxation Code, to read:

Article 2.5. Business Entities

19028. (a) For purposes of this article, in the case of a business entity subject to tax under Part 12 (commencing with Section 27001), the term “estimated tax” means the amount which the business entity estimates as the amount of the tax imposed by Part 12 (commencing with Section 27001).

(b) Estimated tax shall be paid in installments as follows:

If the estimated tax of this subdivision are first met—	The following percentages of the requirements shall be paid on the 15th day of the—			
	4th month	6th month	9th month	12th month
Before the 1st day of the 4th month of the taxable year.....	25	25	25	25
After the last day of the 3rd month and before the 1st day of the 6th month of the taxable year.....	—	33 1/3	33 1/3	33 1/3
After the last day of the 5th month and before the 1st day of the 9th month of the taxable year.....	—	—	50	50
After the last day of the 8th month and	—	—	—	100

before the 1st day
of the 12th month
of the taxable
year.....

SEC. 59. Section 19029 is added to the Revenue and Taxation Code, to read:

19029. If, after paying any installment of estimated tax required by of Section 19028, the taxpayer makes a new estimate, the amount of each remaining installment (if any) shall be the amount which would have been payable if the new estimate had been made when the first estimate for the taxable year was made, increased or decreased (as the case may be) by the amount computed by dividing the amount specified in subdivision (a) by the number specified in subdivision (b).

(a) The difference between:

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

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

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

SEC. 60. Section 19030 is added to the Revenue and Taxation Code, to read:

19030. The application of this article to taxable years of less than 12 months shall be in accordance with regulations prescribed by the Franchise Tax Board.

SEC. 61. Section 19041.5 of the Revenue and Taxation Code is amended to read:

19041.5. (a) Notwithstanding any other provision of this part, Part 10 (commencing with Section 17001), ~~or~~ Part 11 (commencing with Section 23001), or

Part 12 (commencing with Section 27001), the provisions of Section 6603 of the Internal Revenue Code, relating to deposits made to suspend the running of interest on potential underpayments, shall apply, except as otherwise provided. A deposit shall not be considered a payment of tax for purposes of filing a claim for refund pursuant to Section 19306, converting an administrative action to an action on a claim pursuant to Section 19335, or filing an action pursuant to Section 19384, until either of the following occurs:

(1) The taxpayer provides a written statement to the Franchise Tax Board specifying that the deposit shall be a payment of tax for purposes of Section 19306, 19335, or 19384.

(2) The deposit is used to pay a final tax liability.

(b) Section 6603(d) of the Internal Revenue Code is modified to substitute the phrase “notice of proposed deficiency assessment under Article 3 of Chapter 4 of this part” for “30-day letter” in each place that the phrase “30-day letter” appears.

(c) In the case of any amount held by the Franchise Tax Board as a deposit in the nature of a cash bond pursuant to the provisions of this section prior to the amendments made by the act adding this subdivision, the date that the taxpayer identifies that amount as a deposit made pursuant to this section, as amended by the act adding this subdivision, shall be treated as the date that the amount is deposited for purposes of this section, as amended by the act adding this subdivision.

SEC. 62. Section 19043 of the Revenue and Taxation Code is amended to read:

19043. (a) For purposes of this part, “deficiency” means the amount by which the tax imposed by Part 10 (commencing with Section 17001) or, Part 11 (commencing

with Section 23001), or Part 12 (commencing with Section 27001) exceeds the excess of—

(1) The sum of—

(A) The amount shown as the tax by the taxpayer on an original or amended return, if an original or amended return was filed, plus

(B) The amounts previously assessed (or collected without assessment) as a deficiency, over—

(2) The amount of rebates, as defined in paragraph (2) of subdivision (b), made.

(b) For purposes of this section:

(1) The tax imposed by Part 10 (commencing with Section 17001) ~~and~~, Part 11 (commencing with Section 23001), and Part 12 (commencing with Section 27001) and the tax shown on an original or amended return shall both be determined without regard to payments on account of estimated tax, and without regard to the credit under Section 19002.

(2) “Rebate” means so much of an abatement, credit, refund, or other repayment, as was made on the ground that the tax imposed by Part 10 (commencing with Section 17001) ~~or~~, Part 11 (commencing with Section 23001), or Part 12 (commencing with Section 27001) was less than the excess of the amount specified in paragraph (1) of subdivision (a) over the rebates previously made.

SEC. 63. Section 19043.5 of the Revenue and Taxation Code is amended to read:

19043.5. (a) (1) If the Franchise Tax Board determines that the amount of a carryover disclosed by the taxpayer on an original or amended return, including an

amended return reporting federal adjustments pursuant to Section 18622, is more than the amount of the carryover disclosed by its own examination, it may mail a notice or notices to the taxpayer of the proposed carryover adjustment and the proposed adjusted carryover amount.

(2) For purposes of this section, “carryover” means the amount of a credit, loss, deduction, or other item that is shown on an original or amended return for carry forward to a subsequent taxable year.

(b) Except as otherwise provided in this section, the provisions of this article applicable to a proposed deficiency assessment shall be applicable to a proposed adjusted carryover amount, including protest and appeal rights as if that proposed adjusted carryover amount were a proposed deficiency assessment.

(c) (1) A proposed adjusted carryover amount shall become a final adjusted carryover amount under this section following a determination of the board regarding that proposed adjusted carryover amount that becomes final pursuant to the provisions of Section 19048.

(2) A final adjusted carryover amount shall be binding and conclusive with respect to the amount of that carryover for purposes of Part 10 (commencing with Section 17001), this part, ~~and~~ Part 11 (commencing with Section 23001), and Part 12 (commencing with Section 27001), except in the following circumstances:

(A) In the event of fraud, malfeasance, or misrepresentation of a material fact.

(B) Subject to any provision of the Revenue and Taxation Code that expressly provides that effect be given to that provision notwithstanding any other law or rule of law.

(C) Subject to any law that is, or becomes, operative with respect to a taxable year affected by the final adjusted carryover amount.

(D) Subject to any final federal adjustment that is made with respect to the taxpayer's federal income tax liability for a taxable year affected by the final adjusted carryover amount.

(E) In an action brought pursuant to provisions of Section 19382.

(d) (1) In any case where there is a final adjusted carryover amount with respect to a carryover, the taxpayer shall report that final adjusted carryover amount on an original or amended return for any subsequent year.

(2) If a taxpayer fails to comply with paragraph (1), then any adjustment required to make the amount of the carryover shown on the return for any year consistent with the final adjusted carryover amount shall be treated as arising out of a mathematical error and assessed and collected under Section 19051.

(e) Except as provided in subdivision (c), this section shall not affect the determination, issuance, assessment, collection, or validity of a deficiency assessment under this part.

SEC. 64. Section 19054 of the Revenue and Taxation Code is amended to read:

19054. (a) If on any return or claim for refund of taxes imposed under Part 10 (commencing with Section 17001) ~~or~~, Part 11 (commencing with Section 23001), or Part 12 (commencing with 27001), there is an overstatement of the credit for income tax withheld, or of the amount paid as estimated income tax, the amount so overstated which is allowed against the tax shown on the return or which is allowed as a credit

or refund may be assessed by the Franchise Tax Board in the same manner as is provided by Section 19051 in the case of a mathematical error appearing on the return.

(b) No unpaid amount of estimated tax under Section 19025 or 19136 shall be assessed.

SEC. 65. Section 19057 of the Revenue and Taxation Code is amended to read:

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

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

(c) Where, within the 60-day period ending on the day on which the time prescribed in this section for the assessment of any tax imposed under Part 10 (commencing with Section 17001) ~~or~~, Part 11 (commencing with Section 23001), or Part 12 (commencing with Section 27001) for any taxable year would otherwise expire, the Franchise Tax Board receives a written document, other than an amended return

or a report required by Section 18622, signed by the taxpayer showing that the taxpayer owes an additional amount of that tax for that taxable year, the period for the assessment of an additional amount in excess of the amount shown on either an original or amended return shall not expire before the day 60 days after the day on which the Franchise Tax Board receives that document.

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

SEC. 66. Section 19061 of the Revenue and Taxation Code is repealed.

~~19061. In case of a deficiency described in Sections 24945 and 24946, and in Sections 1033(a)(2)(C) and 1033(a)(2)(D) of the Internal Revenue Code, the deficiency may be assessed at any time prior to the expiration of the time therein provided.~~

SEC. 67. Section 19063 of the Revenue and Taxation Code is amended to read:

19063. (a) In the case of any tax imposed by Part 10 (commencing with Section 17001) ~~or~~, Part 11 (commencing with Section 23001), or Part 12 (commencing with Section 27001) with respect to any person, the period for assessing a deficiency attributable to any partnership item of a federally registered partnership shall not expire before the later of the following:

(1) The date which is five years after the date on which the partnership return of the federally registered partnership for the partnership taxable year in which the item arose was filed (or later, if the date prescribed for filing the return).

(2) If the name or address of the person does not appear on the partnership return, the date which is one year after the date on which the information is furnished to the Franchise Tax Board in the manner and at the place as it may prescribe.

(b) For purposes of this section, “partnership item” means both of the following:

(1) Any item required to be taken into account for the partnership taxable year under any provision of subchapter K of Chapter 1 of Title 26 of the Internal Revenue Code to the extent that regulations prescribed by the Franchise Tax Board provide that for purposes of this part that item is more appropriately determined at the partnership level than at the partner level.

(2) Any other item to the extent affected by an item described in paragraph (1).

(c) The extensions referred to in subsection (c)(4) of Section 6501 of the Internal Revenue Code, insofar as they relate to partnership items, may, with respect to any person, be consented to by either of the following:

(1) Except to the extent the Franchise Tax Board is otherwise notified by the partnership, by a general partner of the partnership.

(2) By any person authorized to do so by the partnership in writing.

(d) For purposes of this section, “federally registered partnership” means, with respect to any partnership taxable year, any partnership for which either of the following apply:

(1) Interests have been offered for sale at any time during that taxable year or a prior taxable year in any offering required to be registered with the Securities and Exchange Commission.

(2) At any time during that taxable year or a prior taxable year, was subject to the annual reporting requirements of the Securities and Exchange Commission which relate to the protection of investors in the partnership.

SEC. 68. Section 19066 of the Revenue and Taxation Code is amended to read:

19066. (a) For the purposes of Sections 19057, 19058, and 19065, a return of tax imposed under Part 10 (commencing with Section 17001) ~~or~~, Part 11 (commencing with Section 23001), or Part 12 (commencing with Section 27001), except a return required by Article 5 (commencing with Section 18661) of Chapter 2 (relating to withholding), filed before the last day prescribed by law for filing (determined without regard to any extension of time for filing the return), shall be considered as filed on that day. For purposes of Section 19306, payment of any portion of the tax made before the last day prescribed for the payment of the tax shall be considered made on the last day.

(b) For purposes of this section, if a return required by Article 5 (commencing with Section 18661) of Chapter 2 (relating to withholding) or a return of tax imposed by Section 13020 of the Unemployment Insurance Code (relating to withholding tax on wages), for any period ending with or within a calendar year is filed before April 15 of the succeeding calendar year, that return shall be considered filed on April 15 of that calendar year.

SEC. 69. Section 19066.5 of the Revenue and Taxation Code is amended to read:

19066.5. In the case of any information that is required to be reported to the Franchise Tax Board under Section 19141.2 or 19141.5, the time for assessment of

any tax imposed by Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23001), Part 12 (commencing with Section 27001), or this part with respect to any event or period to which that information relates shall not expire before the date that is four years after the date on which the Franchise Tax Board is furnished the information required to be reported under Section 19141.2 or 19141.5, or within the periods provided in Section 19057, 19058, 19059, 19060, 19065, 24945, 24946, Section 1033(a)(2)(C) of the Internal Revenue Code, or Section 1033(a)(2)(D) of the Internal Revenue Code, whichever period expires later.

SEC. 70. Section 19071 of the Revenue and Taxation Code is amended to read:

19071. The taxes imposed by Part 10 (commencing with Section 17001) or Part 11 (commencing with Section 23001), or Part 12 (commencing with Section 27001) upon any taxpayer other than a transferee for which any person other than the taxpayer is liable may be assessed against that person in the manner provided for the assessment of deficiencies. The taxes may be assessed at any time within which deficiency assessments may be made against the taxpayer; provided, however, the running of the period of limitations upon the assessment of the liability imposed upon any person other than the taxpayer shall, after the mailing of the notice provided for in Section 19033 to the taxpayer, be suspended for the period during which the taxpayer exercises an administrative remedy as provided in Section 19041, 19045, or 19048.

SEC. 71. Section 19101 of the Revenue and Taxation Code is amended to read:

19101. (a) If any amount of tax imposed by Part 10 (commencing with Section 17001) ~~or~~, Part 11 (commencing with Section 23001), or Part 12 (commencing with Section 27001), is not paid on or before the last date prescribed for payment, interest

on that amount at the adjusted annual rate established under Section 19521 shall be paid for the period from that last date to the date paid.

(b) For purposes of this article, the last date prescribed for payment of the tax shall be determined under Chapter 4 (commencing with Section 19001), with the application of the following rules:

(1) The last date prescribed for payment shall be determined without regard to any extension of time for payment or any installment agreement entered into under Section 19008.

(2) The last date prescribed for payment shall be determined without regard to any notice and demand for payment issued, by reason of jeopardy as provided in Article 5 (commencing with Section 19081), prior to the last date otherwise prescribed for that payment.

(3) In all other cases in which the last date for payment is not otherwise prescribed, the last date for payment shall be deemed to be the date the liability for tax arises (and in no event shall be later than the date notice and demand for the tax is made by the Franchise Tax Board).

(c) Except as provided in this article:

(1) Interest prescribed under this article on any tax shall be paid upon notice and demand, and shall be assessed, collected, and paid in the same manner as taxes. Any reference in Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23001), Part 12 (commencing with Section 27001), or this part (except Article 3 (commencing with Section 19031), relating to deficiency assessments) to any tax imposed by Part 10 (commencing with Section 17001) ~~or~~ Part 11 (commencing with

Section 23001), or Part 12 (commencing with Section 27001) shall be deemed also to refer to interest imposed by this article on that tax.

(2) (A) Interest shall be imposed under subdivision (a) in respect to any assessable penalty, additional amount, or addition to the tax (other than an addition to tax imposed under Section 19131, 19132, or 19164) only if that assessable penalty, additional amount, or addition to the tax is not paid within 15 calendar days from the date of notice and demand therefor, and in that case interest shall be imposed only for the period from the date of the notice and demand to the date of payment.

(B) Interest shall be imposed under this article with respect to any addition to tax imposed by Section 19131 (relating to failure to file a return on or before the due date), Section 19132 (relating to underpayment of tax), or Section 19164 (relating to imposition of the accuracy-related penalty), for the period that:

(i) Begins on the date on which the return of the tax with respect to which that addition to tax is imposed is required to be filed (including any extensions), and

(ii) Ends on the date of payment of that addition to tax.

(3) If notice and demand is made for payment of any amount and if that amount is paid within 15 calendar days after the date of the notice and demand, interest under this article on the amount so paid shall not be imposed for the period after the date of the notice and demand.

(d) This article shall not apply to any failure to pay estimated tax required by Section 19025 or 19136.

SEC. 72. Section 19132 of the Revenue and Taxation Code is amended to read:

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

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

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

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

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

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

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

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

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

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

payment of the tax for purposes of this section unless the check or money order is paid on presentment.

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

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

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

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

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

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

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

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

SEC. 73. Section 19135.5 is added to the Revenue and Taxation Code, to read:

19135.5. If a foreign limited liability business entity that fails to qualify to do business in this state or whose powers, rights, and privileges have been forfeited, or any domestic limited liability business entity which has been suspended, and that is doing business in this state, within the meaning of Section 27101, fails to make and file a return as required by this part, the Franchise Tax Board shall impose a penalty of two thousand dollars (\$2,000) per taxable year, unless the failure to file is due to reasonable cause and not willful neglect. The penalty shall be in addition to any other penalty that may be due under this part. The penalty shall be imposed if the return is not filed within 60 days after the Franchise Tax Board sends the taxpayer a notice and demand to file the required tax return.

SEC. 74. Section 19139 is added to the Revenue and Taxation Code, to read:

19139. (a) (1) A taxpayer subject to the tax imposed under Part 12 (commencing with Section 27001) with an understatement of tax in excess of one million dollars (\$1,000,000) for any taxable year shall be subject to the penalty imposed under this section.

(2) For taxpayers included in a combined report under Section 28101 or authorized to be included in a combined report under Section 28101.5, the threshold amount prescribed in paragraph (1) shall apply to the aggregate amount of tax liability under Part 12 (commencing with Section 27001) for all taxpayers that are required to be or authorized to be included in a combined report.

(b) The penalty under this section shall be an amount equal to 20 percent of any understatement of tax. For purposes of this section, “understatement of tax” means the amount by which the tax imposed by Part 12 (commencing with Section 27001) exceeds the amount of tax shown on an original return or shown on an amended return filed on or before the original or extended due date of the return for the taxable year.

(c) The penalty imposed by this section shall be in addition to any other penalty imposed under Part 12 (commencing with Section 27001) or this part.

(d) Article 3 (commencing with Section 19031), relating to deficiency assessments, shall not apply with respect to the assessment or collection of any penalty imposed by subdivision (a).

(e) A refund or credit for any amounts paid to satisfy a penalty imposed under this section may be allowed only on the grounds that the amount of the penalty was not properly computed by the Franchise Tax Board.

(f) (1) No penalty shall be imposed under this section on any understatement to the extent that the understatement is attributable to a change in law that is enacted, promulgated, issued, or becomes final after the earlier of either of the following dates:

(A) The date the taxpayer files the return for the taxable year for which the change is operative.

(B) The extended due date for the return of the taxpayer for the taxable year for which the change is operative.

(2) For purposes of this subdivision, a “change of law” means a statutory change or an interpretation of law or rule of law by regulation, legal ruling of counsel, within

the meaning of subdivision (b) of Section 11340.9 of the Government Code, or a published federal or California court decision.

(3) The Franchise Tax Board shall implement this subdivision in a reasonable manner.

(g) No penalty shall be imposed under this section to the extent that a taxpayer's understatement is attributable to the taxpayer's reasonable reliance on written advice of the Franchise Tax Board, but only if the written advice was a legal ruling by the Chief Counsel, within the meaning of paragraph (1) of subdivision (a) of Section 21012.

SEC. 75. Section 19141.5 of the Revenue and Taxation Code is amended to read:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(3) Section 7701(a)(30) of the Internal Revenue Code, relating to the term “United States person,” shall apply. However, the term “United States person” shall not include ~~any corporation~~ business entity that is not subject to the tax imposed under ~~Chapter 2 (commencing with Section 23101), Chapter 2.5 (commencing with Section 23400), or Chapter 3 (commencing with Section 23501),~~ of Part ~~11~~ 12 (commencing with Section 27001).

SEC. 76. Section 19141.8 is added to the Revenue and Taxation Code, to read:

19141.8. (a) Each taxpayer subject to tax under Part 12 (commencing with Section 27001) shall maintain (in the location, in the manner, and to the extent prescribed in regulations promulgated by the Franchise Tax Board) and make available upon request all of the following:

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

(2) Any records as may be appropriate to determine the correct treatment of amounts that are attributable to the classification of an item as business or nonbusiness income.

(3) Any records as may be appropriate to determine the correct treatment of the apportionment factors.

(4) Documents and information, including any questionnaires completed and submitted to the Internal Revenue Service, that are necessary to audit issues involving the determination of income subject to tax by this state.

(b) For purposes of this section:

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

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

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

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

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

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

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

(A) For purposes of determining the correct treatment under Part 12 (commencing with Section 27001) of the items described in subdivision (a), the Franchise Tax Board

issues a subpoena or subpoena duces tecum to a taxpayer to produce (either directly or as agent for the related party) any records or testimony.

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

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

(D) If the taxpayer fails to maintain or fails to cause another to maintain records as required by subdivision (a), and by reason of that failure, the subpoena, or subpoena duces tecum, is quashed in a proceeding described in subparagraph (B) or the taxpayer is not able to provide the records requested in the subpoena or subpoena duces tecum, the Franchise Tax Board may apply the rules of paragraph (2) to any of the items described in subdivision (a) to which the records relate.

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

(i) The components that are a part of one or more unitary businesses for purposes of determining the business net receipts derived from or attributable to this state pursuant to Chapter 7 (commencing with Section 28101) of Part 12.

(ii) Amounts that are attributable to the classification of an item as business or nonbusiness for purposes of Chapter 3 (commencing with Section 27501) of Part 12.

(iii) The apportionment factors for purposes of Chapter 7 (commencing with Section 28001 of Part 12.

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

(B) This paragraph shall apply to determine the correct treatment of the items described in subdivision (a) unless the taxpayer is authorized by its related parties (in the manner and at the time as the Franchise Tax Board shall prescribe) to act as the related parties' limited agent solely for purposes of applying Section 19504 with respect to any request by the Franchise Tax Board to examine records or produce testimony related to any item described in subdivision (a) or with respect to any subpoena or subpoena duces tecum for the records or testimony. The appearance of persons or the production of records by reason of the taxpayer being an agent shall not subject those persons or records to legal process for any purpose other than determining the correct treatment under Part 12 of the items described in subdivision (a).

(C) Determinations made in the sole discretion of the Franchise Tax Board pursuant to this paragraph may be appealed to the State Board of Equalization, in the manner and at the time prescribed by Section 19045 or 19324, or may be the subject of an action to recover tax, in the manner and at a time prescribed by Section 19382. The review of determinations by the board or the court shall be limited to whether the determinations were arbitrary or capricious, or are not supported by substantial evidence.

(3) (A) Notwithstanding any other law or rule of law, any reporting taxpayer to which the Franchise Tax Board issues a subpoena or subpoena duces tecum referred to in subparagraph (A) of paragraph (1) shall have the right to begin a proceeding to

quash the subpoena or subpoena duces tecum not later than the 90th day after the subpoena or subpoena duces tecum was issued. In that proceeding, the Franchise Tax Board may seek to compel compliance with the subpoena or subpoena duces tecum.

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

(C) The superior courts of the State of California for the Counties of Los Angeles, Sacramento, and San Diego, and for the City and County of San Francisco, shall have jurisdiction to hear any proceeding brought under subparagraphs (A) and (B). Any order or other determination in the proceeding shall be treated as a final order that may be appealed.

(D) If any taxpayer takes any action as provided in subparagraphs (A) and (B), the running of any period of limitations under Sections 19057 to 19064, inclusive (relating to the assessment and collection of tax), or under Section 19704 (relating to criminal prosecutions) with respect to that taxpayer, that taxpayer shall be suspended for the period during which the proceedings, and appeals therein, are pending. In no event shall any period expire before the 90th day after the day on which there is a final determination in the proceeding.

SEC. 77. Section 19142 of the Revenue and Taxation Code is amended to read:

19142. (a) Except as provided in Sections 19147 and 19148 and subdivision (b), in the case of any underpayment of tax imposed under Part 11 (commencing with Section 23001) or Part 12 (commencing with Section 27001), there shall be added to the tax for the taxable year an amount determined at the rate established under Section 19521 on the amount of the underpayment for the period of the underpayment.

(b) (1) No addition to tax shall be imposed under this section to the extent that the underpayment was created or increased by any provision of law that is chaptered during and operative for the taxable year of the underpayment.

(2) Notwithstanding Section 18415, this subdivision applies to penalties imposed on and after January 1, 2005.

SEC. 78. Section 19144 of the Revenue and Taxation Code is amended to read:

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

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

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

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

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

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

SEC. 79. Section 19145 of the Revenue and Taxation Code is amended to read:

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

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

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

SEC. 80. Section 19147 of the Revenue and Taxation Code is amended to read:

19147. (a) Notwithstanding Sections 19142 to 19145, inclusive, the addition to the tax with respect to any underpayment of any installment shall not be imposed if the total amount of all payments of estimated tax paid on or before the last date prescribed for the payment of the installment equals or exceeds the amount which

would have been required to be paid on or before that date if the estimated tax were whichever of the following is the lesser:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(III) Clause (iv) of subparagraph (A) shall be applied by substituting “eleven months” for “nine months.”

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

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

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

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

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

~~“Taxable income”~~

~~“Business net receipts” as used in this paragraph means “net income” includable in the measure of tax or “alternative minimum taxable income” (as defined by Section 23455) “business net receipts” subject to tax under Part 12 (commencing with Section 27001).~~

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

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

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

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

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

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

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

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

(2) For purposes of this subdivision, “testing period” means the three taxable years immediately preceding the taxable year involved.

(c) (1) Any dividend received from a closely held real estate investment trust by any person that owns (after application of Sections 856(d)(5) and 856(l)(3)(B) of the Internal Revenue Code) 10 percent or more (by vote or value) of the stock or beneficial interests in the trust shall be taken into account in computing annualized income

installments under paragraph (2) of subdivision (a) in a manner similar to the manner under which partnership income inclusions are taken into account.

(2) For purposes of paragraph (1), the term “closely held real estate investment trust” means a real estate investment trust with respect to which five or fewer persons own (after application of Sections 856(d)(5) and 856(l)(3)(B) of the Internal Revenue Code) 50 percent or more (by vote or value) of the stock or beneficial interests in the trust.

~~(3) The amendments made to this section by the act adding this subdivision shall apply to estimated tax payments due on or after January 1, 2001.~~

SEC. 81. Section 19149 of the Revenue and Taxation Code is repealed.

~~19149. (a) Notwithstanding any other provision of Sections 19142 to 19151, inclusive, if the amount of estimated tax due and payable under Section 19025 is only the minimum franchise tax imposed by Section 23153 and, if applicable, the tax of a wholly owned subsidiary under Section 23800.5, then the addition to the tax with respect to any underpayment of any installment imposed by Section 19142 shall be calculated only on the basis of the amount of the minimum franchise tax and the amount of the tax of each wholly owned subsidiary.~~

~~(b) This section shall not apply to a large corporation as defined in subdivision (b) of Section 19147.~~

SEC. 82. Section 19164 of the Revenue and Taxation Code is amended to read:

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

relating to imposition of accuracy-related penalty on underpayments, except as otherwise provided.

(B) (i) Except for understatements relating to reportable transactions to which Section 19164.5 applies, in the case of any proposed deficiency assessment issued after the last date of the amnesty period specified in Chapter 9.1 (commencing with Section 19730) for any taxable year beginning prior to January 1, 2003, the penalty specified in Section 6662(a) of the Internal Revenue Code shall be computed by substituting “40 percent” for “20 percent.”

(ii) Clause (i) shall not apply to any taxable year of a taxpayer beginning prior to January 1, 2003, if, as of the start date of the amnesty program period specified in Section 19731, the taxpayer is then under audit by the Franchise Tax Board, or the taxpayer has filed a protest under Section 19041, or the taxpayer has filed an appeal under Section 19045, or the taxpayer is engaged in settlement negotiations under Section 19442, or the taxpayer has a pending judicial proceeding in any court of this state or in any federal court relating to the tax liability of the taxpayer for that taxable year.

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

(A) All taxable years beginning on or after January 1, 1990, and before January 1, 2012.

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

(C) For purposes of this section, references in Section 6662(e) of the Internal Revenue Code and the regulations thereunder, relating to treatment of an affiliated

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

(3) With respect to business entities subject to tax under Part 12 (commencing with Section 27001), this subdivision shall apply to taxable years beginning on or after January 1, 2012.

(3)

(4) Section 6662(d)(1)(B) of the Internal Revenue Code is modified to provide that in the case of a corporation, other than an "S" corporation a taxpayer subject to tax under Part 12 (commencing with Section 27001), there is a substantial understatement of tax for any taxable year if the amount of the understatement for the taxable year exceeds the lesser of:

(A) Ten percent of the tax required to be shown on the return for the taxable year (or, if greater, two thousand five hundred dollars (\$2,500)).

(B) Five million dollars (\$5,000,000).

(4) Section 6662(d)(2)(A) of the Internal Revenue Code is modified to additionally provide that the excess determined under Section 6662(d)(2)(A) of the Internal Revenue Code shall be determined without regard to items to which Section 19164.5 applies and without regard to items with respect to which a penalty is imposed by Section 19774.

(b) For purposes of Section 6662(d) of the Internal Revenue Code, Section 6664 of the Internal Revenue Code, Section 6694(a)(1) of the Internal Revenue Code, and this part, the Franchise Tax Board may prescribe a list of positions for which the Franchise Tax Board believes there is not substantial authority or there is no reasonable belief that the tax treatment is more likely than not the proper tax treatment. That list (and any revisions thereof) shall be published through the use of Franchise Tax Board Notices or other published positions. In addition, the “listed transactions” identified and published pursuant to the preceding sentence shall be published on the Web site of the Franchise Tax Board.

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

(d) Section 6664 of the Internal Revenue Code, relating to definitions and special rules, shall apply, except as otherwise provided.

SEC. 83. Section 19164.1 of the Revenue and Taxation Code is repealed.

~~19164.1. (a) Any understatement determined pursuant to subdivision (a) of Section 19164 (relating to the accuracy-related penalty) may not include amounts that are attributable to the credit allowed under Section 17052.2 (relating to the teacher retention tax credit).~~

~~(b) This section applies only to tax credits claimed under Section 17052.2 for taxable years beginning on or after January 1, 2000, and before January 1, 2001.~~

SEC. 84. Section 19164.5 of the Revenue and Taxation Code is amended to read:

19164.5. (a) A reportable transaction accuracy-related penalty shall be imposed under this part and shall be determined in accordance with Section 6662A of the Internal Revenue Code, relating to the imposition of an accuracy-related penalty on understatements with respect to reportable transactions, except as otherwise provided.

(b) (1) The reportable transaction understatement, as determined under Section 6662A(b) of the Internal Revenue Code, is modified to not include amounts to which the penalty of Section 19774 is imposed.

(2) Section 6662A(b)(1)(A)(ii) of the Internal Revenue Code is modified to substitute the phrase “Sections 17041, 23151, 23181, or 23501” for “section 1 (section 11 in the case of a taxpayer which is a corporation).”

(3) Section 6662A(b)(1)(B) of the Internal Revenue Code is modified to substitute the phrase “Part 10 (commencing with Section 17001) ~~or~~, Part 11 (commencing with Section 23001), or Part 12 (commencing with Section 27001)” for “subtitle A.”

(4) Section 6662A(b)(2)(B) of the Internal Revenue Code is modified to substitute the phrase “income or ~~franchise~~ business net receipts tax” for “Federal income tax.”

(5) Section 6662A(e)(1) of the Internal Revenue Code is modified to additionally provide that the amount of the understatement is increased by noneconomic transaction understatements, as defined in Section 19774.

(c) Section 6662A(e)(2) of the Internal Revenue Code is modified to additionally provide that Section 6662A of the Internal Revenue Code does not apply to amounts to which a penalty is imposed under Section 19774.

(d) The provisions of subdivision (f) of Section 19772, relating to the rescission of the penalty by the Chief Counsel, shall apply to any penalty imposed by this section.

SEC. 85. Section 19169 of the Revenue and Taxation Code is amended to read:

19169. (a) In addition to the criminal penalty provided by Section 19712, any tax preparer who endorses or otherwise negotiates (directly or through an agent) any warrant made in respect of the taxes imposed by Part 10 (commencing with Section 17001)-~~or~~, Part 11 (commencing with Section 23001), or Part 12 (commencing with Section 27001) which is issued to a taxpayer (other than the tax preparer) shall pay a penalty of two hundred fifty dollars (\$250) with respect to each warrant. The preceding sentence shall not apply with respect to the deposit by a bank (as defined by Section 581 of the Internal Revenue Code) of the full amount of the warrant in the taxpayer's account in that bank for the benefit of the taxpayer.

(b) For purposes of subdivision (a), "tax preparer" means any person who prepares for compensation, or who employs one or more persons to prepare for compensation, any return of tax imposed by Part 10 (commencing with Section 17001)-~~or~~, Part 11 (commencing with Section 23001), or Part 12 (commencing with Section 27001) or any claim for refund of tax imposed by Part 10-~~or~~, Part 11, or Part 12. For purposes of the preceding sentence, the preparation of a substantial portion of a return or claim for refund shall be treated as if it were the preparation of that return or claim for refund.

A person shall not be a "tax preparer" merely because the person does any of the following:

- (1) Furnishes typing, reproducing, or other mechanical assistance.
- (2) Prepares a return or claim for refund of the employer (or of an officer or employee of the employer) by whom that person is regularly and continuously employed.

(3) Prepares as a fiduciary a return or claim for refund for any person.

(c) This section shall not apply where the tax preparer has advanced the taxpayer an amount of money equal to or greater than the amount of the taxpayer's refund.

SEC. 86. Section 19173 of the Revenue and Taxation Code is amended to read:

19173. (a) A penalty shall be imposed under this part for failure to maintain lists of advisees with respect to reportable transactions and shall be determined in accordance with Section 6708 of the Internal Revenue Code, except as otherwise provided.

(b) If a material advisor fails to meet the requirements of subdivision (d) of Section 18648 with respect to a listed transaction, as defined in Section 6707A(c)(2) of the Internal Revenue Code, an additional penalty shall be imposed equal to the greater of:

(1) One hundred thousand dollars (\$100,000).

(2) Fifty percent of the gross income that the material advisor derived from that activity.

(c) A penalty imposed under this section does not apply if it is shown that the additional information required under paragraph (1) of subdivision (d) of Section 18648 was not identified in a Franchise Tax Board notice issued prior to the date the transaction or shelter was entered into.

(d) The penalty imposed by subdivision (a) shall be assessed against the person required to maintain or provide a list under Section 18648. The penalty may be assessed at any time during the period ending eight years after the failure has occurred.

(e) (1) The Chief Counsel of the Franchise Tax Board may rescind all or any portion of any penalty imposed by this section with respect to a list required to be maintained or provided under Section 18648, if all of the following apply:

(A) The violation is with respect to a reportable transaction, other than a listed transaction, as defined in Section 6707A(c)(2) of the Internal Revenue Code.

(B) The person on whom the penalty is imposed has a history of complying with the requirements of this part and Part 10 (commencing with Section 17001) ~~or~~, Part 11 (commencing with Section 23001), or Part 12 (commencing with Section 27001).

(C) It is shown that the violation is due to an unintentional mistake of fact.

(D) Imposing the penalty would be against equity and good conscience.

(E) Rescinding the penalty would promote compliance with the requirements of this part and Part 10 (commencing with Section 17001) ~~or~~, Part 11 (commencing with Section 23001), or Part 12 (commencing with Section 27001) and effective tax administration.

(2) The exercise of authority under paragraph (1) shall be at the sole discretion of the Chief Counsel of the Franchise Tax Board and may not be delegated.

(3) Notwithstanding any other law or rule of law, any determination under this subdivision may not be reviewed in any administrative or judicial proceeding.

(f) Article 3 (commencing with Section 19031) of this chapter (relating to deficiency assessments) shall not apply with respect to the assessment or collection of any penalty imposed by subdivision (a).

(g) The penalty imposed by this section is in addition to any penalty imposed under Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23001), or Part 12 (commencing with Section 27001), or this part.

SEC. 87. Section 19179 of the Revenue and Taxation Code is amended to read:

19179. A penalty shall be imposed for filing a frivolous return and shall be determined in accordance with Section 6702 of the Internal Revenue Code, except as otherwise provided.

(a) Section 6702 of the Internal Revenue Code shall be applied to returns required to be filed under this part.

(b) For taxpayers that have a reportable transaction, as defined in Section 6707A(c)(1) of the Internal Revenue Code with respect to which the requirements of Section 6664(d)(2)(A) of the Internal Revenue Code are not met, any listed transaction, as defined in Section 6707A(c)(2) of the Internal Revenue Code, or a gross misstatement within the meaning of Section 6404(g)(2)(D) of the Internal Revenue Code, Section 6702(a) of the Internal Revenue Code is modified as follows:

(1) By substituting “\$5,000” instead of “\$500.”

(2) By substituting the term “person” instead of the term “individual” in each place that it appears.

(3) By substituting “tax imposed under Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23001), or Part 12 (commencing with Section 27001), or this part” instead of the phrase “tax imposed by subtitle A” contained therein.

(4) By substituting the phrase “is based on” instead of the phrase “is due to” contained therein.

(5) By substituting the phrase “frivolous or is based on a position that the Franchise Tax Board has identified as frivolous under subdivision (c) of Section 19179” instead of the term “frivolous” contained therein.

(6) By substituting the phrase “reflects a desire to delay or impede the administration of federal income tax laws as determined by the Secretary of the Treasury or the administration of the tax imposed under Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23001), or Part 12 (commencing with Section 27001), or this part as determined by the Franchise Tax Board” instead of the phrase “a desire (which appears on the purported return) to delay or impede the administration of Federal income tax laws” contained therein.

(c) (1) The Franchise Tax Board shall prescribe (and periodically revise) a list of positions which the Secretary of the Treasury for federal income tax purposes or the Franchise Tax Board has identified as being frivolous for purposes of this section.

(2) Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code does not apply to any standard, criterion, procedure, determination, rule, notice, or guideline established or prescribed by the Franchise Tax Board pursuant to paragraph (1).

(d) (1) Except as provided in paragraph (3), any person who submits a specified frivolous submission shall pay a penalty of five thousand dollars (\$5,000).

(2) For purposes of this section, all of the following shall apply:

(A) The phrase “specified frivolous submission” means a specified submission if any portion of that submission meets any of the following conditions:

(i) Is based on a position which the Franchise Tax Board has identified as frivolous under subdivision (c).

(ii) Reflects a desire to delay or impede the administration of federal income tax laws as determined by the Secretary of the Treasury or the administration of the tax imposed under Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23001), or Part 12 (commencing with Section 27001), or this part as determined by the Franchise Tax Board.

(B) The phrase “specified submission” means any of the following:

(i) A protest under Section 19041.

(ii) A request for a hearing under Section 19044.

(iii) An application under any of the following sections:

(I) Section 19008 (relating to agreements for payment of tax liability in installments).

(II) Section 19443 (relating to compromises).

(III) Section 21004 (relating to actions of the Taxpayers’ Rights Advocate).

(3) If the Franchise Tax Board provides a person with notice that a submission is a specified frivolous submission and the person withdraws that submission within 30 days after the notice, the penalty imposed under paragraph (1) does not apply with respect to that submission.

(e) (1) The Chief Counsel of the Franchise Tax Board may rescind all or any portion of any penalty imposed by this section if both of the following apply:

(A) Imposing the penalty would be against equity and good conscience.

(B) Rescinding the penalty would promote compliance with the requirements of this part and Part 10 (commencing with Section 17001) ~~or~~, Part 11 (commencing with Section 23001), or Part 12 (commencing with Section 27001) and effective tax administration.

(2) The exercise of authority under paragraph (1) shall be at the sole discretion of the Chief Counsel of the Franchise Tax Board and may not be delegated.

(3) Notwithstanding any other law or rule of law, any determination under this subdivision may not be reviewed in any administrative or judicial proceeding.

(f) The penalties imposed by this section shall be in addition to any other penalty provided by law.

SEC. 88. Section 19184 of the Revenue and Taxation Code is amended to read:

19184. (a) A penalty of fifty dollars (\$50) shall be imposed for each failure, unless it is shown that the failure is due to reasonable cause, by any person required to file who fails to file a report at the time and in the manner required by any of the following provisions:

(1) Subdivision (c) of Section 17507, relating to individual retirement accounts.

(2) Section 220(h) of the Internal Revenue Code, relating to medical savings accounts for taxable years beginning on or after January 1, 1997.

(3) Subdivision (b) of Section 17140.3 ~~or subdivision (b) of Section 23711~~ relating to qualified tuition programs.

(4) ~~Subdivision (c) of Section 23712, relating to Coverdell education savings accounts.~~

(b) (1) Any individual who:

(A) Is required to furnish information under Section 17508 as to the amount designated nondeductible contributions made for any taxable year, and

(B) Overstates the amount of those contributions made for that taxable year, shall pay a penalty of one hundred dollars (\$100) for each overstatement unless it is shown that the overstatement is due to reasonable cause.

(2) Any individual who fails to file a form required to be filed by the Franchise Tax Board under Section 17508 shall pay a penalty of fifty dollars (\$50) for each failure unless it is shown that the failure is due to reasonable cause.

(c) Article 3 (commencing with Section 19031) of this chapter (relating to deficiency assessments) shall not apply in respect of the assessment or collection of any penalty imposed under this section.

SEC. 89. Section 19188 is added to the Revenue and Taxation Code, to read:

19188. With respect to any penalty or addition to tax that is imposed on a taxpayer subject to tax under Part 12 (commencing with Section 27001) under a provision of this article and that provision refers to the Internal Revenue Code, any reference to income or taxable income in the applicable provision of the Internal Revenue Code shall be interpreted to mean gross receipts or business net receipts, respectively, subject to tax under Part 12 (commencing with Section 27001).

SEC. 90. Section 19195 of the Revenue and Taxation Code is amended to read:

19195. (a) Notwithstanding any other provision of law, including Section 6254.21 of the Government Code, the Franchise Tax Board shall make available as a matter of public record each calendar year a list of the 250 largest tax delinquencies in excess of one hundred thousand dollars (\$100,000) under Part 10 ~~and~~, Part 11, and

Part 12 of this division, as of December 31 of the preceding year. For purposes of compiling the list, a tax delinquency means the total amount owed by a taxpayer to the State of California for which a notice of state tax lien has been recorded in any county recorder's office in this state, pursuant to Chapter 14 (commencing with Section 7150) of Division 7 of Title 1 of the Government Code.

(b) For purposes of the list, a tax delinquency does not include any of the following and may not be included on the list:

(1) A delinquency for which payment arrangements have been agreed to by both the taxpayer and the Franchise Tax Board and the taxpayer is in compliance with the arrangement.

(2) A delinquency for which the taxpayer has filed for bankruptcy protection pursuant to Title 11 of the United States Code.

(3) A delinquency for which the person or persons liable for the tax have contacted the Franchise Tax Board and for which resolution of the tax delinquency has not been rejected by the Franchise Tax Board.

(c) Each annual list shall, with respect to each delinquency, include all the following:

(1) The name of the person or persons liable for payment of the tax and that person's or persons' address.

(2) The amount of tax delinquency as shown on the notice or notices of state tax lien and any applicable interest or penalties, less any amounts paid.

(3) The earliest date that a notice of state tax lien was filed.

(4) The type of tax that is delinquent.

(d) Prior to making a tax delinquency a matter of public record as required by this section, the Franchise Tax Board shall provide a preliminary written notice to the person or persons liable for the tax by certified mail, return receipt requested. If within 30 days after issuance of the notice, the person or persons do not remit the amount due or make arrangements with the Franchise Tax Board for payment of the amount due, the tax delinquency shall be included on the list.

(e) The annual list described in subdivision (a) shall include the following:

(1) The telephone number and address of the Franchise Tax Board office to contact if a person believes placement of his or her name on the list is in error.

(2) The aggregate number of persons that have appeared on the list who have satisfied their delinquencies in their entirety and the dollar amounts, in the aggregate, that have been paid attributable to those delinquencies.

(f) As promptly as feasible, but no later than five business days from the occurrence of any of the following, the Franchise Tax Board shall remove that taxpayer's name from the list of tax delinquencies:

(1) Tax delinquencies for which the person liable for the tax has contacted the Franchise Tax Board and resolution of the delinquency has been arranged.

(2) Tax delinquencies for which the Franchise Tax Board has verified that an active bankruptcy proceeding has been initiated.

(3) Tax delinquencies for which the Franchise Tax Board has verified that a bankruptcy proceeding has been completed and there are no assets available with which to pay the delinquent amount or amounts.

(4) Tax delinquencies that the Franchise Tax Board has determined to be uncollectible.

(g) A person whose delinquency appears on the annual list, and who satisfies that delinquency in whole or in part, may request the Franchise Tax Board to include in its annual list any payments that person made to satisfy the delinquency. Upon receipt of that request, the Franchise Tax Board shall include those payments on the list as promptly as feasible.

SEC. 91. Section 19201 of the Revenue and Taxation Code is amended to read:

19201. If any amount due under Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23001), or Part 12 (commencing with Section 27001), or any amount that may be collected by the Franchise Tax Board as though it were a tax, is not paid, the Franchise Tax Board may file in the Office of the County Clerk of Sacramento County, or any other county, a certificate specifying the amount due, the name and last known address of the taxpayer liable for the amount due, and the fact that the Franchise Tax Board has complied with all provisions of the law in the computation and levy of the amount due, and a request that judgment be entered against the taxpayer in the amount set forth in the certificate.

SEC. 92. Section 19202 of the Revenue and Taxation Code is amended to read:

19202. The county clerk immediately upon the filing of the certificate shall enter a judgment for the people of the State of California against the taxpayer in the amount set forth in the certificate. The county clerk may file the judgment in a loose-leaf book entitled “Personal Income Tax Judgments,” ~~or~~ “Bank and Corporation Tax Judgments,” or “Business Net Receipts Tax Judgments.” as appropriate.

SEC. 93. Section 19221 of the Revenue and Taxation Code is amended to read:

19221. (a) If any taxpayer or person fails to pay any liability imposed under Part 10 (commencing with Section 17001)~~or~~, Part 11 (commencing with Section 23001), or Part 12 (commencing with Section 27001) at the time that it becomes due and payable, the amount thereof, (including any interest, additional amount, addition to tax, or penalty, together with any costs that may accrue in addition thereto) shall thereupon be a perfected and enforceable state tax lien. This lien is subject to Chapter 14 (commencing with Section 7150) of Division 7 of Title 1 of the Government Code.

(b) For the purpose of this section, amounts are “due and payable” on the following dates:

(1) For amounts of any liability disclosed on a return filed on or before the date payment is due (with regard to any extension of time to pay), the date the amount is established on the records of the Franchise Tax Board, except that in no case will it be prior to the day after the payment due date;

(2) For amounts of any liability disclosed on a return filed after the date payment is due (with regard to any extension of time to pay), the date the amount is established on the records of the Franchise Tax Board;

(3) For amounts of any liability determined under Section 19081 or 19082 (pertaining to jeopardy assessments), the date the notice of the Franchise Tax Board’s finding is mailed or issued;

(4) For all other amounts of liability, the date the assessment is final.

(c) Notwithstanding subdivision (a), during any period that Section 362 of Title 11 of the United States Code applies, any tax lien that would otherwise attach to property

by reason of subdivision (a) shall not take effect, unless the tax is a debt of the debtor that will not be discharged in the bankruptcy proceeding and the property or its proceeds are transferred out of the bankruptcy estate to, or otherwise revested in, the debtor.

SEC. 94. Section 19222 of the Revenue and Taxation Code is amended to read:

19222. For the purposes of this section, if any certified, treasurer's, or cashier's check (or other guaranteed draft), or any money order received in payment of any liability imposed under Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23001), Part 12 (commencing with Section 27001), or this part is not duly paid, the state shall, in addition to its right to exact payment from the party originally indebted therefor, have a perfected and enforceable state tax lien for the amount of that check (or draft) upon all the assets of the financial institution on which drawn or for the amount of that money order upon all the assets of the issuer thereof. The lien referred to in the preceding sentence shall be subject to Chapter 14 (commencing with Section 7150) of Division 7 of Title 1 of the Government Code.

SEC. 95. Section 19254 of the Revenue and Taxation Code is amended to read:

19254. (a) (1) If any person, other than an organization exempt from taxation under Section 23701 or 27701, fails to pay any amount of tax, penalty, addition to tax, interest, or other liability imposed and delinquent under Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23001), Part 12 (commencing with Section 27001), or this part, a collection cost recovery fee shall be imposed if the Franchise Tax Board has mailed notice to that person for payment that advises that continued failure to pay the amount due may result in collection action, including the

imposition of a collection cost recovery fee. The collection cost recovery fee shall be in the amount of:

(A) In the case of an individual, ~~partnership, limited liability company~~ classified as a ~~partnership~~ for California income tax purposes, or fiduciary, eighty-eight dollars (\$88) or an amount as adjusted under subdivision (b).

(B) In the case of a business entity subject to tax under Part 12 (commencing with Section 27001), other than an ~~individual corporation or limited liability company~~ classified as a corporation for California income tax purposes, one hundred sixty-six dollars (\$166) or an amount as adjusted under subdivision (b).

(2) If any person, other than an organization exempt from taxation under Section 23701 or 27701, fails or refuses to make and file a tax return required by Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23001), Part 12 (commencing with Section 27001), or this part, within 25 days after formal legal demand to file the tax return is mailed to that person by the Franchise Tax Board, the Franchise Tax Board shall impose a filing enforcement cost recovery fee in the amount of:

(A) In the case of an individual, ~~partnership, limited liability company~~ classified as a ~~partnership~~ for California income tax purposes, or fiduciary, fifty-one dollars (\$51) or an amount as adjusted under subdivision (b).

(B) In the case of a business entity subject to tax under Part 12 (commencing with Section 27001), other than an ~~individual corporation or limited liability company~~ classified as a corporation for California income tax purposes, one hundred nineteen dollars (\$119) or an amount as adjusted under subdivision (b).

(b) For fees imposed under this section during the fiscal year 1993–94 and fiscal years thereafter, the amount of those fees shall be set to reflect actual costs and shall be specified in the annual Budget Act.

(c) Interest shall not accrue with respect to the cost recovery fees provided by this section.

(d) The amounts provided by this section are obligations imposed by this part and may be collected in any manner provided under this part for the collection of a tax.

(e) Subdivision (a) is operative with respect to the notices for payment or formal legal demands to file, either of which is mailed on or after September 15, 1992.

(f) The Franchise Tax Board shall determine the total amount of the cost recovery fees collected or accrued through June 30, 1993, and shall notify the Controller of that amount. The Controller shall transfer that amount to the Franchise Tax Board, and that amount is hereby appropriated to the board for the 1992–93 fiscal year for reimbursement of its collection and filing enforcement efforts.

SEC. 96. Section 19255 of the Revenue and Taxation Code is amended to read:

19255. (a) Except as otherwise provided in subdivisions (b) and (e), after 20 years have lapsed from the date the latest tax liability for a taxable year or the date any other liability that is not associated with a taxable year becomes “due and payable” within the meaning of Section 19221, the Franchise Tax Board may not collect that amount and the taxpayer’s liability to the state for that liability is abated by reason of lapse of time. Any actions taken by the Franchise Tax Board to collect an uncollectible liability shall be released, withdrawn, or otherwise terminated by the Franchise Tax

Board, and no subsequent administrative or civil action shall be taken or brought to collect all or part of that uncollectible amount. Any amounts received in contravention of this section shall be considered an overpayment pursuant to Section 19306 that may be credited and refunded in accordance with Section 19301.

(b) If a timely civil action filed pursuant to Article 2 of Chapter 6 of this part is commenced, or a claim is filed in a probate action, the period for which the liability is collectable shall be extended and shall not expire until that liability, probate claim, or judgment against the taxpayer arising from that liability is satisfied or becomes unenforceable under the laws applicable to the enforcement of civil judgments.

(c) For purposes of this section, both of the following apply:

(1) "Tax liability" means a liability imposed under Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23001), Part 12 (commencing with Section 27001), or this part, and includes any additions to tax, interest, penalties, fees and any other amounts relating to the imposed liability.

(2) If more than one liability is "due and payable" for a particular taxable year, with the exception of a liability resulting from a penalty imposed under Section 19777.5, the "due and payable" date that is later in time shall be the date upon which the 20-year limitation of subdivision (a) commences.

(d) This section shall not apply to amounts subject to collection by the Franchise Tax Board pursuant to Article 5, 5.5, or 6 of this chapter, or any other amount that is not a tax imposed under Part 10-~~or~~, Part 11, or Part 12, but which the Franchise Tax Board is collecting as though it were a final personal income tax delinquency.

(e) (1) The expiration of the period of limitation on collection under this section shall be suspended for the following periods:

(A) The period that the Franchise Tax Board is prohibited from involuntary collection under subparagraph (B) of paragraph (1) of subdivision (b) of Section 19271 relating to collection of child support delinquencies, plus 60 days thereafter.

(B) The period during which the Franchise Tax Board is prohibited by reason of a bankruptcy case from collecting, plus six months thereafter.

(C) The period described under subdivision (d) of Section 19008 relating to installment payment agreements.

(D) The period during which collection is postponed by operation of law under Section 18571, related to postponement by reason of service in a combat zone, or under Section 18572, related to postponement by reason of presidentially declared disaster or terroristic or military action.

(E) During any other period during which collection of a tax is suspended, postponed, or extended by operation of law.

(2) A suspension of the period of limitation under this subdivision shall apply with respect to both parties of any liability that is joint and several.

(f) This section shall be applied on and after July 1, 2006, to any liability "due and payable" before, on, or after that date.

SEC. 97. Section 19280 of the Revenue and Taxation Code is amended to read:

19280. (a) (1) Fines, state or local penalties, forfeitures, restitution fines, restitution orders, or any other amounts imposed by a superior court of the State of California upon a person or any other entity that are due and payable in an amount

totaling no less than one hundred dollars (\$100), in the aggregate, for criminal offenses, including all offenses involving a violation of the Vehicle Code, may, no sooner than 90 days after payment of that amount becomes delinquent, be referred by the superior court, the county, or the state to the Franchise Tax Board for collection under guidelines prescribed by the Franchise Tax Board. Unless the victim of the crime notifies the Department of Corrections and Rehabilitation to the contrary, the Department of Corrections and Rehabilitation may refer a restitution order to the Franchise Tax Board, in accordance with subparagraph (B) of paragraph (2), for any person subject to the restitution order who is or has been under the jurisdiction of the Department of Corrections and Rehabilitation.

(2) For purposes of this subdivision:

(A) The amounts referred by the superior court, the county, or state under this section may include an administrative fee and any amounts that a government entity may add to the court-imposed obligation as a result of the underlying offense, trial, or conviction. For purposes of this article, those amounts shall be deemed to be imposed by the court.

(B) Restitution orders may be referred to the Franchise Tax Board only by a government entity, as agreed upon by the Franchise Tax Board, provided that all of the following apply:

(i) The government entity has the authority to collect on behalf of the state or the victim.

(ii) The government entity shall be responsible for distributing the restitution order collections, as appropriate.

(iii) The government entity shall ensure, in making the referrals and distributions, that it coordinates with any other related collection activities that may occur by superior courts, counties, or other state agencies.

(iv) The government entity shall ensure compliance with laws relating to the reimbursement of the State Restitution Fund.

(C) The Franchise Tax Board shall establish criteria for referral, which shall include setting forth a minimum dollar amount subject to referral and collection.

(b) The Franchise Tax Board, in conjunction with the Judicial Council, shall seek whatever additional resources are needed to accept referrals from all 58 counties or superior courts.

(c) Upon written notice to the debtor from the Franchise Tax Board, any amount referred to the Franchise Tax Board under subdivision (a) and any interest thereon, including any interest on the amount referred under subdivision (a) that accrued prior to the date of referral, shall be treated as final and due and payable to the State of California, and shall be collected from the debtor by the Franchise Tax Board in any manner authorized under the law for collection of a delinquent personal income tax liability, including, but not limited to, issuance of an order and levy under Article 4 (commencing with Section 706.070) of Chapter 5 of Division 2 of Title 9 of Part 2 of the Code of Civil Procedure in the manner provided for earnings withholding orders for taxes.

(d) (1) Part 10 (commencing with Section 17001), this part, Part 10.7 (commencing with Section 21001), ~~and~~ Part 11 (commencing with Section 23001), and Part 12 (commencing with Section 27001) shall apply to amounts referred under

this article in the same manner and with the same force and effect and to the full extent as if the language of those laws had been incorporated in full into this article, except to the extent that any provision is either inconsistent with this article or is not relevant to this article.

(2) Any information, information sources, or enforcement remedies and capabilities available to the court or the state referring to the amount due described in subdivision (a), shall be available to the Franchise Tax Board to be used in conjunction with, or independent of, the information, information sources, or remedies and capabilities available to the Franchise Tax Board for purposes of administering Part 10 (commencing with Section 17001), this part, Part 10.7 (commencing with Section 21001), ~~or~~, Part 11 (commencing with Section 23001) or Part 12 (commencing with Section 27001).

(e) The activities required to implement and administer this part shall not interfere with the primary mission of the Franchise Tax Board to administer Part 10 (commencing with Section 17001) ~~and~~, Part 11 (commencing with Section 23001), or Part 12 (commencing with Section 27001).

(f) For amounts referred for collection under subdivision (a), interest shall accrue at the greater of the rate applicable to the amount due being collected or the rate provided under Section 19521. When notice of the amount due includes interest and is mailed to the debtor and the amount is paid within 15 days after the date of notice, interest shall not be imposed for the period after the date of notice.

(g) In no event shall a collection under this article be construed as a payment of income taxes imposed under Part 10 (commencing with Section 17001) ~~or~~, Part 11 (commencing with Section 23001), or Part 12 (commencing with Section 27001).

SEC. 98. Section 19290 of the Revenue and Taxation Code is amended to read:

19290. (a) The Department of Industrial Relations shall enter into an agreement with the Franchise Tax Board that transfers responsibility from the department to the Franchise Tax Board for the collection of delinquent fees, wages, penalties, and costs, and any interest thereon, effective July 1, 1995. Under the agreement, the Franchise Tax Board shall collect unsatisfied judgments that are issued pursuant to Sections 98.2, 226.5, 1023, 1289, 2681, and 6650 of the Labor Code. The agreement shall also provide for the collection of delinquent debts that result from a final determination by the department after the exhaustion of appeal remedies pursuant to Sections 98.3, 210, 1174.5, 1193.6, 1194, 1194.2, 1197.1, 1197.5, 1771, 1774, 3722, 7314, 7350, 7721, and 7904 of the Labor Code. The agreement shall specify the terms under which fees, wages, penalties, and costs, and any interest thereon, become subject to collection by the Franchise Tax Board.

The agreement may also provide for reimbursement to the Franchise Tax Board on the basis of a percentage of the amount of revenue realized as a result of the Franchise Tax Board's services, provided that the amount of any reimbursement shall not exceed the actual costs of collection, including court costs and reasonable attorney's fees.

Wherever possible the collection costs shall be borne by the judgment debtor. Any fee for the recovery of wages shall not be paid by the workers. The department shall adopt rules and regulations to provide for a reasonable fee to cover actual collection costs.

The Franchise Tax Board shall be entitled to court costs and reasonable attorney's fees as a judgment creditor under subdivision (i) of Section 98.2 of the Labor Code.

(b) Upon written notice to the obligor from the Franchise Tax Board, any amount referred to the Franchise Tax Board under subdivision (a) and any interest thereon, including any interest on the amount referred under subdivision (a) that accrued prior to the date of referral and any fee imposed to cover collection costs as provided under subdivision (a), shall be treated as final and due and payable to the State of California, and shall be collected from the obligor by the Franchise Tax Board in any manner authorized under the law for collection of a delinquent personal income tax liability, including, but not limited to, issuance of an order and levy under Article 4 (commencing with Section 706.070) of Chapter 5 of Division 2 of Title 9 of Part 2 of the Code of Civil Procedure, in the manner provided for earnings withholding orders for taxes.

(c) (1) Part 10 (commencing with Section 17001), this part, Part 10.7 (commencing with Section 21001), ~~and~~ Part 11 (commencing with Section 23001), and Part 12 (commencing with Section 27001) shall apply to amounts referred under this article in the same manner and with the same force and effect and to the full extent as if the language of those laws had been incorporated in full into this article, except to the extent that any provision is either inconsistent with this article or is not relevant to this article.

(2) Any information, information sources, or enforcement remedies and capabilities available to the agency referring the amount due described in subdivision (a), shall be available to the Franchise Tax Board to be used in conjunction with, or independent of, the information, information sources, or remedies and capabilities

available to the Franchise Tax Board for purposes of administering Part 10 (commencing with Section 17001), this part, Part 10.7 (commencing with Section 21001), ~~or~~ Part 11 (commencing with Section 23001), or Part 12 (commencing with Section 27001).

(d) The activities required to implement and administer this part shall not interfere with the primary mission of the Franchise Tax Board to administer Part 10 (commencing with Section 17001) ~~and~~, Part 11 (commencing with Section 23001), and Part 12 (commencing with Section 27001).

(e) For amounts referred for collection under subdivision (a), interest shall accrue at the greater of the rate applicable to the amount due being collected or the rate provided under Section 19521. When notice of the amount due includes interest and is mailed to the obligor, and the amount is paid within 15 days after the date of notice, interest shall not be imposed for the period after the date of notice.

(f) In no event shall a collection under this article be construed as a payment of income taxes imposed under Part 10 (commencing with Section 17001) or Part 11 (commencing with Section 23001).

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

SEC. 99. Section 19301 of the Revenue and Taxation Code is amended to read:

19301. (a) If the Franchise Tax Board or the board, as the case may be, finds that there has been an overpayment of any liability imposed under Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23001), Part 12 (commencing with Section 27001), or this part by a taxpayer for any year for any reason, the amount

of the overpayment may be credited against any amount then due from the taxpayer and the balance shall be refunded to the taxpayer.

(b) In the case of a joint return filed under Section 18521, the amount of the overpayment may be credited against the amount then due from both taxpayers and the balance shall be refunded to both taxpayers in the names under which the return was paid.

(c) In the case of a corporation, the balance shall be refunded to the taxpayer or its successor through reorganization, merger, or consolidation, or to its shareholders upon dissolution.

SEC. 100. Section 19313 of the Revenue and Taxation Code is amended to read:

19313. (a) In the case of any tax imposed by Part 10 (commencing with Section 17001) ~~or~~, Part 11 (commencing with Section 23001), or Part 12 (commencing with Section 27001) with respect to any person, the period for filing a claim for credit or refund of any overpayment attributable to any partnership item of a federally registered partnership shall not expire before the later of the following:

(1) The date which is five years after the date prescribed by law (including extensions thereof) for filing the partnership return for the partnership taxable year in which the item arose.

(2) If an agreement under Section 6501(c)(4) of the Internal Revenue Code of 1954 extending the period for the assessment of any deficiency attributable to the partnership item is made before the date specified in paragraph (1), the date six months after the expiration of the extension.

In any case to which the preceding sentence applies, the amount of the credit or refund may exceed the portion of the tax paid within the period provided in Section 19306 or 19308, whichever is applicable.

(b) For purposes of this subdivision, “partnership item” and “federally registered partnership” have the same meanings as when used in Section 19063.

SEC. 101. Section 19314 of the Revenue and Taxation Code is amended to read:

19314. (a) Notwithstanding any statute of limitations otherwise provided for in this part, any overpayment due a taxpayer for any year, shall be allowed as an offset in computing any deficiency in tax, for the same or any other year, if the overpayment results from any of the following:

(1) A transfer of items of income or deductions or both to or from another year for the same taxpayer.

(2) A transfer of items of income or deductions or both for the same year for a related taxpayer described in Section 19110.

(3) A transfer of items of income, receipt, purchase, or deductions, ~~or both,~~ to or from another taxpayer for the same or different years if the items of income, receipt, purchase, or deductions are transferred between affiliated taxpayers whose tax is determined under Chapter 17 (commencing with Section 25101) of Part 11 or Chapter 7 (commencing with Section 28001) of Part 12.

(b) The offset provided under subdivision (a) shall not be allowed after the expiration of seven years from the due date of the return or returns on which the overpayment is determined.

(c) No refund shall be allowed under subdivision (a) unless before the period set forth in Section 19306 a claim therefor is filed by the taxpayer or unless before the expiration of that period the Franchise Tax Board has allowed a credit or made a refund.

SEC. 102. Section 19340 of the Revenue and Taxation Code is amended to read:

19340. Interest shall be allowed and paid on any overpayment in respect of any tax, at the adjusted annual rate established pursuant to Section 19521 as follows:

(a) In the case of a credit, from the date of the overpayment to the due date of the amount for which the credit is allowed. Any interest allowed on any credit shall first be credited on any amounts due from the taxpayer under Part 10 (commencing with Section 17001), this part, ~~or~~ Part 11 (commencing with Section 23001), or Part 12 (commencing with Section 27001).

(b) In the case of a refund, including a refund in excess of tax liability as prescribed in subdivision (j) of Section 17053.5, from the date of the overpayment to a date preceding the date of the refund warrant by not more than 30 days, the date to be determined by the Franchise Tax Board.

SEC. 103. Section 19365 of the Revenue and Taxation Code is repealed.

~~19365. (a) (1) A corporation electing to be treated as an "S corporation" for a taxable year beginning in 2002 under Chapter 4.5 (commencing with Section 23800) of Part 11 may file an application for the transfer of an overpayment with respect to payments of estimated tax for taxable years beginning in 2002 to the personal income tax accounts of its shareholders. An application under this subdivision shall not constitute a claim for credit or refund.~~

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

~~(A) The amount the "S corporation" estimates as its tax liability under this part for the taxable year, which shall not be less than the greater of $1\frac{1}{2}$ percent of its net income or the applicable minimum franchise tax.~~

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

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

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

~~(b) (1) Within a period of 45 days from the date on which an application for a transfer is filed under subdivision (a), the Franchise Tax Board shall make, to the extent it deems practicable in that period, a limited examination of the application to discover omissions and errors therein, and shall determine the final amount of the transfers upon the basis of the application and the examination, except that the Franchise Tax Board may disallow, without further action, any application which it finds contains material omissions or errors which it deems cannot be corrected within the 45-day period.~~

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

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

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

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

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

SEC. 104. Section 19371 of the Revenue and Taxation Code is amended to read:

19371. (a) At any time within 10 years after the determination of liability for any tax, penalties, and interest, or within the period during which a lien is in force as the result of the recording of an abstract under Section 19203 or of the recording or filing of a notice of state tax lien under Section 7171 of the Government Code, the Franchise Tax Board may bring an action in the courts of this state, of any other state,

or of the United States in the name of the people of the State of California to recover the amount of any taxes, penalties, and interest due and unpaid under Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23001), or this part.

(b) The amendments made by Sections 41 and 108 of Chapter 117 of the Statutes of 1991 shall apply to any of the following:

(1) Taxes assessed under Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23001), Part 12 (commencing with Section 27001), or this part after July 16, 1991.

(2) Taxes assessed on or before July 16, 1991, under Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23001), or this part, if the period specified in subdivision (a), determined without regard to those amendments, has not expired on July 16, 1991.

SEC. 105. Section 19374 of the Revenue and Taxation Code is amended to read:

19374. In the action a certificate by the Franchise Tax Board showing the delinquency shall be prima facie evidence of the levy of the tax, penalties and interest of the delinquency, and of the compliance by the Franchise Tax Board and the board with all the provisions of Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23001), Part 12 (commencing with Section 27001), and this part in relation to the computation and levy of the tax.

SEC. 106. Section 19377 of the Revenue and Taxation Code is amended to read:

19377. (a) The Franchise Tax Board may enter into agreement with one or more persons for the purpose of collecting delinquent accounts with respect to amounts assessed or imposed under Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23001), Part 12 (commencing with Section 27001), or this part, provided the agreements do not cause the net displacement of civil service employees. The agreement may provide for the rate and manner of payment for the contracted collection services. However, the consideration payable by the Franchise Tax Board under the agreement shall not be included in the amounts to be collected from the tax debtor by the contractor providing collection services.

(b) For purposes of this section, “displacement” includes layoff, demotion, involuntary transfer to a new class, involuntary transfer to a new location requiring a change of residence, and time base reductions. “Displacement” does not include changes in shifts or days off, nor does it include reassignment to any other position within the same class and general location.

SEC. 107. Section 19441 of the Revenue and Taxation Code is amended to read:

19441. (a) The Franchise Tax Board or any person authorized in writing by the Franchise Tax Board is authorized to enter into an agreement in writing with any person (or the person or estate for whom that person acts) in respect of any tax, interest, penalty, or addition to tax levied under Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23001), Part 12 (commencing with Section 27001), or this part for any taxable period.

(b) If the agreement is approved by the Franchise Tax Board, itself, within the time as may be stated in the agreement, or later agreed to, the agreement shall be final and conclusive, and except upon a showing of fraud or malfeasance, or misrepresentation of a material fact:

(1) The case shall not be reopened as to the matters agreed upon or the agreement modified, by any officer, employee, or agent of the state, and

(2) In any suit, action, or proceeding, the agreement, or any determination, assessment, collection, payment, abatement, refund, or credit made in accordance therewith, shall not be annulled, modified, set aside, or disregarded.

SEC. 108. Section 19443 of the Revenue and Taxation Code is amended to read:

19443. (a) (1) The Executive Officer and Chief Counsel of the Franchise Tax Board, jointly, or their delegates, may compromise any final tax liability in which the reduction of tax is seven thousand five hundred dollars (\$7,500) or less.

(2) Except as provided in paragraph (3), the Franchise Tax Board, upon recommendation by its executive officer and chief counsel, jointly, may compromise a final tax liability involving a reduction in tax in excess of seven thousand five hundred dollars (\$7,500). Any recommendation for approval of an offer in compromise that is not either approved or disapproved by the Franchise Tax Board, itself, within 45 days of the submission of the recommendation shall be deemed approved.

(3) The Franchise Tax Board, itself, may by resolution delegate to the executive officer and the chief counsel, jointly, the authority to compromise a final tax liability

in which the reduction of tax is in excess of seven thousand five hundred dollars (\$7,500) but less than ten thousand dollars (\$10,000).

(b) For purposes of this section, “a final tax liability” means any final tax liability arising under Part 10 (commencing with Section 17001) ~~or~~, Part 11 (commencing with Section 23001), or Part 12 (commencing with Section 27001), or related interest, additions to tax, penalties, or other amounts assessed under this part.

(c) For an amount to be compromised under this section, the following conditions shall exist:

(1) The taxpayer shall establish that the:

(A) Amount offered in payment is the most that can be expected to be paid or collected from the taxpayer’s present assets or income, and

(B) Taxpayer does not have reasonable prospects of acquiring increased income or assets that would enable the taxpayer to satisfy a greater amount of the liability than the amount offered, within a reasonable period of time.

(2) The Franchise Tax Board shall have determined that acceptance of the compromise is in the best interest of the state.

(d) A determination by the Franchise Tax Board that it would not be in the best interest of the state to accept an offer in compromise in satisfaction of a final tax liability shall not be subject to administrative appeal or judicial review.

(e) When an offer in compromise is either accepted or rejected, or the terms and conditions of a compromise agreement are fulfilled, the Franchise Tax Board shall notify the taxpayer in writing.

(f) In the case of a joint and several liability, the acceptance of an offer in compromise from one liable spouse shall not relieve the other spouse from paying the entire liability. However, the amount of the liability shall be reduced by the amount of the accepted offer.

(g) Whenever a compromise of tax or penalties or total tax and penalties in excess of five hundred dollars (\$500) is approved, there shall be placed on file for at least one year in the office of the Executive Officer of the Franchise Tax Board a public record with respect to that compromise. The public record shall include all of the following information:

- (1) The name of the taxpayer.
- (2) The amount of unpaid tax, and related penalties, additions to tax, interest, or other amounts involved.
- (3) The amount offered.
- (4) A summary of the reason why the compromise is in the best interest of the state.

The public record shall not include any information that relates to any trade secret, patent, process, style of work, apparatus, business secret, or organizational structure, that if disclosed, would adversely affect the taxpayer or the national defense. No list shall be prepared and no releases distributed by the Franchise Tax Board in connection with these statements.

(h) Any compromise made under this section may be rescinded, all compromised liabilities may be reestablished (without regard to any statute of limitations that

otherwise may be applicable), and no portion of the amount offered in compromise refunded, if either of the following occurs:

(1) The Franchise Tax Board determines that any person did any of the following acts regarding the making of the offer:

(A) Concealed from the Franchise Tax Board any property belonging to the estate of any taxpayer or other person liable for the tax.

(B) Received, withheld, destroyed, mutilated, or falsified any book, document, or record or made any false statement, relating to the estate or financial condition of the taxpayer or other person liable for the tax.

(2) The taxpayer fails to either:

(A) Comply with any of the terms and conditions relative to the offer.

(B) File subsequent required returns and pay subsequent final tax liabilities within 20 days after the Franchise Tax Board issues notice and demand to the person stating that the continued failure to file or pay the tax may result in rescission of the compromise.

(i) This section shall become operative on the effective date of the act adding this section without regard to the taxable year at issue.

SEC. 109. Section 19501 of the Revenue and Taxation Code is amended to read:

19501. The Franchise Tax Board shall administer and enforce Part 10 (commencing with Section 17001), Part 10.7 (commencing with Section 21001), Part 11 (commencing with Section 23001), Part 12 (commencing with Section 27001), and this part. For this purpose, it may divide the state into a reasonable number of districts,

in each of which a branch office or offices may be maintained during all or part of the time as may be necessary.

SEC. 110. Section 19503 of the Revenue and Taxation Code is amended to read:

19503. (a) The Franchise Tax Board shall prescribe all rules and regulations necessary for the enforcement of Part 10 (commencing with Section 17001), Part 10.7 (commencing with Section 21001), Part 11 (commencing with Section 23001), Part 12 (commencing with Section 27001), and this part and may prescribe the extent to which any ruling (including any judicial decision or any administrative determination other than by regulation) shall be applied without retroactive effect.

(b) (1) Except as otherwise provided in this subdivision, no regulation relating to Part 10 (commencing with Section 17001), Part 10.7 (commencing with Section 21001), Part 11 (commencing with Section 23001), Part 12 (commencing with Section 27001), or this part shall apply to any taxable year ending before the date on which any notice substantially describing the expected contents of any regulation is issued to the public.

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

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

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

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

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

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

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

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

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

SEC. 111. Section 19504 of the Revenue and Taxation Code is amended to read:

19504. (a) The Franchise Tax Board, for the purpose of administering its duties under this part, including ascertaining the correctness of any return; making a return where none has been made; determining or collecting the liability of any person in respect of any liability imposed by Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23001), Part 12 (commencing with Section 27001), or this part (or the liability at law or in equity of any transferee in respect of that liability); shall have the power to require by demand, that an entity of any kind including, but

not limited to, employers, persons, or financial institutions provide information or make available for examination or copying at a specified time and place, or both, any book, papers, or other data which may be relevant to that purpose. Any demand to a financial institution shall comply with the California Right to Financial Privacy Act set forth in Chapter 20 (commencing with Section 7460) of Division 7 of Title 1 of the Government Code. Information that may be required upon demand includes, but is not limited to, any of the following:

(1) Addresses and telephone numbers of persons designated by the Franchise Tax Board.

(2) Information contained on Federal Form W-2 (Wage and Tax Statement), Federal Form W-4 (Employee's Withholding Allowance Certificate), or State Form DE-4 (Employee's Withholding Allowance Certificate).

(b) The Franchise Tax Board may require the attendance of the taxpayer or of any other person having knowledge in the premises and may take testimony and require material proof for its information and administer oaths to carry out this part.

(c) (1) The Franchise Tax Board may issue subpoenas or subpoenas duces tecum, which subpoenas must be signed by any member of the Franchise Tax Board, and may be served on any person for any purpose.

(2) For taxpayers that have been contacted by the Franchise Tax Board regarding the use of a potentially abusive tax shelter (within the meaning of Section 19777), the subpoena may be signed by any member of the Franchise Tax Board, the Executive Officer of the Franchise Tax Board, or any designee.

(d) Obedience to subpoenas or subpoenas duces tecum issued in accordance with this section may be enforced by application to the superior court as set forth in Article 2 (commencing with Section 11180) of Chapter 2 of Part 1 of Division 3 of Title 2 of the Government Code.

(e) When examining a return, the Franchise Tax Board shall not use financial status or economic reality examination techniques to determine the existence of unreported income of any taxpayer unless the Franchise Tax Board has a reasonable indication that there is a likelihood of unreported income. This subdivision applies to any examination beginning on or after October 10, 1999.

SEC. 112. Section 19504.5 of the Revenue and Taxation Code is amended to read:

19504.5. (a) (1) Except as provided in subdivision (b), no subpoena may be issued under this part and the Franchise Tax Board may not begin any action under Article 2 (commencing with Section 11180) of Chapter 2 of Part 1 of Division 3 of Title 2 of the Government Code to enforce any subpoena to produce or analyze any tax-related computer software source code.

(2) Any software and related materials that are provided to the Franchise Tax Board under this part shall be subject to the safeguards under subdivision (c).

(b) (1) Paragraph (1) of subdivision (a) shall not apply to any portion, item, or component of the tax-related computer software source code if all of the following apply:

(A) The Franchise Tax Board is unable to otherwise reasonably ascertain the correctness of any item on a return from either of the following:

(i) The taxpayer's books, papers, records, or other data.

(ii) The computer software executable code (and any modifications thereof) to which the source code relates and any associated data which, when executed, produces the output to ascertain the correctness of the item.

(B) The Franchise Tax Board identifies with reasonable specificity the portion, item, or component of the source code needed to verify the correctness of the item on the return.

(C) The Franchise Tax Board determines that the need for the portion, item, or component of the source code with respect to the item outweighs the risks of unauthorized disclosure of trade secrets.

(2) Paragraph (1) of subdivision (a) shall not apply to any of the following:

(A) Any inquiry into any offense connected with the administration or enforcement of this part, Part 10 (commencing with Section 17001), Part 10.7 (commencing with Section 21001), ~~or~~ Part 11 (commencing with Section 23001), or Part 12 (commencing with Section 27001).

(B) Any tax-related computer software source code acquired or developed by the taxpayer or related person primarily for internal use by the taxpayer or that person rather than for commercial distribution.

(C) Any communications between the owner of the tax-related computer software source code and the taxpayer or related persons.

(D) Any tax-related computer software source code which is required to be provided or made available pursuant to any other provision of this part, Part 10 (commencing with Section 17001), Part 10.7 (commencing with Section 21001), ~~or~~

Part 11 (commencing with Section 23001), or Part 12 (commencing with Section 27001).

(3) For purposes of paragraph (1), the Franchise Tax Board shall be treated as meeting the requirements of subparagraphs (A) and (B) of that paragraph if all of the following apply:

(A) The Franchise Tax Board determines that it is not feasible to determine the correctness of an item without access to the computer software executable code and associated data described in clause (ii) of subparagraph (A) of paragraph (1).

(B) The Franchise Tax Board makes a formal request to the taxpayer for the code and data and to the owner of the computer software source code for the executable code.

(C) The code and data are not provided within 180 days of that request.

(4) In any proceeding brought under Article 2 (commencing with Section 1180) of Chapter 2 of Part 1 of Division 3 of Title 2 of the Government Code to enforce a subpoena issued under the authority of this subdivision, the court shall, at the request of any party, hold a hearing to determine whether the applicable requirements of this section have been met.

(c) (1) In any court proceeding to enforce a subpoena for any portion of software, the court may receive evidence and issue any order necessary to prevent the disclosure of trade secrets or other confidential information with respect to that software, including requiring that any information be placed under seal to be opened only as directed by the court.

(2) Notwithstanding any other provision of this section, and in addition to any protections ordered pursuant to paragraph (1), in the case of software that comes into the possession or control of the Franchise Tax Board in the course of any examination with respect to any taxpayer, all of the following shall apply:

(A) The software may be used only in connection with the examination of that taxpayer's return, any protest or appeal by the taxpayer, any judicial proceeding and any appeals therefrom, or any inquiry into any offense connected with the administration or enforcement of this part, Part 10 (commencing with Section 17001), Part 10.7 (commencing with Section 21001), ~~or~~ Part 11 (commencing with Section 23001), or Part 12 (commencing with Section 27001).

(B) The Franchise Tax Board shall provide, in advance, to the taxpayer and the owner of the software a written list of the names of all individuals who will analyze or otherwise have access to the software.

(C) (i) The software shall be maintained in a secure area or place, and in the case of computer software source code, shall not be removed from the owner's place of business unless the owner permits, or a court orders, that removal.

(ii) For purposes of clause (i), the owner shall make available any necessary equipment or materials for analysis of computer software source code required to be conducted on the owner's premises.

(D) The software may not be copied except as necessary to perform an analysis, and the Franchise Tax Board shall number all copies made and certify in writing that no other copies have been or will be made.

(E) At the end of the period during which the software may be used under subparagraph (A), both of the following apply:

(i) The software and all copies thereof shall be returned to the person from whom they were obtained and any copies thereof made under subparagraph (D) on the hard drive of a machine or other mass storage device shall be permanently deleted.

(ii) The Franchise Tax Board shall obtain from any person who analyzes or otherwise had access to that software a written certification under penalty of perjury that all copies and related materials have been returned and that no copies were made of them.

(F) The software may not be decompiled or disassembled.

(G) (i) The Franchise Tax Board shall provide to the taxpayer and the owner of any interest in the software, as the case may be, a written agreement, between the Franchise Tax Board and any person who is not an officer or employee of the State of California and who will analyze or otherwise have access to that software, which provides that the person agrees not to do either of the following:

(I) Disclose the software to any person other than persons to whom the information could be disclosed for tax administration purposes under Section 19542.

(II) Participate for two years in the development of software which is intended for a similar purpose as the software examined.

(ii) The owner of any interest in the software shall be considered a party to any agreement described in clause (i).

(H) The software shall be treated as return information for purposes of Section 19542.

(d) For purposes of this section:

(1) "Software" includes computer software source code and computer software executable code.

(2) "Computer software source code" means all of the following:

(A) The code written by a programmer using a programming language which is comprehensible to appropriately trained persons and is not capable of directly being used to give instructions to a computer.

(B) Related programmers' notes, design documents, memoranda, and similar documentation.

(C) Related customer communications.

(3) "Computer software executable code" means both of the following:

(A) Any object code, machine code, or other code readable by a computer when loaded into its memory and used directly by the computer to execute instructions.

(B) Any related user manuals.

(4) "Owner" includes, with respect to any software, the developer of the software.

(5) A person shall be treated as related to another person if the persons are related persons under Section 267 or 707(b) of the Internal Revenue Code.

(6) "Tax-related computer software source code" means the computer source code for any computer software program intended for accounting, tax return preparation or compliance, or tax planning.

(e) This section and Section 19542.3 shall not apply to any software acquired or developed for internal use by the Franchise Tax Board.

(f) This section shall apply to subpoenas issued, and software acquired, after the effective date of the act adding this section. In the case of any software acquired on or before the effective date of the act adding this section, the requirements of paragraph (2) of subdivision (a) shall apply after the 90th day after the effective date of the act adding this section. The preceding sentence shall not apply to the requirement under clause (ii) of subparagraph (G) of paragraph (2) of subdivision (c).

SEC. 113. Section 19512 of the Revenue and Taxation Code is amended to read:

19512. Any person acting in a fiduciary capacity shall assume the duties and, upon giving notice to the Franchise Tax Board, shall assume the rights and privileges of the taxpayers in respect of any tax, additions to tax, penalties, and interest imposed by Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23001), Part 12 (commencing with Section 27001), or this part except as otherwise specifically provided, until he or she gives notice that his or her fiduciary has terminated. He or she shall give notice under this section pursuant to rules and regulations prescribed by the Franchise Tax Board.

SEC. 114. Section 19521 of the Revenue and Taxation Code is amended to read:

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

(1) (A) For taxpayers other than corporations, the overpayment rate specified in Section 6621(a)(1) of the Internal Revenue Code shall be modified to be equal to the underpayment rate determined under Section 6621(a)(2) of the Internal Revenue Code.

(B) In the case of any corporation, for purposes of determining interest on overpayments for periods beginning before July 1, 2002, the overpayment rate specified in Section 6621(a)(1) of the Internal Revenue Code shall be modified to be equal to the underpayment rate determined under Section 6621(a)(2) of the Internal Revenue Code.

(C) In the case of any corporation, for purposes of determining interest on overpayments for periods beginning on or after July 1, 2002, the overpayment rate specified in Section 6621(a)(1) of the Internal Revenue Code shall be modified to be the lesser of 5 percent or the bond equivalent rate of 13-week United States Treasury bills, determined as follows:

(i) The bond equivalent rate of 13-week United States Treasury bills established at the first auction held during the month of January shall be utilized in determining the appropriate rate for the following July 1 to December 31, inclusive. Any such rate shall be rounded to the nearest full percent (or, if a multiple of one-half of 1 percent, that rate shall be increased to the next highest full percent).

(ii) The bond equivalent rate of 13-week United States Treasury bills established at the first auction held during the month of July shall be utilized in determining the appropriate rate for the following January 1 to June 30, inclusive. Any such rate shall be rounded to the nearest full percent (or, if a multiple of one-half of 1 percent, that rate shall be increased to the next highest full percent).

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

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

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

(b) (1) For purposes of this part, Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23001), Part 12 (commencing with Section 27001), and any other provision of law referencing this method of computation, in computing the amount of any interest required to be paid by the state or by the taxpayer, or any other amount determined by reference to that amount of interest, that interest and that amount shall be compounded daily.

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

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

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

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

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

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

(3) Section 6621(c)(2)(B)(iii) of the Internal Revenue Code shall apply for purposes of determining interest for periods after December 31, 1998.

(d) Section 6621(d) of the Internal Revenue Code, relating to the elimination of interest on overlapping periods of tax overpayments and underpayments, shall not apply.

SEC. 115. Section 19525 of the Revenue and Taxation Code is amended to read:

19525. The Franchise Tax Board, under regulations prescribed by the Franchise Tax Board, may establish a reward program for information resulting in the identification of underreported or unreported income subject to taxes imposed by Part 10 (commencing with Section 17001)~~or~~, Part 11 (commencing with Section 23001), or Part 12 (commencing with Section 27001). Any reward may not exceed 10 percent of the taxes collected as a result of the information provided. Any person employed by or under contract with any state or federal tax collection agency shall not be eligible for a reward provided for pursuant to this section.

SEC. 116. Section 19533 of the Revenue and Taxation Code is amended to read:

19533. In the event the debtor has more than one debt being collected by the Franchise Tax Board and the amount collected by the Franchise Tax Board is insufficient to satisfy the total amount owing, the amount collected shall be applied in the following priority:

(a) Payment of any delinquencies transferred for collection under Article 5 (commencing with Section 19270) of Chapter 5.

(b) Payment of any taxes, additions to tax, penalties, interest, fees, or other amounts due and payable under Part 7.5 (commencing with Section 13201), Part 10

(commencing with Section 17001), Part 11 (commencing with Section 23001), Part 12 (commencing with Section 27001), or this part.

- (c) Payment of delinquent wages collected pursuant to the Labor Code.
- (d) Payment of delinquencies collected under Section 10878.
- (e) Payment of any amounts due that are referred for collection under Article 5.5 (commencing with Section 19280) of Chapter 5.
- (f) Payment of any amounts that are referred for collection pursuant to Section 62.9 of the Labor Code.
- (g) Payment of delinquent penalties collected for the Department of Industrial Relations pursuant to the Labor Code.
- (h) Payment of delinquent fees collected for the Department of Industrial Relations pursuant to the Labor Code.
- (i) Payment of delinquencies referred by the Student Aid Commission.
- (j) Notwithstanding the payment priority established by this section, voluntary payments made by a taxpayer designated by the taxpayer as payment for a personal income tax liability, shall not be applied pursuant to this priority, but shall instead be applied solely to the personal income tax liability for which the voluntary payment was made.

SEC. 117. Section 19542.1 of the Revenue and Taxation Code is amended to read:

19542.1. (a) Except as otherwise provided by this article, it shall be unlawful for any person described in Section 19542 to willfully inspect any confidential information furnished or secured pursuant to this part, Part 10 (commencing with

Section 17001), ~~or~~ Part 11 (commencing with Section 23001), or Part 12 (commencing with Section 27001). For purposes of this section, “inspection” means any examination of confidential information. Any willful unauthorized inspection or unwarranted disclosure or use of confidential information by the persons described in Section 19542 is a misdemeanor.

(b) The Franchise Tax Board shall notify a taxpayer of any known incidents of willful unauthorized inspection or unwarranted disclosure or use of his or her confidential tax records, but only if criminal charges have been filed for the willful unauthorized inspection or unwarranted disclosure.

SEC. 118. Section 19547 of the Revenue and Taxation Code is amended to read:

19547. In a matter involving tax administration under this part, a return or return information shall be open to inspection by the Attorney General or other legal representatives of the state, if any of the following apply:

(a) The taxpayer is or may be a party to the proceeding, or the proceeding arose out of, or in connection with, determining the taxpayer’s civil or criminal liability, or the collection of the taxpayer’s civil liability with respect to any tax imposed under Part 10 (commencing with Section 17001) ~~or~~, Part 11 (commencing with Section 23001), or Part 12 (commencing with Section 27001).

(b) The treatment of an item reflected on the return is or may be related to the resolution of an issue in the proceeding or investigation.

(c) The return or return information relates or may relate to a transactional relationship between a person who is a party to the proceeding and the taxpayer, which affects or may affect, the resolution of an issue in the proceeding or investigation.

In addition, the Attorney General may inspect any report or return required under this part when required in the enforcement of any public or charitable trust or in compelling adherence to any charitable purposes for which any nonprofit corporation is formed.

SEC. 119. Section 19549 of the Revenue and Taxation Code is amended to read:

19549. For purposes of this article:

(a) "Return" means any tax or information return, or claim for refund required by, or provided for or permitted under, the provisions of Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23001), Part 12 (commencing with Section 27001), or this part which is filed with the Franchise Tax Board by, on behalf of, or with respect to any person, estate, or trust, and any amendment or supplement thereto, including supporting schedules, attachments, or lists which are supplemental to, or part of, the return so filed.

(b) "Return information" means a taxpayer's identity, the nature, source, or amount of his, her, or its 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, recorded by, prepared by, furnished to, or collected by the Franchise Tax Board 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 Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23001), Part 12 (commencing with Section 27001), or this part for any tax, addition to tax, penalty, interest, fine, forfeiture, or other imposition, or offense.

(c) "Taxpayer return information" means return information as defined in subdivision (b) which is filed with, or furnished to, the Franchise Tax Board by or on behalf of the taxpayer to whom the return information relates.

(d) "Tax administration" means the administration, management, conduct, direction, and supervision of the execution and application of Part 10 (commencing with Section 17001), Part 10.7 (commencing with Section 21001), Part 11 (commencing with Section 23001), Part 12 (commencing with Section 27001), and this part.

SEC. 120. Section 19563 of the Revenue and Taxation Code is amended to read:

19563. This article does not prohibit the publication of statistics, so classified as to prevent the identification of particular reports or returns and the items thereof, or the publication of the percentage of dividends paid by any corporation that is deductible by the recipient under Part 11 (commencing with Section 23001) or Part 12 (commencing with Section 27001).

SEC. 121. Section 19565 of the Revenue and Taxation Code is amended to read:

19565. (a) If an organization is exempt from taxation under Section 23701 or Section 27701 for any taxable year, the application filed by the organization with

respect to which the Franchise Tax Board made its determination that the organization was entitled to exemption under Section 23701 or Section 27701, together with any papers submitted in support of the application, and any letter or other document issued by the Franchise Tax Board, with respect to the application, shall be open to public inspection. Any inspection under this subdivision may be made at the times, and in the manner, as the Franchise Tax Board shall by regulations prescribe. After the application of any organization has been opened to public inspection under this subdivision, the Franchise Tax Board shall, on the request of any person with respect to the organization, furnish a statement indicating the section which it has been determined describes the organization.

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

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

SEC. 122. Section 19566 of the Revenue and Taxation Code is amended to read:

19566. Any information provided to or secured by the Franchise Tax Board for purposes of administering Part 10 (commencing with Section 17001) ~~or~~, Part 11 (commencing with Section 23001), or Part 12 (commencing with Section 27001) may be used by Franchise Tax Board for purposes of administering Section 10878 or Article 6 (commencing with Section 19280) of Chapter 5.

SEC. 123. Section 19570 of the Revenue and Taxation Code is amended to read:

19570. The provisions of Sections 1798.35, 1798.36, 1798.37, and Article 9 (commencing with Section 1798.45) of Chapter 1 of Title 1.8 of the Civil Code shall not be applied, directly or indirectly, to the determination of the existence or possible existence of liability (or the amount thereof) of any person for any tax, penalty, interest, fine, forfeiture, or other imposition or offense to which the provisions of Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23001), Part 12 (commencing with Section 27001), or this part apply.

SEC. 124. Section 19591 of the Revenue and Taxation Code is amended to read:

19591. (a) Specialized tax services fees shall be imposed upon the following services provided by the board:

- (1) Installment payment programs.
- (2) Expedited services for:
 - (A) Corporation and business entity revivor requests.
 - (B) Tax clearance certificate requests.
 - (C) Tax-exempt status requests.

(b) (1) For periods on or after the effective date of this section and prior to January 1, 2006, the Franchise Tax Board shall publish by notice a schedule of specialized tax services fees to be imposed, which notice shall be exempt from the requirements of Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code. The amounts of these fees under this paragraph shall be calculated in the same general manner as required under paragraph (2).

(2) Commencing on January 1, 2006, the amount of the specialized tax services fees shall be established by the board through regulations adopted pursuant to Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code, and shall be established in the manner and in the amounts necessary to reimburse the board for the costs of administering the specialized services, including the board's direct and indirect costs for providing specialized tax services.

SEC. 125. Section 19604 of the Revenue and Taxation Code is amended to read:

19604. (a) (1) Except for fees received for services under Section 23305e, all moneys and remittances received by the Franchise Tax Board as amounts imposed under Part 11 (commencing with Section 23001), and related penalties, additions to tax, fees, and interest imposed under this part, shall be deposited in a special fund in the State Treasury, to be designated the Corporation Tax Fund. The moneys in the fund shall, upon the order of the Controller, be drawn therefrom for the purpose of making refunds under this part or be transferred into the General Fund. All undelivered refund warrants shall be redeposited into the Corporation Tax Fund upon receipt by the Controller. Fees received for services under Section 23305e shall be treated as

reimbursement of the Franchise Tax Board's costs and shall be deposited into the General Fund.

(2) All moneys and remittances received by the Franchise Tax Board as amounts imposed under Part 12 (commencing with Section 27001), and related penalties, additions to tax, fees, and interest imposed under this part, shall be deposited in a special fund in the State Treasury, to be designated the Business Net Receipts Tax Fund. The moneys in the fund shall, upon the order of the Controller, be drawn therefrom for the purpose of making refunds under this part or be transferred into the General Fund. All undelivered refund warrants shall be redeposited into the Business Net Receipts Tax Fund upon receipt by the Controller.

(b) Notwithstanding Section 13340 of the Government Code, all moneys in the Corporation Tax Fund are hereby continuously appropriated, without regard to fiscal year, to the Franchise Tax Board for purposes of making all payments as provided in this section.

SEC. 126. Section 19701 of the Revenue and Taxation Code is amended to read:

19701. Any person who does any of the following is liable for a penalty of not more than five thousand dollars (\$5,000):

(a) With or without intent to evade any requirement of Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23001), Part 12 (commencing with Section 27001), or this part or any lawful requirement of the Franchise Tax Board, repeatedly over a period of two years or more, fails to file any return or to supply any information required, or who, with or without that intent, makes, renders, signs, or

verifies any false or fraudulent return or statement, or supplies any false or fraudulent information, resulting in an estimated delinquent tax liability of at least fifteen thousand dollars (\$15,000).

(b) Aids, abets, advises, encourages, or counsels any person to evade the tax imposed by Part 10 (commencing with Section 17001) ~~or~~, Part 11 (commencing with Section 23001), or Part 12 (commencing with Section 27001) by not filing any return or supplying any information required under Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23001), Part 12 (commencing with Section 27001), or this part, or, by making, rendering, signing, or verifying any false or fraudulent return or statement, or by supplying false or fraudulent information.

(c) Under this part, is required to pay any estimated tax or tax, who willfully fails to pay that estimated tax or tax, at the time or times required by law or regulations.

The penalty shall be recovered in the name of the people in any court of competent jurisdiction. Counsel for the Franchise Tax Board may, upon request of the district attorney or other prosecuting attorney, assist the prosecuting attorney in presenting the law or facts to recover the penalty at the trial of a criminal proceeding for violation of this section.

That person is also guilty of a misdemeanor and shall upon conviction be fined not to exceed five thousand dollars (\$5,000) or be imprisoned not to exceed one year, or both, at the discretion of the court, together with costs of investigation and prosecution. The preceding sentence shall not apply to any person who is mentally incompetent, or suffers from dementia, Alzheimer's disease, or similar condition.

(d) For purposes of subdivision (a), the president of a corporation, or the chief operating officer, is the person presumed to be responsible for filing any return or supplying information required from that corporation.

SEC. 127. Section 19702 of the Revenue and Taxation Code is amended to read:

19702. The prosecutor may, with the consent of the Franchise Tax Board, compromise any penalty for which he or she may bring action under this chapter. The penalties provided by this chapter are additional to all other penalties provided in Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23001), Part 12 (commencing with Section 27001), or this part.

SEC. 128. Section 19705 of the Revenue and Taxation Code is amended to read:

19705. (a) Any person who does any of the following shall be guilty of a felony and, upon conviction, shall be fined not more than fifty thousand dollars (\$50,000) or imprisoned in the state prison, or both, together with the costs of investigation and prosecution:

(1) Willfully makes and subscribes any return, statement, or other document, that contains or is verified by a written declaration that it is made under penalty of perjury, and he or she does not believe to be true and correct as to every material matter.

(2) Willfully aids or assists in, or procures, counsels, or advises the preparation or presentation under, or in connection with any matter arising under, the Personal Income Tax Law or the Corporation Tax Law, of a return, affidavit, claim, or other document, that is fraudulent or is false as to any material matter, whether or not that

falsity or fraud is with the knowledge or consent of the person authorized or required to present that return, affidavit, claim, or document.

(3) Simulates or falsely or fraudulently executes or signs any bond, permit, entry, or other document required by the provisions of the Personal Income Tax Law ~~or~~, the Corporation Tax Law, or the Business Net Receipts Tax Law, or by any regulation pursuant to that law, or procures the same to be falsely or fraudulently executed or advises, aids in, or connives at that execution.

(4) Removes, deposits, or conceals, or is concerned in removing, depositing, or concealing, any goods or commodities for or in respect whereof any tax is or shall be imposed, or any property upon which levy is authorized by Chapter 5 (commencing with Section 19201); or Chapter 8 (commencing with Section 688.010) of Division 1 of, and Chapter 5 (commencing with Section 706.010) of Division 2 of, Title 9 of the Code of Civil Procedure, with intent to evade or defeat the assessment or collection of any tax, additions to tax, penalty, or interest imposed by Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23001), Part 12 (commencing with Section 27001), or this part.

(5) In connection with any settlement under Section 19442, or offer of that settlement, or in connection with any closing agreement under Section 19441 or offer to enter into that agreement, or compromise under Section 19443, or offer of that compromise, willfully does any of the following:

(A) Conceals from any officer or employee of this state any property belonging to the estate of a taxpayer or other person liable in respect of the tax.

(B) Receives, withholds, destroys, mutilates, or falsifies any book, document, or record, or makes any false statement, relating to the estate or financial condition of the taxpayer or other person liable in respect of the tax.

(b) In the case of a corporation, the fifty thousand dollars (\$50,000) limitation specified in subdivision (a) shall be increased to two hundred thousand dollars (\$200,000).

(c) The fact that an individual's name is signed to a return, statement, or other document filed, including a return, statement, or other document filed using electronic technology pursuant to Section 18621.5, shall be prima facie evidence for all purposes that the return, statement, or other document was actually signed by him or her.

(d) For purposes of this section, "person" means the taxpayer, any member of the taxpayer's family, any corporation, agent, fiduciary, or representative of, or any other individual or entity acting on behalf of, the taxpayer, or any other corporation or entity owned or controlled by the taxpayer, directly or indirectly, or which owns or controls the taxpayer, directly or indirectly.

(e) The changes made to this section by the act adding this subdivision apply to offers made on or after January 1, 1999.

SEC. 129. Section 19706 of the Revenue and Taxation Code is amended to read:

19706. Any person or any officer or employee of any corporation who, within the time required by or under the provisions of this part, willfully fails to file any return or to supply any information with intent to evade any tax imposed by Part 10 (commencing with Section 17001) ~~or~~, Part 11 (commencing with Section 23001), or

Part 12 (commencing with Section 27001), or who, willfully and with like intent, makes, renders, signs, or verifies any false or fraudulent return or statement or supplies any false or fraudulent information, is punishable by imprisonment in the county jail not to exceed one year, or in the state prison, or by fine of not more than twenty thousand dollars (\$20,000), or by both the fine and imprisonment, at the discretion of the court, together with the costs of investigation and prosecution.

SEC. 130. Section 19712 of the Revenue and Taxation Code is amended to read:

19712. Any tax preparer, as defined in subdivision (b) of Section 19169, who endorses or otherwise negotiates (directly or through an agent) any warrant made in respect of the taxes imposed by Part 10 (commencing with Section 17001) ~~or~~, Part 11 (commencing with Section 23001), or Part 12 (commencing with Section 27001) which is issued to a taxpayer (other than the tax preparer) shall, in addition to other penalties provided by law, be guilty of a misdemeanor, and upon conviction thereof, shall be fined not more than one thousand dollars (\$1,000) or imprisoned not more than one year, or both, together with the costs of prosecution.

This section shall not apply where the tax preparer has advanced the taxpayer an amount of money equal to or greater than the amount of the taxpayer's tax refund.

SEC. 131. Section 19772 of the Revenue and Taxation Code is amended to read:

19772. (a) Section 6707A of the Internal Revenue Code, relating to penalty for failure to include reportable transactions information with a return, shall apply, except as otherwise provided.

(b) The penalty amounts in Section 6707A(b) of the Internal Revenue Code shall not apply, and in lieu thereof, the following shall apply:

(1) Except as provided in paragraph (2), the amount of the penalty shall be fifteen thousand dollars (\$15,000).

(2) The amount of the penalty with respect to a listed transaction shall be thirty thousand dollars (\$30,000).

(c) (1) Section 6707A(c)(1) of the Internal Revenue Code is modified to include reportable transactions within the meaning of paragraph (3) of subdivision (a) of Section 18407.

(2) Section 6707A(c)(2) of the Internal Revenue Code is modified to include listed transactions within the meaning of paragraph (4) of subdivision (a) of Section 18407.

(d) The penalty under this section only applies to taxpayers with taxable income greater than two hundred thousand dollars (\$200,000).

(e) Section 6707A(e) of the Internal Revenue Code, relating to a penalty reported to the Securities and Exchange Commission, shall not apply.

(f) Section 6707A(d) of the Internal Revenue Code, relating to the authority to rescind a penalty, shall not apply, and in lieu thereof, the following shall apply:

(1) The Chief Counsel of the Franchise Tax Board may rescind all or any portion of any penalty imposed by this section with respect to any violation if all of the following apply:

(A) The violation is with respect to a reportable transaction other than a listed transaction.

(B) The person on whom the penalty is imposed has a history of complying with the requirements of this part and Part 10 (commencing with Section 17001) ~~or~~, Part 11 (commencing with Section 23001), or Part 12 (commencing with Section 27001).

(C) It is shown that the violation is due to an unintentional mistake of fact.

(D) Imposing the penalty would be against equity and good conscience.

(E) Rescinding the penalty would promote compliance with the requirements of this part and Part 10 (commencing with Section 17001) ~~or~~, Part 11 (commencing with Section 23001), or Part 12 (commencing with Section 27001) and effective tax administration.

(2) The exercise of authority under paragraph (1) shall be at the sole discretion of the Chief Counsel of the Franchise Tax Board and may not be delegated.

(3) Notwithstanding any other law or rule of law, any determination under this subdivision may not be reviewed in any administrative or judicial proceeding.

(g) Article 3 (commencing with Section 19031) of Chapter 4 (relating to deficiency assessments) shall not apply with respect to the assessment or collection of any penalty imposed under this section.

(h) The penalty imposed by this section is in addition to any penalty imposed under Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23001), Part 12 (commencing with Section 27001), or this part.

SEC. 132. Section 19777 of the Revenue and Taxation Code is amended to read:

19777. (a) If a taxpayer has been contacted by the Franchise Tax Board regarding a reportable transaction, as defined in Section 6707A(c)(1) of the Internal

Revenue Code with respect to which the requirements of Section 6664(d)(2)(A) of the Internal Revenue Code are not met, any listed transaction, as defined in Section 6707A(c)(2) of the Internal Revenue Code, or a gross misstatement within the meaning of Section 6404(g)(2)(D) of the Internal Revenue Code, and has a deficiency, there shall be added to the tax an amount equal to 100 percent of the interest payable under Section 19101 for the period beginning on the last date prescribed by law for the payment of that tax (determined without regard to extensions) and ending on the date the notice of proposed assessment is mailed.

(b) The penalty imposed by this section is in addition to any other penalty imposed under Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23001), Part 12 (commencing with Section 27001), or this part.

SEC. 133. Section 19801 of the Revenue and Taxation Code is amended to read:

19801. In the determination of any issue of law or fact under Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23001), Part 12 (commencing with Section 27001), or this part, neither the Franchise Tax Board nor any officer or agency having any administrative duties under this part nor any court is bound by the determination of any other officer or administrative agency of the state.

SEC. 134. Section 23005 is added to the Revenue and Taxation Code, to read:

23005. (a) Except as otherwise provided in Part 12 (commencing with Section 27001), this part shall cease to be operative for taxable years beginning on or after January 1, 2012.

SEC. 135. Part 12 (commencing with Section 27001) is added to Division 2 of the Revenue and Taxation Code, to read:

PART 12. BUSINESS NET RECEIPTS TAX LAW

CHAPTER 1. GENERAL PROVISIONS AND DEFINITIONS

Article 1. General Provisions

27001. This part shall be known and may be cited as the Business Net Receipts Tax Law.

27003. Whenever this part refers to “regulations of the Franchise Tax Board,” or makes similar reference, the reference authorizes the Franchise Tax Board to make rules and regulations as to the subject matter concerning that reference.

Article 2. Definitions

27011. Except where the context otherwise requires, the definitions given in this chapter govern the construction of this part.

27013. “Fiscal year” means an accounting period of 12 months or less ending on the last day of any month other than December.

27014. “Paid or incurred” and “paid or accrued” shall be construed according to the method of accounting upon the basis of which net receipts is computed.

27015. “State” means any state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States, and any foreign country or political subdivision thereof.

27016. “Counsel for the Franchise Tax Board” means attorney or attorneys appointed or employed by the Franchise Tax Board and acting subject to the approval and under the supervision of the Attorney General.

27017. The term “tax” means the tax imposed under Chapter 2 (commencing with Section 27101).

27018. “Taxpayer” means any person subject to the tax imposed under Chapter 2 (commencing with Section 27101).

27019. (a) For purposes of the tax imposed under Chapter 2 (commencing with Section 27101), “business entity” means any entity engaged in a trade or business, including an incorporated entity, an association, a partnership, including an eligible business entity classified as a partnership for federal income tax purposes, a business trust, and a business owned by an individual and operated as a sole proprietorship.

(b) For purposes of this part, the classification of a business entity as a partnership or an association taxable as a corporation shall be the same as the classification of that entity for federal income tax purposes. If the separate existence of an eligible business entity is disregarded for federal income tax purposes, the separate existence of that business entity shall not be disregarded for purposes of this part.

(c) The following entities shall not be subject to the tax imposed under Chapter 2 (commencing with Section 27101):

(1) An estate, except to the extent the estate relates to a business owned by an individual and operated as a sole proprietorship.

(2) A trust, other than a business trust.

27020. "Bank" includes national banking associations, and also includes any "bank" operated by any receiver, liquidator, referee, trustee, or other officers or agents appointed by any court, or an assignee for the benefit of creditors.

27021. Receipts derived from or attributable to sources within this state includes receipts from tangible or intangible property located or having a situs in this state and receipts from any activity carried on in this state, regardless of whether carried on in intrastate, interstate, or foreign commerce.

27022. For purposes of the tax imposed under this part, "taxable year" means all of the following:

(a) The calendar year or the fiscal year for which the tax is payable.

(b) The calendar year or fiscal year upon the basis of which the net receipts are computed.

(c) A period of 12 months or less.

27023. (a) Unless otherwise specifically provided, the terms "Internal Revenue Code," "Internal Revenue Code of 1954," or "Internal Revenue Code of 1986," for purposes of this part, mean Title 26 of the United States Code, including all amendments thereto, as applicable for federal purposes for the applicable taxable year.

27024. If any chapter, article, section, subdivision, paragraph, subparagraph, clause, subclause, sentence, or phrase of this part that is reasonably separable from the remaining provisions of this part, or the application thereof to any person, taxpayer,

or circumstance, is for any reason determined unconstitutional, that determination shall not affect the remainder of this part, nor shall the application of the provision to any other person, taxpayer, or circumstance be affected thereby.

27025. Unless otherwise specifically provided therein, the provisions of any act:

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

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

27026. Provisions in other codes or statutes that are related to this part include all of the following:

(a) Sections 15700 to 15702.1, inclusive, of the Government Code, relating to the Franchise Tax Board.

(b) Part 10 (commencing with Section 17001), relating to the Personal Income Tax Law.

(c) Part 10.2 (commencing with Section 18401), relating to the administration of franchise and income taxes.

(d) Part 10.7 (commencing with Section 21001), relating to the Taxpayers' Bill of Rights.

(e) Part 11 (commencing with Section 23001), relating to the Corporation Tax Law.

CHAPTER 2. THE BUSINESS NET RECEIPTS TAX

Article 1. Definitions and General Provisions

27101. (a) A taxpayer is doing business in this state for a taxable year if any of the following applies:

- (1) The taxpayer is organized or commercially domiciled in this state.
- (2) Sales, as defined in subdivision (e) of Section 28120, of the taxpayer in this state exceed the lesser of five hundred thousand dollars (\$500,000) or 25 percent of the taxpayer's total sales. For purposes of this paragraph:

(A) Sales of the taxpayer include sales by an agent or independent contractor of the taxpayer.

(B) Sales in this state shall be determined using the rules for assigning sales under Sections 28135 and 28136 and the regulations thereunder, as modified by regulations under Section 28137.

(3) The real property and tangible personal property of the taxpayer in this state exceed the lesser of fifty thousand dollars (\$50,000) or 25 percent of the taxpayer's total real property and tangible personal property. The value of real and tangible personal property and the determination of whether property is in this state shall be determined using the rules contained in Sections 28129 to 28131, inclusive, and the regulations thereunder, as modified by regulations under Section 28137.

(4) The amount paid in this state by the taxpayer for compensation, as defined in subdivision (c) of Section 29120, exceeds the lesser of fifty thousand dollars

(\$50,000) or 25 percent of the total compensation paid by the taxpayer. Compensation in this state shall be determined using the rules for assigning payroll contained in Section 28133 and the regulations thereunder, as modified by regulations under Section 28137.

(b) (1) The Franchise Tax Board shall annually revise the amounts in paragraphs (2), (3), and (4) of subdivision (b) in accordance with subdivision (h) of Section 17041.

(2) For purposes of the adjustment required by paragraph (1), subdivision (h) of Section 17041 shall be applied by substituting "2012" in lieu of "1988."

(c) The sales, property, and payroll of the taxpayer include the taxpayer's pro rata or distributive share from pass-through entities. For purposes of this subdivision, "pass-through entities" means a partnership or an "S" corporation.

27102. The tax imposed under this chapter shall attach whether a taxpayer has a taxable year of 12 months or less.

27103. A business entity shall not be subject to the taxes imposed by this chapter if the business entity did no business in this state during the taxable year and the taxable year was 15 days or less.

Article 2. Tax on Business Entities Other than Banks and Financial Business Entities

27151. (a) With the exception of banks and financial business entities, each business entity doing business within the limits of this state and not expressly exempted from taxation by the California Constitution or by this part, shall annually pay to the

state, for the privilege of exercising its franchise within this state, a tax computed at the rate of ____ percent of its net receipts for the taxable year.

Article 3. Tax on Financial Institutions

27161. (a) Except as otherwise provided herein, each financial institution doing business within this state and not expressly exempted from taxation by the California Constitution or this part, shall annually pay to the state, for the privilege of exercising its franchise within this state, a tax computed at the rate of ____ percent of its net business receipts for the taxable year.

27162. The tax imposed under this part upon financial institutions is in lieu of all other taxes and licenses, state, county, and municipal, upon those financial institutions except taxes upon their real property, local utility user taxes, sales and use taxes, state energy resources surcharge, state emergency telephone users surcharge, and motor vehicle and other vehicle registration license fees, and any other tax or license fee imposed by the state upon vehicles, motor vehicles, or the operation thereof.

27163. (a) For purposes of this part, “financial institution” means:

(1) Any corporation or other business entity registered under state law as a bank holding company or registered under the Federal Bank Holding Company Act of 1956, as amended, or registered as a savings and loan holding company under the Federal National Housing Act, as amended.

(2) A national bank organized and existing as a national bank association pursuant to the National Bank Act (12 U.S.C. Sec. 21 et seq.).

(3) A savings association or federal savings bank as defined in the Federal Deposit Insurance Act (12 U.S.C. Sec. 1813(b)(1)).

(4) Any bank or thrift institution incorporated or organized under the laws of any state.

(5) Any corporation organized under Sections 611 to 631, inclusive, of the United States Code.

(6) Any agency or branch of a foreign depository as defined in Section 3101 of the United States Code.

(7) A state credit union the loan assets of which exceed fifty million dollars (\$50,000,000) as of the first day of its taxable year.

(8) A production credit association organized under the Federal Farm Credit Act of 1933, all of whose stock held by the Federal Production Credit Corporation has been retired.

(9) Any corporation whose voting stock is more than 50 percent owned, directly or indirectly, by any person or business entity described in paragraphs (1) to (8), inclusive, other than an insurance company.

(10) A corporation or other business entity that derives more than 50 percent of its total gross income for financial accounting purposes from finance leases. For purposes of this paragraph, a "finance lease" means any lease transaction that is the functional equivalent of an extension of credit and that transfers substantially all of the benefits and risks incident to the ownership of property. "Finance lease" includes any "direct financing lease" or "leverage lease" that meets the criteria of Financial Accounting Standards Board Statement No. 13, "Accounting for Leases" or any other

lease that is accounted for as a financing by a lessor under generally accepted accounting principles. For this classification to apply, the average of the gross income in the current taxable year and immediately preceding two taxable years shall satisfy the more than 50 percent requirement and gross income from incidental or occasional transactions shall be disregarded.

(11) Any other person or business entity, other than an insurance company, that derives more than 50 percent of its gross income from activities that a person described in paragraphs (2) to (8), inclusive, and paragraph (10) is authorized to transact. For purposes of this paragraph, the computation of gross income shall not include income from nonrecurring, extraordinary items.

(12) The Franchise Tax Board is authorized to exclude any person from the application of paragraph (11) upon the person proving, by clear and convincing evidence, that the income-producing activity of the person is not in substantial competition with those persons described in paragraphs (2) to (8), inclusive, and paragraph (10).

Article 3.5. Suspension and Revivor

27191. Except for purposes of filing an application for exempt status or amending the articles of incorporation or organization as necessary either to perfect that application or to set forth a new name, the powers, rights, and privileges of a domestic limited liability taxpayer may be suspended, and the exercise of the powers,

rights, and privileges of a foreign limited liability taxpayer in this state may be forfeited, if any of the following conditions occur:

(a) If any tax, penalty, or interest, or any portion thereof, that is due and payable under Chapter 4 (commencing with Section 19001) of Part 10.2 (commencing with Section 18401), or under this part, either at the time the return is required to be filed or on or before the 15th day of the ninth month following the close of the taxable year, is not paid on or before 6 p.m. on the last day of the 12th month after the close of the taxable year.

(b) If any tax, penalty, or interest, or any portion thereof, due and payable under Chapter 4 (commencing with Section 19001) of Part 10.2 (commencing with Section 18401), or under this part, upon notice and demand from the Franchise Tax Board, is not paid on or before 6 p.m. on the last day of the 11th month following the due date of the tax.

(c) If any liability, or any portion thereof, that is due and payable under Article 7 (commencing with Section 19131) of Chapter 4 of Part 10.2 (commencing with Section 18401), is not paid on or before 6 p.m. on the last day of the 11th month following the date that the tax liability is due and payable.

27192. Except for the purposes of filing an application for exempt status or amending the articles of incorporation or organization as necessary either to perfect that application or to set forth a new name, the powers, rights, and privileges of a domestic limited liability taxpayer may be suspended, and the exercise of the powers, rights, and privileges of a foreign limited liability taxpayer in this state may be forfeited,

if a taxpayer fails to file a tax return required by this part or Part 10.2 (commencing with Section 18401).

27193. Sections 27191, 27192, and 27775 shall apply to a foreign limited liability taxpayer only if the taxpayer is qualified to do business in this state. A taxpayer that is required under Section 2105 of the Corporations Code to qualify to do business shall not be deemed to have qualified to do business for purposes of this article unless the taxpayer has qualified with the Secretary of State.

27194. (a) Forfeiture or suspension of a limited liability taxpayer's powers, rights, and privileges pursuant to Section 27191, 27192, or 27775 shall occur and become effective only as expressly provided in this section in conjunction with Section 21020, which requires notice prior to the suspension of a taxpayer's corporate powers, rights, and privileges.

(b) The notice requirements of Section 21020 shall also apply to any forfeiture of a taxpayer's corporate powers, rights, and privileges pursuant to Section 27191, 27192, or 27775 and to any voidability pursuant to subdivision (d) of Section 27196.

(c) The Franchise Tax Board shall transmit the names of taxpayers to the Secretary of State as to which the suspension or forfeiture provisions of Section 27191, 27192, or 27775 are or become applicable, and the suspension or forfeiture therein provided for shall thereupon become effective. The certificate of the Secretary of State shall be prima facie evidence of the suspension or forfeiture.

(d) If a taxpayer's powers, rights, and privileges are forfeited or suspended pursuant to Section 27191, 27192, or 27775, without limiting any other consequences

of the forfeiture or suspension, the taxpayer shall not be entitled to sell, transfer, or exchange real property in this state during the period of forfeiture or suspension.

27195. Notwithstanding Section 27191 or 27192, any limited liability entity that transacts business or receives business net receipts within the period of its suspension or forfeiture shall be subject to tax under this chapter.

27196. (a) Every contract made in this state by a limited liability taxpayer during the time that the taxpayer's powers, rights, and privileges are suspended or forfeited pursuant to Section 27191, 27192, or 27775 shall, subject to Section 27197, be voidable at the instance of any party to the contract other than the limited liability taxpayer.

(b) If a foreign limited liability taxpayer that neither is qualified to do business nor has a business entity account number from the Franchise Tax Board, fails to file a tax return required under this part, any contract made in this state by that taxpayer during the applicable period specified in subdivision (c) shall, subject to Section 27197, be voidable at the instance of any party to the contract other than the taxpayer.

(c) For purposes of subdivision (b), the applicable period shall be the period beginning on January 1, 2012, or the first day of the taxable year for which the taxpayer has failed to file a return, whichever is later, and ending on the earlier of the date the taxpayer qualified to do business in this state or the date the taxpayer obtained a business entity account number from the Franchise Tax Board.

(d) If a taxpayer fails to file a tax return required under this part, to pay any tax or other amount owing to the Franchise Tax Board under this part or to file any statement or return required under Section 27772 or 27774, within 60 days after the

Franchise Tax Board mails a written demand, any contract made in this state by the taxpayer during the period beginning at the end of the 60-day demand period and ending on the date relief is granted under Section 27198.1, or the date the taxpayer qualifies to do business in this state, whichever is earlier, shall be voidable at the instance of any party to the contract other than the taxpayer. This subdivision shall apply only to a taxpayer if the taxpayer has a corporate account number from the Franchise Tax Board, but has not qualified to do business under Section 2105 of the Corporations Code. In the case of a taxpayer that has not complied with the 60-day demand, the taxpayer's name, Franchise Tax Board corporate account number, date of the demand, date of the first day after the end of the 60-day demand period, and the fact that the taxpayer did not within that period pay the tax or other amount or file the statement or return, as the case may be, shall be a matter of public record.

27197. A party that has the right to declare a contract to be voidable pursuant to Section 27196 may exercise that right only in a lawsuit brought by either party with respect to the contract in a court of competent jurisdiction and the rights of the parties to the contract shall not be affected by Section 27196 except to the extent expressly provided by a final judgment of the court, which judgment shall not be issued unless the taxpayer is allowed a reasonable opportunity to cure the voidability under Section 27198.1. If the court finds that the contract is voidable under Section 27196, the court shall order the contract to be rescinded. However, in no event shall the court order rescission of a taxpayer's contract unless the taxpayer receives full restitution of the benefits provided by the taxpayer under the contract.

27198. Any taxpayer that has suffered the suspension or forfeiture provided for in Section 27191 or 27192 may be relieved upon making application in writing to the Franchise Tax Board and upon the filing of all tax returns required under this part, and the payment of the tax, additions to tax, penalties, interest, and any other amounts for nonpayment of which the suspension or forfeiture occurred, together with all other taxes, additions to tax, penalties, interest, and any other amounts due under this part, and upon the issuance by the Franchise Tax Board of a certificate of revivor. Application for the certificate on behalf of any taxpayer that has suffered suspension or forfeiture may be made by any stockholder or creditor, by a majority of the surviving trustees or directors, by an officer, or by any other person who has interest in the relief from suspension or forfeiture.

27198.1. (a) A taxpayer may make an application to the Franchise Tax Board for relief from the voidability provisions of Section 27196. To be relieved from voidability, the taxpayer shall do all of the following:

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

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

(3) File any tax returns required to be filed under this part and Part 10.2 (commencing with Section 18401) with the Franchise Tax Board, including returns for the period for which relief is requested.

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

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

(6) In the case of a taxpayer that applies for and enters into an approved voluntary disclosure agreement in accordance with Article 8 (commencing with Section 19191) of Chapter 4 of Part 10.2, for purposes of this section, the taxpayer shall be considered to have met the requirements of paragraphs (3), (4), and (5) if the taxpayer fulfills to the satisfaction of the Franchise Tax Board all the specifications of the voluntary disclosure agreement within the meaning of paragraph (2) of subdivision (d) of Section 19191 and if the Franchise Tax Board has not found that any of the circumstances described in Section 19194 has rendered the voluntary disclosure agreement null and void.

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

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

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

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

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

(B) The Franchise Tax Board shall assess a daily penalty equal to one hundred dollars (\$100) for each day of the period for which relief from voidability is granted, but not to exceed a total penalty equal to that amount of the tax that would be imposed under Section 27151 for the period for which relief is requested.

(C) In the case of an exempt organization or trust subject to the tax on unrelated business net receipts under Article 2 (commencing with Section 27731) of Chapter 4 (the tax on unrelated business net receipts), the daily penalty provided in subparagraph (B) shall not exceed a total penalty equal to the amount of tax imposed upon its unrelated business taxable income for the period for which relief is requested.

(3) Any penalty imposed under this subdivision shall, subject to Section 27198.2, be due and payable on demand by the Franchise Tax Board.

(c) (1) Upon satisfaction of the conditions specified in subdivision (a), including through the application of Section 27198.2, the following shall apply:

(A) All contracts entered into during the period for which relief is granted that have not been rescinded by a final court order pursuant to Section 27196 may be enforced in the same manner and to the same extent, with regard to both the parties to the contract and any third parties, as if the contract had never been voidable.

(B) Any sale, transfer, or exchange of real property in this state during the period for which relief is granted and which the taxpayer at that time was not entitled to sell, transfer, or exchange by reason of subdivision (d) of Section 27194 and which has not been rescinded by a final court order pursuant to Section 27197, shall be as valid as if the taxpayer had not been subject to subdivision (d) of Section 27194 at the time of the sale, transfer, or exchange.

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

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

27198.2. Notwithstanding Sections 27198 and 27198.5 that require a taxpayer to pay any liability to the Franchise Tax Board as a condition to revivor or relief from voidability, the Franchise Tax Board shall issue a certificate of revivor under Section 27198, or of relief from voidability under Section 27198.5, if the taxpayer provides the Franchise Tax Board with an assumption of liability, or a bond, deposit, or other security for taxpayer's liability, that is acceptable to the Franchise Tax Board. The Franchise Tax Board shall notify the person filing the application for revivor or relief

from voidability of the amount of the bond, deposit, or other security, or of the terms of an assumption of liability, that must be furnished as a condition of the revivor or the relief from voidability. Obtaining revivor or voidability relief by securing the debt pursuant to this section shall not constitute an admission of liability by the taxpayer, nor relieve the taxpayer or any individual or corporation from liability for any taxes, additions to tax, penalties, or interest imposed by this part. A taxpayer that provides an assumption of liability or a bond, deposit, or other security to obtain revivor or relief from voidability may, notwithstanding Section 27198 or 27198.5, file any returns required under those sections within a reasonable time after relief is granted by the Franchise Tax Board.

27198.5. For the purposes of this article, “limited liability taxpayer” means any business entity that is organized under the laws of a state, the United States, or a foreign country where, pursuant to those laws, one or more owners of the business entity are not liable for the obligations of the business entity.

27198a. Before the certificate of revivor is issued by the Franchise Tax Board, it shall obtain from the Secretary of State an endorsement upon the application of the fact that the name of the taxpayer that is an incorporated entity then meets the requirements of subdivision (b) of Section 201 of the Corporations Code in the case of a domestic incorporated taxpayer or of subdivision (b) of Section 2106 of the Corporations Code in the case of a foreign incorporated taxpayer that has qualified to do business. The reference to amendment of the articles of incorporation to set forth a new name contained in Sections 27191, 27192, and 27775 includes in the case of a foreign taxpayer the filing of an amended statement and designation to set forth its

new name or to set forth an assumed name under subdivision (b) of Section 2106 of the Corporations Code. Upon the issuance of the certificate by the Franchise Tax Board the incorporated taxpayer therein named shall become reinstated but the reinstatement shall be without prejudice to any action, defense, or right that has accrued by reason of the original suspension or forfeiture, except that contracts that were voidable pursuant to Section 27196, but that have not been rescinded pursuant to Section 27197, may have that voidability cured in accordance with Section 27198.1. The certificate of revivor shall be prima facie evidence of the reinstatement and the certificate may be recorded in the office of the county recorder of any county in this state.

27198b. Notwithstanding Section 27198, the Franchise Tax Board may revive a limited liability taxpayer to good standing without full payment of the taxes, penalties, and interest due if it determines that the revivor will improve the prospects for collection of the full amount due. This revivor may be limited as to time or may limit the functions the revived limited liability taxpayer can perform, or both. The powers, rights, and privileges may again be suspended or forfeited if the Franchise Tax Board determines that the prospects for collection of the full amount due have not been improved by the revivor of the limited liability taxpayer.

27198c. (a) Upon issuance of the certificate of revivor, the Franchise Tax Board shall transmit to the Secretary of State the revived taxpayer's name and registration number.

(b) The taxpayer's name and registration number, the fact that the taxpayer's powers, rights, and privileges have been revived and the effective date of the revivor shall be a matter of public record.

(c) If the Franchise Tax Board determines that a suspension or forfeiture was in error by the Franchise Tax Board, the Franchise Tax Board shall, in connection with the revivor, indicate that the taxpayer is “restored.” The status of the restored taxpayer shall be retroactive to the date of suspension or forfeiture as if there had been no suspension or forfeiture.

(d) If the Franchise Tax Board determines that the mailing of the 60-day demand notice referred to in subdivision (d) of Section 27196 was in error or that the Franchise Tax Board’s original determination as to compliance with the 60-day demand notice was in error, the Franchise Tax Board’s revised conclusions shall also be part of the public record referred to in that subdivision.

27198d. A certificate of suspension or forfeiture from the Franchise Tax Board setting forth that the suspended or forfeited taxpayer has been notified of its liability for tax or requirement to file a return under this part and that the tax has not been paid or the return has not been filed, shall constitute prima facie evidence of the facts.

27198e. (a) The Franchise Tax Board may provide letters of good standing, verifying a corporation’s status for doing business in California, at a charge reflecting the reasonable costs to the department of responding to these requests.

(b) Fees received under this section shall be handled pursuant to Section 19604.

CHAPTER 3. COMPUTATION OF NET RECEIPTS

Article 1. General

27501. For purposes of the tax imposed under Section 27151, “net receipts” means business net receipts apportioned to this state and nonbusiness net receipts allocated to this state.

Article 2. Net Receipts

27511. “Business net receipts” means business gross receipts less business purchases from other businesses.

27512. “Nonbusiness net receipts” means nonbusiness gross receipts less nonbusiness purchases from other businesses, and includes all net receipts other than business net receipts.

Article 3. Receipts

27521. “Business gross receipts” means gross receipts that satisfy either of the following:

(a) Gross receipts arising from transactions and activity in the regular course of the taxpayer’s trade or business.

(b) Gross receipts from the sale or exchange of tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer’s regular trade or business operations.

27522. “Nonbusiness gross receipts” means gross receipts other than business gross receipts.

27523. (a) (1) “Gross receipts” means gross amounts realized (the sum of money and the fair market value of other property or services received) on the sale, rental, licensing, or exchange of property, or from the performance of services.

(2) For financial institutions subject to tax under Article 3 (commencing with Section 27161) of Chapter 2, gross receipts includes interest received.

(b) Notwithstanding paragraph (1) of subdivision (a), “gross receipts” shall not include, among other items, any of the following:

(1) Interest, dividends, principal, and any amount realized from loans, bonds, mutual funds, certificates of deposit, repurchase agreements, derivative financial instruments (including but not limited to futures contracts, forward contracts, and options), or any other financial instruments, whether the financial instruments are traded in connection with a treasury function, a hedging function, or any other purpose.

(2) Proceeds from the issuance of the taxpayer’s own stock or from the sale of treasury stock.

(3) Proceeds that constitute contributions to capital to the business entity.

(4) Proceeds from selling a division, subsidiary, or interest in another business, except to the extent of the gain realized on the sale of that interest.

(5) Damages and other amounts received as the result of litigation, unless the recipient is a law firm.

(6) Property acquired by an agent on behalf of another.

(7) Tax refunds.

(8) Pension reversions.

(9) Income from discharge of indebtedness, except as otherwise provided.

(10) Price of commodities or other goods that are traded for similar commodities or other goods, whether the trading is done for hedging or other purposes.

(11) Proceeds from selling accounts receivables.

(12) Proceeds from selling land, except to the extent of the gain realized on the sale of that land.

(13) Proceeds from intercompany transactions that are eliminated under regulations issued by the Franchise Tax Board.

(14) Receipts allocated or apportioned to a business entity in its capacity as a member of, or holder of, an economic interest in a pass-through entity if those receipts are directly or indirectly attributable to receipts that are subject to the tax imposed under this part. For purposes of this paragraph, pass-through entity means a partnership or an "S" corporation.

27524. The following amounts, as calculated under the rules set forth below, are specifically included as items of gross receipts within the meaning of subdivision (a) of Section 27523:

(a) The provisions of Section 72(u) of the Internal Revenue Code, relating to the treatment of annuity contracts not held by natural persons, shall be applicable.

(b) Amounts received other than amounts paid by reason of the death of the insured under life insurance, endowment or annuity contracts, either during the term or at maturity or upon surrender of the contract, equal to the total amount of premiums paid. In the case of a transfer for a valuable consideration by assignment or otherwise, of a life insurance, endowment, or annuity contract or any interest therein, only the actual value of the consideration and the amount of the premiums and other sums

subsequently paid by the transferee shall be excluded from gross income under Section 24305 or this section. The preceding sentence shall not apply in the case of that transfer if the contract or interest has a basis for determining gain or loss in the hands of a transferee determined in whole or in part by reference to that basis of that contract or interest in the hands of the transferor or to a corporation in which the insured is a shareholder or officer.

(c) (1) Except as provided in paragraph (2), amounts received under life insurance policies and contracts paid by reason of the death of the insured but if the amounts are held by the insurer under an agreement to pay interest, the interest payments shall be included in gross income.

(2) Proceeds of flexible premium contracts payable by reason of death shall be excluded from gross income only in accordance with Section 101(f) of the Internal Revenue Code.

(d) (1) Section 108 of the Internal Revenue Code, relating to income from discharge of indebtedness, shall apply, except as otherwise provided.

(2) Section 108(b)(2)(B) of the Internal Revenue Code, relating to general business credit, is modified by substituting “this part” in lieu of “Section 38 (relating to general business credit).”

(3) Section 108(b)(2)(G) of the Internal Revenue Code, relating to foreign tax credit carryovers, shall not apply.

(4) Section 108(b)(3)(B) of the Internal Revenue Code, relating to credit carryover reduction, is modified by substituting “11.1 cents” in lieu of “33 1/3 cents” in each

place in which it appears. In the case where more than one credit is allowable under this part, the credits shall be reduced on a pro rata basis.

(5) Section 108(g)(3)(B) of the Internal Revenue Code, relating to adjusted tax attributes, is modified by substituting “\$9” in lieu of “\$3.”

(e) (1) Section 110 of the Internal Revenue Code, relating to qualified lessee construction allowances for short-term leases, shall apply, except as otherwise provided.

(2) Section 110(b) of the Internal Revenue Code is modified by substituting the phrase “(including for purposes of paragraph (2) of subdivision (e) of former Section 24349)” for the phrase “(including for purposes of Section 168(i)(8)(B)).”

(3) Section 110(c)(2) of the Internal Revenue Code is modified by substituting the phrase “(as determined under the rules of paragraph (3) of subdivision (e) of former Section 24349)” for the phrase “(as determined under the rules of Section 168(i)(3)).”

(f) (1) Section 111 of the Internal Revenue Code, relating to recovery of tax benefit items, shall apply, except as otherwise provided.

(2) Sections 111(b) and 111(c) of the Internal Revenue Code, relating to credits and treatment of credit carryovers, shall be applicable with respect to credits allowable under this part.

Article 4. Purchases

27531. (a) “Business purchases from other businesses” means purchases from other businesses that satisfy either of the following:

(1) Arising from transactions and activity in the regular course of the taxpayer's trade or business.

(2) Purchases or acquisitions of tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.

(b) (1) "Purchases from other businesses" means purchases from other entities that are utilized in the production of the gross receipts subject to the tax imposed by this part, and includes purchases from entities not subject to the tax imposed by this part, including nonprofit entities, insurance companies and governmental entities, and specifically means all of the following:

(A) Inventory acquired during the taxable year, including freight, shipping, delivery, or engineering charges included in the original contract price for that inventory.

(B) Assets, including the costs of fabrication and installation, acquired during the taxable year of a type that are, or under the Internal Revenue Code will become, eligible for depreciation, amortization, or accelerated capital cost recovery for federal income tax purposes.

(C) To the extent not included in inventory or depreciable property, materials, and supplies, including repair parts and fuel.

(D) Payments for the rental or leasing of property.

(E) For a staffing company, compensation of personnel supplied to customers of staffing companies.

(F) As used in this paragraph:

(i) “Compensation” means that term as defined under Section 28120, plus all payroll tax and worker’s compensation costs directly related thereto.

(ii) “Staffing company” means a taxpayer whose business activities are included in industry group 736 under the Standard Industrial Classification Code, as compiled by the United States Department of Labor.

(2) For purposes of this subdivision, “inventory” means all of the following:

(A) The stock of goods held for resale in the regular course of trade of a retail or wholesale business, including electricity or natural gas purchased for resale.

(B) Finished goods, goods in process, and raw materials of a manufacturing business purchased from another person.

(C) For a person that is a securities trader, broker, or dealer or a person included in the unitary business group of that securities trader, broker, or dealer that buys and sells for its own account, contracts that are subject to the Commodity Exchange Act, (7 U.S.C. Secs. 1-27f, incl.), the cost of securities as defined under Section 475(c)(2) of the Internal Revenue Code, and for a securities trader the cost of commodities as defined under Section 475(e)(2) of the Internal Revenue Code, and for a broker or dealer the cost of commodities as defined under Section 475(e)(2)(b), (c), and (d) of the Internal Revenue Code, excluding interest expense other than interest expense related to repurchase agreements. As used in this subparagraph:

(i) “Broker” means that term as defined under Section 78c(a)(4) of the Securities Exchange Act of 1934 (15 U.S.C. Sec. 78c).

(ii) “Dealer” means that term as defined under Section 78c(a)(5) of the Securities Exchange Act of 1934 (15 U.S.C. Sec. 78c).

(iii) "Securities trader" means a person that engages in the trade or business of purchasing and selling investments and trading assets.

(3) For financial institutions subject to tax under Article 3 (commencing with Section 27161) of Chapter 2, purchases includes interest paid.

27532. There shall be allowed as a deduction for a taxable year an amount equal to the net excess purchase carryover to that taxable year. For purposes of this section, the term "net excess purchase" means the excess of the purchases allowed to reduce gross receipts under this chapter over the gross receipts for a taxable year. A net excess purchase for any taxable year shall be a net excess purchase carryover to each of the five taxable years following the taxable year of excess purchases. The Franchise Tax Board shall issue regulations to implement this section, which shall be comparable to the provisions of Section 172 of the Internal Revenue Code and the applicable regulations.

27533. The following amounts, as calculated under the rules set forth below, are specifically excluded as business purchases from other businesses within the meaning of subdivision (a) of Section 27531:

(a) (1) Amounts paid by a taxpayer with respect to acquisition from a club which restricts membership or the use of its services or facilities on the basis of ancestry or any characteristic listed or defined in Section 11135 of the Government Code.

(2) A club described in paragraph (1) of subdivision (a) holding an alcoholic beverage license pursuant to Division 9 (commencing with Section 23000) of the Business and Professions Code, except a club holding an alcoholic beverage license pursuant to Section 23425 thereof, shall provide on each receipt furnished to a taxpayer

a printed statement as follows: “The expenditures covered by this receipt are nondeductible for state income tax purposes or net receipts tax purposes.”

(3) For purposes of this subdivision:

(A) “Amounts paid” means those amounts otherwise treated as purchases under this article, and includes, but is not limited to, club membership dues and assessments, food and beverage expenses, expenses for services furnished by the club, and reimbursements or salary adjustments to officers or employees for any of the preceding expenses.

(B) “Club” means a club as defined in Division 9 (commencing with Section 23000) of the Business and Professions Code, except a club as defined in Section 23425.

(b) The amount of any bad debt deduction under the Internal Revenue Code for the taxable year that is in excess of the amount of any debts that become worthless within the taxable year.

(c) (1) Any amounts directly attributable to illegal activities, as defined in Chapters 9 (commencing with Section 319), 10 (commencing with Section 330), or 10.5 (commencing with Section 337.1) of Title 9 of Part 1 of the Penal Code.

(2) For purposes of this subdivision, a prior, final determination by a court of competent jurisdiction of this state in any criminal proceedings or any proceeding in which the state, county, city and county, city or other political subdivision was a party on the merits of the legality of the activities of a taxpayer or predecessor in interest of a taxpayer shall be binding in determining whether this subdivision applies.

(d) (1) Any amounts, including deductions for cost of goods sold, directly attributable to illegal activities as defined in Sections 266h or 266i of, or in Chapter 4 (commencing with Section 211) of Title 8 of, Chapter 7.5 (commencing with Section 311) of Title 9 of, Chapter 8 (commencing with Section 314) of Title 9 of, or Chapter 2 (commencing with Section 459), Chapter 5 (commencing with Section 484), or Chapter 6 (commencing with Section 503) of Title 13 of, Part 1 of the Penal Code, or as defined in Chapter 6 (commencing with Section 11350) of Division 10 of the Health and Safety Code.

(2) For purposes of this subdivision, a prior, final determination by a court of competent jurisdiction of this state in any criminal proceedings or any proceeding in which the state, county, city and county, city, or other political subdivision was a party on the merits of the legality of the activities of a taxpayer or predecessor in interest of a taxpayer shall be binding in determining whether this subdivision applies.

(e) (1) Any amounts paid or incurred in the taxable year with respect to substandard housing located in this state, except as provided in paragraph (5).

(2) "Substandard housing" means occupied dwellings from which the taxpayer derives rental income or unoccupied or abandoned dwellings for which both of the following apply:

(A) Either of the following occurs:

(i) For occupied dwellings from which the taxpayer derives rental income, a state or local government regulatory agency has determined that the housing violates state law or local codes dealing with health, safety, or building.

(ii) For dwellings that are unoccupied or abandoned for at least 90 days, a state or local government regulatory agency has cited the housing for conditions that constitute a serious violation of state law or local codes dealing with health, safety, or building, and that constitute a threat to public health and safety.

(B) Either of the following occurs:

(i) After written notice of violation by the regulatory agency, specifying the applicability of this section, the housing has not been repaired or brought to a condition of compliance within six months after the date of the notice or the time prescribed in the notice, whichever period is later.

(ii) Good faith efforts for compliance have not been commenced, as determined by the regulatory agency. "Substandard housing" also means employee housing that has not, within 30 days of the date of the written notice of violation or the date for compliance prescribed in the written notice of violation, been brought into compliance with the conditions stated in the written notice of violation of the Employee Housing Act (Part 1 (commencing with Section 17000) of Division 13 of the Health and Safety Code) issued by the enforcement agency that specifies the application of this section. The regulatory agency may, for good cause shown, extend the compliance date prescribed in a violation notice.

(3) (A) When the period specified in subparagraph (B) of paragraph (2) of this subdivision has expired without compliance, the government regulatory agency shall mail to the taxpayer a notice of noncompliance. The notice of noncompliance shall be in a form and shall include information prescribed by the Franchise Tax Board, shall be mailed by certified mail to the taxpayer at his or her last known address, and shall

advise the taxpayer of (i) an intent to notify the Franchise Tax Board of the noncompliance within 10 days unless an appeal is filed, (ii) where an appeal may be filed, and (iii) a general description of the tax consequences of that filing with the Franchise Tax Board. Appeals shall be made to the same body and in the same manner as appeals from other actions of the regulatory agency. If no appeal is made within 10 days or if after disposition of the appeal the regulatory agency is sustained, the regulatory agency shall notify, in writing, the Franchise Tax Board of the noncompliance.

(B) The notice of noncompliance shall contain the legal description or the lot and block numbers of the real property, the assessor's parcel number, and the name of the owner of record as shown on the latest equalized assessment roll. In addition, the regulatory agency shall, at the same time as notification of the notice of noncompliance is sent to the Franchise Tax Board, record a copy of the notice of noncompliance in the office of the recorder for the county in which the substandard housing is located that includes a statement of tax consequences that may be determined by the Franchise Tax Board. However, the failure to record a notice with the county recorder does not relieve the liability of any taxpayer nor does it create any liability on the part of the regulatory agency.

(C) The regulatory agency may charge the taxpayer a fee in an amount not to exceed the regulatory agency's costs incurred in recording any notice of noncompliance or issuing any release of that notice. The notice of compliance shall be recorded and shall serve to expunge the notice of noncompliance. The notice of compliance shall contain the same recording information required for the notice of noncompliance. No

deduction by the taxpayer, or any other taxpayer who obtains title to the property subsequent to the recordation of the notice of noncompliance, shall be allowed for the items provided in paragraph (1) of this subdivision from the date of the notice of noncompliance until the date the regulatory agency determines that the substandard housing has been brought to a condition of compliance. The regulatory agency shall mail to the Franchise Tax Board and the taxpayer a notice of compliance, which notice shall be in the form and include the information prescribed by the Franchise Tax Board. In the event the period of noncompliance does not cover an entire taxable year, the deductions shall be denied at the rate of one-twelfth for each full month during the period of noncompliance.

(D) If the property is owned by more than one owner or the recorded title is in the name of a fictitious owner, the notice requirements provided in subdivision (b) and this subdivision shall be satisfied for each owner if the notices are mailed to one owner or to the fictitious name owner at the address appearing on the latest available property tax bill. However, notices made pursuant to this subdivision shall not relieve the regulatory agency from furnishing taxpayer identification information required to implement this section to the Franchise Tax Board.

(4) For purposes of this section, a notice of noncompliance shall not be mailed by the regulatory agency to the Franchise Tax Board if any of the following occurs:

(A) The housing was rendered substandard solely by reason of earthquake, flood, or other natural disaster unless the condition remains for more than three years after the disaster.

(B) The owner of the substandard housing has secured financing to bring the housing into compliance with those laws or codes that have been violated, causing the housing to be classified as substandard, and has commenced repairs or other work necessary to bring the housing into compliance.

(C) The owner of substandard housing that is not within the meaning of housing accommodation, as defined in subdivision (d) of Section 35805 of the Health and Safety Code, has done both of the following:

(i) Attempted to secure financing to bring the housing into compliance with those laws or codes that have been violated, causing the housing to be classified as substandard.

(ii) Been denied that financing solely because the housing is located in a neighborhood or geographical area in which financial institutions do not provide financing for rehabilitation of any of that type of housing.

(5) This section shall not apply to deductions from gross receipts derived from property rendered substandard solely by reason of a change in applicable state or local housing standards unless those violations cause substantial danger to the occupants of the property, as determined by the regulatory agency that has served notice of violation pursuant to paragraph (2).

(6) The owner of substandard housing found to be in noncompliance shall, upon total or partial divestiture of interest in the property, immediately notify the regulatory agency of the name and address of the person or persons to whom the property has been sold or otherwise transferred and the date of the sale or transference.

(7) By July 1 of each year, the regulatory agency shall report, to the appropriate legislative body of its jurisdiction, all of the following information, for the preceding calendar year, regarding its activities to secure code enforcement, which shall be public information:

(A) The number of written notices of violation issued for substandard housing under paragraph (2).

(B) The number of violations complied with within the period prescribed in paragraph (2).

(C) The number of notices of noncompliance issued pursuant to paragraph (3).

(D) The number of appeals from those notices pursuant to paragraph (3).

(E) The number of successful appeals by owners.

(F) The number of notices of noncompliance mailed to the Franchise Tax Board pursuant to paragraph (3).

(G) The number of cases in which a notice of noncompliance was not sent pursuant to the provisions of paragraph (4).

(H) The number of extensions for compliance granted pursuant to paragraph (2) and the mean average length of the extensions.

(I) The mean average length of time from the issuance of a notice of violation to the mailing of a notice of noncompliance to the Franchise Tax Board where the notice is actually sent to the Franchise Tax Board.

(J) The number of cases where compliance is achieved after a notice of noncompliance has been mailed to the Franchise Tax Board.

(K) The number of instances of disallowance of tax deductions by the Franchise Tax Board resulting from referrals made by the regulatory agency. This information may be filed in a supplemental report in succeeding years as it becomes available.

(8) The provisions of this section relating to substandard housing consisting of abandoned or unoccupied dwellings do not apply to any lender engaging in a “federally related transaction,” as defined in Section 11302 of the Business and Professions Code, who acquires title through judicial or nonjudicial foreclosure, or accepts a deed in lieu of foreclosure. The exception provided in this subdivision covers only substandard housing consisting of abandoned or unoccupied dwellings involved in the federally related transaction.

Article 5. Treatment of Preenactment Credits, Excess Capital Losses, and Net Operating Losses

27541. (a) Notwithstanding any provision to the contrary in Part 11 (commencing with Section 23001), for taxable years beginning on or after January 1, 2012, the amount of any remaining net operating loss, excess capital loss, or credit carryforward calculated under Part 11 (commencing with Section 23001) shall be allowed to be taken against net receipts in the case of net operating loss and excess capital loss carryovers or against the tax liability in the case of credit carryovers under the net business receipts tax under Part 12 (commencing with Section 27001), subject to the annual limitation specified in paragraph (3) of subdivision (b).

(b) For purposes of this section, the following rules shall apply:

(1) The amount of any net operating loss, excess capital loss, or credit carryover remaining on the first day of the first taxable year beginning on or after January 1, 2012, shall, regardless of the number of years remaining in the carryover period under Part 11 (commencing with Section 23001), be allowed to be carried forward under this part for a period of up to 20 years, until exhausted.

(2) The limitation in paragraph (3) upon the amount of any net operating loss, excess capital loss, or credit carryover that may be used in any taxable year under this part shall be computed after first applying against the net business receipts tax liability any credits allowed under Sections 17039.3 and 27811, including any carryovers of those credits allowed under this part.

(3) The annual limitation under this section shall be computed as follows:

(A) For net operating loss carryovers, no more than 5 percent of the net business receipts under Part 12 (commencing with Section 27001) before the application of any net operating loss carryovers.

(B) For excess capital losses, no more than 5 percent of the net business receipts under Part 12 (commencing with Section 27001) before the application of any excess capital losses.

(C) For credit carryovers, no more than 5 percent of the net business receipts tax liability under Part 12 (commencing with Section 27001) after the application of any credits under this part and before the application of any credit carryovers.

(D) The annual limitation under this paragraph shall not exceed 5 percent of the aggregate of the amounts specified in subparagraphs (A), (B), and (C).

(c) The Franchise Tax Board may prescribe by forms and instructions any rules necessary to implement this section.

Article 6. Assignment of Credits

27542. (a) (1) Notwithstanding any other law, for each taxable year beginning on or after January 1, 2012, any credit allowed to a taxpayer under Chapter 3.5 of Part 11 (commencing with Section 23604) that is an “eligible credit,” within the meaning of paragraph (2) of subdivision (b), may be assigned by that taxpayer to any “eligible assignee” within the meaning of paragraph (3) of subdivision (b).

(2) Except as specifically provided in this section, following an assignment of any eligible credit under this section, the eligible assignee shall be treated as if it originally earned the assigned credit.

(b) For purposes of this section, the following definitions shall apply:

(1) “Affiliated corporation” means a corporation that is a member of a commonly controlled group as defined in Section 25105.

(2) “Eligible credit” means either of the following:

(A) Any credit earned by the taxpayer in a taxable year beginning before January 1, 2012, that is eligible to be carried forward to the taxpayer’s first taxable year beginning on or after January 1, 2012, under Part 11 (commencing with Section 23001).

(B) Any credit earned under Section 27811 in any taxable year beginning on or after January 1, 2012.

(3) “Eligible assignee” means any affiliated corporation that is properly treated as a member of the same combined reporting group pursuant to Section 28101 or 28110 as the taxpayer assigning the eligible credit as of:

(A) In the case of credits earned in taxable years beginning before January 1, 2012:

(i) December 31, 2011.

(ii) The last day of the taxable year of the assigning taxpayer in which the eligible credit is assigned.

(B) In the case of credits earned in taxable years beginning on or after January 1, 2012:

(i) The last day of the first taxable year in which the credit was allowed to the taxpayer.

(ii) The last day of the taxable year of the assigning taxpayer in which the eligible credit is assigned.

(c) (1) The election to assign any credit under subdivision (a) shall be irrevocable once made, and shall be made by the taxpayer allowed that credit on its original return for the taxable year in which the assignment is made.

(2) The taxpayer assigning any credit under this section shall reduce the amount of its unused credit by the face amount of any credit assigned under this section, and the amount of the assigned credit shall not be available for application against the assigning taxpayer’s “business net receipts tax” in any taxable year, nor shall it thereafter be included in the amount of any credit carryover of the assigning taxpayer.

(3) The eligible assignee of any credit under this section may apply all or any portion of the assigned credits against the “business net receipts tax,” as defined in Section 27036, of the eligible assignee for the taxable year in which the assignment occurs, or any subsequent taxable year, subject to any carryover period limitations that apply to the assigned credit and the rules of Section 27541 limiting the amount of carryover credits which may be applied in any taxable year.

(4) The eligible assignee shall not sell, otherwise transfer, or thereafter assign the assigned credit to any other taxpayer.

(d) (1) Consideration shall not be required to be paid by the eligible assignee to the assigning taxpayer for assignment of any credit under this section.

(2) If any consideration is paid by the eligible assignee to the assigning taxpayer for the transfer of an eligible credit under this section, then:

(A) Any amounts paid to the eligible assignee under this part with respect to the assignment shall not be treated as a purchase.

(B) Any amounts received by the assigning taxpayer shall not be treated as a gross receipt under this part.

(e) (1) The Franchise Tax Board shall specify the form and manner in which the election required under this section shall be made, as well as any necessary information that shall be required to be provided by the taxpayer assigning the credit to the eligible assignee.

(2) Any taxpayer who assigns any credit under this section shall report any information, in the form and manner specified by the Franchise Tax Board, necessary

to substantiate any credit assigned under this section and verify the assignment and subsequent application of any assigned credit.

(3) Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code shall not apply to any standard, criterion, procedure, determination, rule, notice, or guideline established or issued by the Franchise Tax Board pursuant to paragraphs (1) and (2).

(4) The Franchise Tax Board may issue any regulations necessary to implement this section, including any regulations necessary to specify the treatment of any assignment that does not comply with the requirements of this section (including, for example, where the taxpayer and eligible assignee are not properly treated as members of the same combined reporting group on any of the dates specified in paragraph (3) of subdivision (b).

(f) (1) The taxpayer and the eligible assignee shall be jointly and severally liable for any tax, addition to tax, or penalty that results from the disallowance, in whole or in part, of any eligible credit assigned under this section.

(2) This section shall not limit the authority of the Franchise Tax Board to audit either the assigning taxpayer or the eligible assignee with respect to any eligible credit assigned under this section.

CHAPTER 4. EXEMPT BUSINESS ENTITIES

Article 1. Exemptions from this Part

27701. Organizations that are organized and operated for nonprofit purposes within the provisions of a specific section of this article are exempt from taxes imposed under this part, except as provided in this article or in Article 2 (commencing with Section 27731) of this chapter, if all of the following apply:

(a) An application for exemption is submitted in the form prescribed by the Franchise Tax Board.

(b) A filing fee of twenty-five dollars (\$25) is paid with each application for exemption filed with the Franchise Tax Board.

(c) The Franchise Tax Board issues a determination exempting the organization from tax.

This section shall not prevent a determination from having retroactive effect and shall not prevent the issuance of a determination with respect to a domestic organization that was in existence prior to January 1, 1970, and exempt under prior law without the submission of a formal application or payment of a filing fee. For purposes of this section, the term “domestic” means created or organized under the laws of this state. The Franchise Tax Board may issue rulings and regulations as are necessary and reasonable to carry out this article.

27701a. Labor, agricultural, or horticultural organizations other than cooperative organizations described in Section 27904 or 27905 (unless the cooperative organization is determined by the Internal Revenue Service to be an organization described in Section 501(c)(5) of the Internal Revenue Code, as amended). For purposes of this section, the term “agricultural” includes the art or science of cultivating land, harvesting crops or aquatic resources, or raising livestock.

27701b. A fraternal order described in Section 501(c)(8) of the Internal Revenue Code.

27701c. A cemetery company described in Section 501(c)(13) of the Internal Revenue Code.

27701d. (a) A corporation, community chest or trust, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involved the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda or otherwise attempting to influence legislation (except as otherwise provided in Section 27704.5), and which does not participate in, or intervene in (including the publishing or distribution of statements), any political campaign on behalf of (or in opposition to) any candidate for public office. An organization is not organized exclusively for exempt purposes listed above unless its assets are irrevocably dedicated to one or more purposes listed in this section. Dedication of assets requires that in the event of dissolution of an organization or the impossibility of performing the specific organizational purposes, the assets would continue to be devoted to exempt purposes. Assets shall be deemed irrevocably dedicated to exempt purposes if the articles of organization provide that upon dissolution the assets will be distributed to an organization which is exempt under this section or Section 501(c)(3) of the Internal Revenue Code or to the federal government, or to a state or local government for public purposes; or by a provision

in the articles of organization, satisfactory to the Franchise Tax Board, that the property will be distributed in trust for exempt purposes; or by establishing that the assets are irrevocably dedicated to exempt purposes by operation of law. The irrevocable dedication requirement shall not be a sole basis for revocation of an exempt determination made by the Franchise Tax Board prior to the effective date of this amendment.

(b) (1) In the case of a qualified amateur sports organization.

(A) The requirement of subdivision (a) that no part of its activities involves the provision of athletic facilities or equipment shall not apply.

(B) That organization shall not fail to meet the requirements of subdivision (a) merely because its membership is local or regional in nature.

(2) For purposes of this subdivision, “qualified amateur sports organization” means any organization organized and operated exclusively to foster national or international amateur sports competition if that organization is also organized and operated primarily to conduct national or international competition in sports or to support and develop amateur athletes for national or international competition in sports.

(c) (1) Notwithstanding subdivisions (a), (b), and (c) of Section 27701, an organization organized and operated for nonprofit purposes in accordance with this section shall be exempt from taxes imposed by this part, except as provided in this article or in Article 2 (commencing with Section 27731), upon its submission to the Franchise Tax Board of a copy of the notification issued by the Internal Revenue Service approving the organization’s tax-exempt status pursuant to Section 501(c)(3) of the Internal Revenue Code. The effective date of an organization’s tax-exempt status

for state income tax purposes pursuant to this subdivision shall be no later than the effective date of the organization's tax-exempt status, under Section 501(c)(3) of the Internal Revenue Code, for federal income tax purposes.

(2) If, for federal income tax purposes, an organization's tax-exempt status under Section 501(c)(3) of the Internal Revenue Code is suspended or revoked, the organization shall notify the Franchise Tax Board of the suspension or revocation, in the form and manner prescribed by the Franchise Tax Board. Upon notification, the board shall suspend or revoke, whichever is applicable, for state income tax purposes, an organization's tax-exempt status granted pursuant to paragraph (1) of this subdivision.

(3) This subdivision shall not be construed to prevent the Franchise Tax Board from revoking the exemption of an organization that is not organized or operated in accordance with this chapter or Section 501(c)(3) of the Internal Revenue Code.

(d) The Franchise Tax Board may prescribe rules and regulations to implement this section.

27701e. A business league, chamber of commerce, real estate board, or a board of trade described in Section 501(c)(6) of the Internal Revenue Code, except that the phrase "or professional football leagues (whether or not administering a pension fund for football players)" shall not apply.

27701f. (a) A civic league, social welfare organization, or local organization of employees described in Section 501(c)(4) of the Internal Revenue Code, except as otherwise provided.

(b) An organization is not organized exclusively for exempt purposes under Section 501(c)(4) of the Internal Revenue Code unless its assets are irrevocably

dedicated to one or more purposes listed in Section 501(c)(4) of the Internal Revenue Code.

27701g. A social organization described in Section 501(c)(7) of the Internal Revenue Code.

27701h. (a) A corporation described in Section 501(c)(2) of the Internal Revenue Code, relating to certain title-holding companies.

(b) For purposes of applying Section 501(c)(2) of the Internal Revenue Code under this section, the term “corporation” includes a limited liability company that is classified as a partnership.

27701i. A voluntary employees’ beneficiary association described in Section 501(c)(9) of the Internal Revenue Code.

27701j. A teachers’ retirement fund association described in Section 501(c)(11) of the Internal Revenue Code.

27701k. Religious or apostolic corporations, if those corporations have a common treasury or community treasury even if those corporations engaged in business for the common benefit of the members, but only if the members thereof include (at the time of filing their returns) in their gross income their entire pro rata shares, whether distributed or not, of the net income of the corporation for the year. Any amount so included in the gross income of a member shall be treated as a dividend received.

27701l. (a) A domestic fraternal society described in Section 501(c)(10) of the Internal Revenue Code, except as otherwise provided.

(b) For purposes of this section, the term “domestic” means created or organized in the United States or under the law of the United States or of any state or territory therein.

27701n. (a) A supplemental unemployment compensation trust described in Section 501(c)(17) of the Internal Revenue Code, except as otherwise provided.

(b) The following references in Section 501(c)(17)(E) of the Internal Revenue Code shall be modified as follows:

(1) The phrase “under Section 27701” shall be substituted for the phrase “under subsection (a).”

(2) The phrase “Section 27701i” shall be substituted for the phrase “paragraph (9) of this subsection.”

27701p. A trust or plan which meets the requirements of Public Law 87-792, 76 U.S. Stats. 809, approved October 10, 1962 (the Self-Employed Individuals Tax Retirement Bill of 1962), but only if such trust or plan is not exempt from taxation under Section 17631.

27701r. (a) A political organization. However, a political organization shall be subject to tax under this part with respect to its “political organization net receipts” and such net receipts shall be subject to tax as provided by Chapter 2 (commencing with Section 27101).

(b) For purposes of this section, the political organization net receipts of any organization for any taxable year is an amount equal to the excess over one hundred dollars (\$100), if any, of the gross receipts for the taxable year (excluding any exempt

function receipts), divided by the deductions allowed by this part which are directly connected with the production of the gross receipts (excluding exempt function receipts).

(c) For purposes of this section, the term “exempt function net receipts” means any amount received as the following:

- (1) A contribution of money or other property.
- (2) Membership dues, a membership fee or assessment from a member of the political organization.
- (3) Proceeds from a political fundraising or entertainment event, or proceeds from the sale of political campaign materials, that are not received in the ordinary course of any trade or business, to the extent the amount is segregated for use only for the exempt function of the political organization.

(d) For purposes of this part, if any political organization:

(1) Contributes any amount to or for the use of any political organization that is treated as exempt from tax under subdivision (a) of this section.

(2) Contributes any amount to or for the use of any organization described in paragraph (1) or (2) of Section 509(a) of the Internal Revenue Code, that is exempt from tax under Section 27701.

(3) Deposits any amount in the General Fund or the Treasury of the United States or in the General Fund of any state or local government, such amount shall be treated as an amount not diverted for the personal use of the candidate or any other person. No deduction shall be allowed under this part for the contribution or deposit of any amount described in the preceding sentence.

(e) For purposes of this section:

(1) The term “political organization” means a party, committee, association, fund (including the trust of an individual candidate), or other organization (whether or not incorporated) organized and operated primarily for the purpose of directly or indirectly accepting contributions or making expenditures, or both, for an exempt function.

(2) The term “exempt function” means the function of influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any federal, state, or local public office or office in a political organization, or the election of Presidential or Vice Presidential electors, whether or not such individual or electors are selected, nominated, elected, or appointed. The term includes the making of expenditures relating to an office described in the preceding sentence which, if incurred by the individual, would be allowable as a deduction under Section 162(a) of the Internal Revenue Code.

(3) The term “contributions” has the meaning given to that term by Section 271(b)(2) of the Internal Revenue Code.

(4) The term “expenditures” has the meaning given to that term by Section 271(b)(3) of the Internal Revenue Code.

(f) For purposes of paragraph (1) of subdivision (e), a separate segregated fund (within the meaning of Section 610 of Title 18 of the United States Code or of any similar state statute, or within the meaning of any state statute that permits the segregation of dues money for exempt functions, within the meaning of paragraph (2) of subdivision (e)) that is maintained by an organization described in Sections 27701a

to 27701p, inclusive, or Section 27701s that is exempt from tax under Section 27701 shall be treated as a separate organization.

(g) (1) For purposes of this section, a fund established and maintained by an individual who holds, has been elected to, or is a candidate (within the meaning of paragraph (3)) for nomination or election to, any federal, state, or local elective public office for use by that individual exclusively for the preparation and circulation of that individual's newsletter shall, except as provided in paragraph (2), be treated as if that fund constituted a political organization.

(2) In the case of any fund described in paragraph (1), the exempt function shall be only the preparation and circulation of the newsletter.

(3) For purposes of paragraph (1), "candidate" means with respect to any federal, state, or local elective public office, an individual who does both of the following:

(A) Publicly announces that he or she is a candidate for nomination or election to that office.

(B) Meets the qualifications prescribed by law to hold that office.

(h) The requirements set forth in subdivisions (a), (b), and (c) of Section 27701 shall not apply to a political organization or newsletter fund described in this section.

(i) The requirements set forth in Section 27772 or Section 27774 shall not apply to a political organization or newsletter fund. Further, the requirements set forth in Sections 18505, 18506, and 18601 shall not apply to a political organization or newsletter fund described in this section, except that if it has political organization net receipts for any taxable year, the political organization shall be required to file income

tax returns or statements as determined by the Franchise Tax Board under Chapter 2 (commencing with Section 27101).

27701s. (a) An employee-funded pension trust described in Section 501(c)(18) of the Internal Revenue Code, except as otherwise provided.

(b) The last sentence in Section 501(c)(18) of the Internal Revenue Code, relating to excess contributions under Section 4979 of the Internal Revenue Code, shall not apply.

27701t. (a) A homeowners' association organized and operated to provide for the acquisition, construction, management, maintenance, and care of residential association property if all of the following apply:

(1) Sixty percent or more of the gross income of the organization for the taxable year consists solely of amounts received as membership dues, fees, and assessments from either of the following:

(A) Tenant-stockholders or owners of residential units, residences, or lots.

(B) Owners of time-share rights to use, or time-share ownership interests in, association property in the case of a time-share association.

(2) Ninety percent or more of the expenditures of the organization for the taxable year are expenditures for the acquisition, construction, management, maintenance, and care of association property and, in the case of a time-share association, for activities provided to or on behalf of members of the association.

(3) No part of the net earnings inures (other than by providing management, maintenance, and care of association property or by a rebate of excess membership dues, fees, or assessments) to the benefit of any private shareholder or individual.

(4) Amounts received as membership dues, fees, and assessments not expended for association purposes during the taxable year are transferred to and held in trust to provide for the management, maintenance, and care of association property and common areas.

(b) The term “association property” means:

- (1) Property held by the organization.
- (2) Property held in common by the members of the organization.
- (3) Property within the organization privately held by the members of the organization. In the case of a time-share association, “association property” includes property in which the time-share association, or members of the association, have rights arising out of recorded easements, covenants, or other recorded instruments to use property related to the time-share project.

(c) A homeowners’ association shall be subject to tax under this part with respect to its “homeowners’ association net receipts,” and those net receipts shall be subject to tax as provided by Chapter 2 (commencing with Section 27101).

(1) For purposes of this section, the term “homeowners’ association net receipts” of any organization for any taxable year means an amount equal to the excess over one hundred dollars (\$100), if any, of the gross receipts for the taxable year (excluding any exempt function receipts), divided by the deductions allowed by this part that are directly connected with the production of the gross receipts (excluding exempt function receipts).

(2) For purposes of this section, the term “exempt function gross receipts” means any amount received as membership fees, dues, and assessments from

tenant-shareholders or owners of residential units, residences, or lots, or owners of time-share rights to use, or time-share ownership interests in, association property in the case of a time-share association.

(d) The term “homeowners’ association” includes a condominium management association, a residential real estate management association, a time-share association, and a cooperative housing corporation.

(e) “Cooperative housing corporation” includes, but is not limited to, a limited-equity housing cooperative, as defined in Section 33007.5 of the Health and Safety Code, organized either as a nonprofit public benefit corporation pursuant to Part 2 (commencing with Section 5110) of Division 2 of Title 1 of the Corporations Code, or a nonprofit mutual benefit corporation pursuant to Part 3 (commencing with Section 7110) of Division 2 of Title 1 of the Corporations Code.

(f) The term “time-share association” means any organization (other than a condominium management association) organized and operated to provide for the acquisition, construction, management, maintenance, and care of association property if any member thereof holds a time-share right to use, or a time-share ownership interest in, real property constituting association property.

27701u. An organization is operated exclusively for exempt purposes listed in Section 27701f and its net earnings are devoted exclusively to charitable purposes if that organization is a nonprofit public benefit corporation organized under Part 2 (commencing with Section 5110) of Division 2 of Title 1 of the Corporations Code, and if the specific and primary purpose for which the corporation is formed is to render financial assistance to government by financing, refinancing, acquiring, constructing,

improving, leasing, selling, or otherwise conveying property of any kind to government. This financing ability shall be limited to the issuance of certificates of participation, or similar security arrangements. For purposes of this section, "government" means this state, a city, city and county, county, school district, board of education, public corporation, hospital district, and any other special district. An organization is not organized exclusively for the exempt purposes referred to in the first paragraph unless its assets are irrevocably dedicated to one or more purposes listed in Section 27701f. Dedication of assets requires that in the event of dissolution of an organization or the impossibility of performing the specific organizational purposes, including default of lease payments, the assets would continue to be devoted to exempt purposes. Assets shall be deemed irrevocably dedicated to exempt purposes if the articles of organization provide that upon dissolution the assets will be distributed to an organization that is exempt under this section, Section 27701d, or Section 27701f, or under Section 501(c)(3) or Section 501(c)(4) of the Internal Revenue Code or to the federal government, or to a state or local government for public purposes; or by a provision in the articles of organization, satisfactory to the Franchise Tax Board, that the property will be distributed in trust for exempt purposes; or by establishing that the assets are irrevocably dedicated to exempt purposes by operation of law. Any organization that has had its exemption revoked by the Franchise Tax Board for failure to comply with Section 27701f may request a further review of its status under this section.

27701v. (a) An organization of owners of manufactured homes or mobilehomes, who are tenants in a mobilehome park, formed for the purpose of purchasing the

mobilehome park to convert it to condominium, stock cooperative, or other resident ownership interests.

(b) An organization shall not fail to meet the requirements of subdivision (a) merely because it manages, maintains, or cares for the mobilehome park it has purchased.

27701w. A veterans' organization, as defined by Section 501(c)(19) of the Internal Revenue Code.

27701x. (a) A corporation or trust described in Section 501(c)(25) of the Internal Revenue Code, relating to certain title-holding companies.

(b) For purposes of applying Section 501(c)(25) of the Internal Revenue Code under this section, the term "corporation" includes a limited liability company that is classified as a partnership.

27701y. A credit union as defined in Section 14002 of the Financial Code. In addition, those credit unions are exempt from all other taxes and licenses, state, county, and municipal, imposed upon those credit unions, except taxes upon their real property, local utility user taxes, sales and use taxes, state energy resources surcharges, state emergency telephone users surcharges, unrelated business net receipts taxes pursuant to Section 27731, motor vehicle and other vehicle registration license fees, and any other tax or license fee imposed by the state upon vehicles, motor vehicles, or the operation thereof.

27701z. An organization established pursuant to Section 5005.1 of the Corporations Code by three or more corporations as an arrangement for the pooling of self-insured claims or losses of those corporations.

27702. Section 502 of the Internal Revenue Code, relating to feeder organizations, shall apply, except as otherwise provided.

(a) Exemption shall not be allowed to any organization on the basis that all of its profits are payable to another organization exempt from taxation under either Section 501 of the Internal Revenue Code or this article, if that business activity is being conducted by a separate organization.

(b) The reference to Section 501 of the Internal Revenue Code, relating to exemption, shall be modified to refer to Section 27701.

(c) The reference to Sections 512 and 512(b)(3) of the Internal Revenue Code, relating to the exclusion of the deriving of rents from the definition of “trade or business,” shall be modified to refer to Section 27732.

27703. (a) No exemption shall be allowed under this article to any charitable corporation as defined in Sections 12582.1 and 12583 of the Government Code for any year or years for which it fails to file with the Attorney General, on or before the due date, any registration or periodic report required by Article 7 (commencing with Section 12580) of Chapter 6 of Part 2 of Division 3 of Title 2 of the Government Code.

(b) The exemption shall be disallowed under this section only after the Attorney General has notified the Franchise Tax Board in writing that a charitable corporation subject to the provisions of subdivision (a) has failed to file any such registration or periodic report on or before the due date thereof.

(c) If an exemption is disallowed under this section, the exemption may be reinstated when the registration or periodic reports are filed.

(d) The Franchise Tax Board may make any regulations that it deems necessary to effectuate the purposes of this section.

27703.5. Section 501(p) of the Internal Revenue Code, relating to suspension of tax-exempt status of terrorist organizations, shall apply, except as otherwise provided:

(a) References to Section 501(a) of the Internal Revenue Code shall be modified to refer to Section 27701.

(b) Section 501(p)(4) of the Internal Revenue Code is modified by substituting the phrase “under Part 10 (commencing with Section 17001) and this part” for the phrase “under any provision of this title, including Sections 170, 545(b)(2), 556(b)(2), 642(c), 2055, 2106(a)(2), and 2522” contained therein.

(c) This section shall apply only during the period described in Section 501(p)(3) of the Internal Revenue Code that the federal tax exemption of the organization described in Section 501(p)(2) of the Internal Revenue Code is suspended for federal income tax purposes under Section 501(p)(1) of the Internal Revenue Code.

(d) Section 501(p)(5) of the Internal Revenue Code shall not apply and in lieu thereof, notwithstanding any other provision of law, no organization or other person may challenge a suspension under this section, a designation or identification described in Section 501(p)(2) of the Internal Revenue Code, the period of suspension described in Section 501(p)(3) of the Internal Revenue Code, or a denial of a deduction under Section 501(p)(4) of the Internal Revenue Code as modified in subdivision (b) in any administrative or judicial proceeding relating to the California tax liability of the organization or other person.

(e) (1) Credit or refund (with interest) with respect to an overpayment shall be made if all of the following apply with respect to that overpayment:

(A) The tax exemption of any organization described in Section 501(p)(2) of the Internal Revenue Code is suspended under this section.

(B) Each designation and identification described in Section 501(p)(2) of the Internal Revenue Code which has been made with respect to that organization is determined to be erroneous under Section 501(p)(6) of the Internal Revenue Code for federal income tax purposes.

(C) The erroneous designations and identifications result in an overpayment of income tax for any taxable year by that organization.

(2) If the credit or refund of any overpayment of tax described in subparagraph (C) of paragraph (1) is prevented at any time by the operation of any law or rule of law (including res judicata), the credit or refund may nevertheless be allowed or made if the claim therefor is filed before the close of the one-year period beginning on the date of the last determination described in subparagraph (B) of paragraph (1).

27704. Section 501(e) of the Internal Revenue Code, relating to cooperative hospital service organizations, shall apply, except as otherwise provided.

(a) References to Section 501(c)(3) of the Internal Revenue Code, relating to charitable organizations, shall be modified to refer to Section 27701d.

(b) References to Section 501(a) of the Internal Revenue Code, relating to exemptions, shall be modified to refer to Section 27701.

(c) The services which may be provided under Section 501(e)(1) of the Internal Revenue Code shall include laundry services.

(d) Section 501(e)(1)(B)(iii) of the Internal Revenue Code is modified by substituting the phrase “owned and operated by the United States, the State, or a county or political subdivision thereof, or an agency or instrumentality of any of the foregoing” for the phrase “owned and operated by the United States, a State, the District of Columbia, or a possession of the United States, or a political subdivision or an agency or instrumentality of any of the foregoing.”

(e) References to Section 170(b)(1)(A)(iii) of the Internal Revenue Code, relating to the deductibility of contributions to hospitals, shall be modified to refer to subdivision (e) of Section 27736.

27704.3. Section 501(o) of the Internal Revenue Code, relating to treatment of hospitals participating in provider-sponsored organizations, shall apply, except that the reference to Section 501(c)(3) of the Internal Revenue Code, relating to charitable organizations, shall be modified to refer to Section 27701d.

27704.4. Section 501(k) of the Internal Revenue Code, relating to the treatment of certain organizations providing care of children, shall apply, except as otherwise provided.

(a) The reference to Section 501(c)(3) of the Internal Revenue Code, relating to charitable organizations, shall be modified to refer to Section 27701d.

(b) The reference to Section 2522(a)(2) of the Internal Revenue Code, relating to the computation of taxable gifts, or Section 2055 of the Internal Revenue Code, relating to transfers for public, charitable, and religious uses, shall not apply.

27704.5. Section 501(h) of the Internal Revenue Code, relating to expenditures by public charities engaged in activities to influence legislation, shall apply, except as otherwise provided.

(a) The reference to Section 501(a) of the Internal Revenue Code, relating to exemption from taxation, shall be modified to refer to Section 27701.

(b) The reference to Section 501(c)(3) of the Internal Revenue Code, relating to charitable organizations, shall be modified to refer to Section 27701d.

27704.6. Section 504 of the Internal Revenue Code, relating to status after organization ceases to qualify for exemption under Section 501(c)(3) because of substantial lobbying or because of political activities, shall apply, except as otherwise provided.

(a) The reference to Section 501(a) of the Internal Revenue Code, relating to exemption from taxation, shall be modified to refer to Section 27701.

(b) The reference to Section 501a(c)(3) of the Internal Revenue Code, relating to charitable organizations, shall be modified to refer to Section 27701d.

(c) The reference to Section 501(c)(4) of the Internal Revenue Code, relating to civic leagues, social welfare organizations, and local associations of employees, shall be modified to refer to Section 27701f.

27705. (a) (1) An organization described in Section 27701i (voluntary employee's beneficiary associations) or 27701q (qualified group legal service plans) which is part of a plan of an employer shall not be exempt from tax under Section 27701, unless that plan meets the requirements of Section 505(b) of the Internal Revenue Code.

(2) Paragraph (1) shall not apply to any organization described in Section 505(a)(2) of the Internal Revenue Code.

(b) A copy of any notice filed with the Secretary of the Treasury, pursuant to Section 505(c) of the Internal Revenue Code, relating to application for tax-exempt status, shall be filed at the same time and in the same manner with the Franchise Tax Board.

27706. Any exemption from the net receipts tax under Chapter 2 (commencing with Section 27101) granted by any statute of this state on or after January 1, 1985, for an organization that is an instrumentality of this state, shall be provided for in this part.

27707. (a) Except as provided in subdivision (b), the status of any organization as a private foundation shall be terminated only if either of the following occurs:

(1) The organization notifies the Franchise Tax Board (at such time and in such manner as the Franchise Tax Board may by regulations prescribe) of its intent to accomplish such termination.

(2) The organization has been terminated by the Attorney General of this state or by action taken pursuant to Section 507 of the Internal Revenue Code.

(b) (1) The status as a private foundation of any organization shall be terminated only if either of the following occurs:

(A) The organization distributes all of its net assets to one or more organizations described below (other than clause (vii), (viii), (ix), or (x)) each of which has been in existence and so described for a continuous period of at least 60 calendar months immediately preceding the distribution and exempt from tax under Section 27701d of

the Revenue and Taxation Code or Section 501(c)(3) of the Internal Revenue Code during the last 60 months, or:

- (i) A church or a convention or association of churches,
- (ii) An educational organization that normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on,
- (iii) An organization the principal purpose or functions of which are the providing of medical or hospital care or medical education or medical research, if the organization is a hospital, or if the organization is a medical research organization directly engaged in the continuous active conduct of medical research in conjunction with a hospital, and during the calendar year in which the contribution is made the organization is committed to spend such contributions for the research before January 1 of the fifth calendar year which begins after the date the contribution is made.
- (iv) An organization that normally receives a substantial part of its support (exclusive of income received in the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under Section 27701d) from the United States or any state or political subdivision thereof or from direct or indirect contributions from the general public, and that is organized and operated exclusively to receive, hold, invest, and administer property and to make expenditures to or for the benefit of a college or university that is an organization referred to in clause (ii) of this subparagraph and that is an agency or instrumentality of a state or political subdivision thereof, or that is owned or operated

by a state or political subdivision thereof or by an agency or instrumentality of one or more states or political subdivisions,

(v) A governmental unit referred to in Section 170(c)(1) of the Internal Revenue Code,

(vi) An organization referred to in Section 170(c)(2) of the Internal Revenue Code that normally receives a substantial part of its support (exclusive of income received in the exercise or performance by the organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under Section 27701d) from a governmental unit referred to in Section 170(c)(1) of the Internal Revenue Code or from direct or indirect contributions from the general public,

(vii) A private operating foundation (as defined in Section 4942(j) (3) of the Internal Revenue Code),

(viii) Any other private foundation (as defined in Section 509(a) of the Internal Revenue Code) that, not later than the 15th day of the third month after the close of the foundation's taxable year in which contributions are received, makes qualifying distributions (as defined in Section 4942(g) of the Internal Revenue Code, as amended by Public Law 94-455, without regard to paragraph (3) thereof), that are treated, after the application of Section 4942(g)(3) of the Internal Revenue Code as distributions out of corpus (in accordance with Section 4942(h) of the Internal Revenue Code) in an amount equal to 100 percent of the contributions, and with respect to which the taxpayer maintains adequate records or other sufficient evidence from the foundation showing that the foundation made the qualifying distributions,

(ix) A private foundation all of the contributions to which are pooled in a common fund and which would be described in paragraph (3) of Section 509(a) of the Internal Revenue Code but for the right of any substantial contributor (hereafter in this clause called “donor”) or his spouse to designate annually the recipients, from among organizations described in paragraph (1) of Section 509(a) of the Internal Revenue Code, of the income attributable to the donor’s contribution to the fund and to direct (by deed or by will) the payment, to an organization described in paragraph (1), of the corpus in the common fund shall apply only if all the income of the common fund is required to be (and is) distributed to one or more organizations described in paragraph (1) not later than the 15th day of the third month after the close of the taxable year in which the income is realized by the fund and only if all of the corpus attributable to any donor’s contribution to the fund is required to be (and is) distributed to one or more of the organizations not later than one year after his or her death or after the death of his or her surviving spouse if he or she has the right to designate the recipients of the corpus, and

(x) An organization described in paragraph (2) or (3) of Section 509(a) of the Internal Revenue Code.

(B) The organization meets the requirements of Section 507(b)(1)(B) or paragraph (1), (2), or (3) of Section 509(a) of the Internal Revenue Code, whichever applies, and furnishes copies of its federal notice of termination of its private foundation status to the Franchise Tax Board.

(2) For purposes of this part, in the case of a transfer of assets of any private foundation to another private foundation pursuant to any liquidation, merger,

redemption, recapitalization, or other adjustment, organization, or reorganization, the transferee foundation shall not be treated as a newly created organization.

27708. (a) For purposes of this part, unless otherwise indicated in context, the term “an organization exempt from tax” shall mean an organization that has satisfied the provisions of Section 27701.

(b) Except as provided in subdivision (c), any organization (including an organization in existence on December 31, 1970) that is described in Section 27701d and that does not notify the Franchise Tax Board at the time and the manner as the Franchise Tax Board may prescribe, that it is not a private foundation shall be presumed to be a private foundation. The time prescribed for giving notice under this subdivision shall not expire before the 90th day after the day on which the regulations first prescribed under this subdivision become final.

(c) Subdivision (b) shall not apply to the following:

(1) Churches, their integrated auxiliaries, and conventions or associations of churches.

(2) Any organization that is not a private foundation (as defined in Section 27709).

(3) The Franchise Tax Board may by regulations exempt (to the extent and subject to those conditions as may be prescribed in the regulations) the following from subdivision (b):

(A) Educational organizations that normally maintain a regular faculty and curriculum and normally have a regularly enrolled body of pupils or students in attendance at the place where their educational activities are regularly carried on.

(B) Any other class of organizations with respect to which the Franchise Tax Board determines that full compliance with subdivision (b) is not necessary to the efficient administration of this part relating to private foundations.

(d) (1) A private foundation shall not be exempt from taxation under Section 27701d unless its governing instrument includes provisions the effects of which are both of the following:

(A) To require its income for each taxable year to be distributed at the time and in the manner as not to subject the foundation to tax under Section 4942 of the Internal Revenue Code, as amended by Public Law 94-455.

(B) To prohibit the foundation from engaging in any act of self-dealing (as defined in Section 4941 of the Internal Revenue Code) from retaining any excess business holdings (as defined in Section 4943 of the Internal Revenue Code), from making any investments in the manner as to subject the foundation to tax under Section 4944 of the Internal Revenue Code.

(2) In the case of any organization organized before January 1, 1970, paragraph (1) shall not apply to the following:

(A) To any taxable year beginning before January 1, 1972.

(B) To any period after December 31, 1971, during the pendency of any judicial proceeding begun before January 1, 1972, by the private foundation which is necessary to reform, or to excuse such foundation from compliance with, its governing instrument or any other instrument in order to meet the requirements of paragraph (1).

(C) To any period after the termination of any judicial proceeding described in subparagraph (B) during which its governing instrument or any other instrument does not permit it to meet the requirements of paragraph (1).

(3) This subdivision shall not apply to require the inclusion in governing instruments of any provisions inconsistent with this subdivision.

(e) Notwithstanding any of the requirements of this section, if they are determined to be met under federal law they are also met for state purposes.

27709. (a) For the purposes of this part the term “private foundation” means a domestic or foreign organization defined in the Internal Revenue Code as a private foundation.

(b) For the purposes of this part, if an organization is a private foundation (within the meaning of subdivision (a)) on December 31, 1970, or becomes a private foundation on any subsequent date, the organization shall be treated as a private foundation for all periods after December 31, 1970, or after that subsequent date, unless its status as such is terminated.

(c) For purposes of this part, an organization the status of which as a private foundation is terminated shall be treated as an organization created on the day after the date of the termination, except in the case of a transfer of assets of any private foundation to another private foundation pursuant to any liquidation, merger, redemption, recapitalization, or other adjustment, organization, or reorganization, the transferee shall not be treated as a newly created organization.

(d) For purposes of this part, the term “support” includes, but is not limited to, the following:

- (1) Gifts, grants, contributions, or membership fees.
- (2) Gross receipts from admissions, sales of merchandise, performance of services, or furnishing of facilities in any activity that is not an unrelated trade or business (within the meaning of Section 27734).
- (3) Net receipts from unrelated business activities, whether or not such activities are carried on regularly as a trade or business.
- (4) Gross investment receipts (as defined in subdivision (e)).
- (5) Tax revenues levied for the benefit of an organization and either paid to or expended on behalf of the organization.
- (6) The value of services or facilities (exclusive of services or facilities generally furnished to the public without charge) furnished by a governmental unit referred to in Section 170(c)(1) of the Internal Revenue Code to an organization without charge. The term does not include any gain from the sale or other disposition of property that would be considered as gain from the sale or exchange of a capital asset, or the value of exemption from any federal, state, or local tax or any similar benefit.

(e) For purposes of this section, the term “gross investment receipts” means the gross amount of interest, dividends, rents, and royalties, but not including any such receipts to the extent included in computing the tax imposed by Section 27731.

27710. Any organization exempted from taxes imposed under this part pursuant to this article shall not be disqualified for the exemption on the basis that it conducts bingo games pursuant to Section 326.5 of the Penal Code, provided that the proceeds from those games are used exclusively for charitable purposes.

27711. Section 529 of the Internal Revenue Code, relating to qualified state tuition programs, shall apply, except as otherwise provided.

(a) Section 529(a) of the Internal Revenue Code is modified as follows:

(1) By substituting the phrase “under Part 10 (commencing with Section 17001) and this part” in lieu of the phrase “under this subtitle.”

(2) By substituting “Article 2 (commencing with Section 27731)” in lieu of “section 511.”

(b) A copy of the report required to be filed with the Secretary of the Treasury under Section 529(d) of the Internal Revenue Code shall be filed with the Franchise Tax Board at the same time and in the same manner as specified in that section.

27711.5. The Golden State Scholarshare Trust, established pursuant to Article 19 (commencing with Section 69980) of Chapter 2 of Part 42 of the Education Code, is an instrumentality of this state and the receipts of the Scholarshare trust shall be exempt from taxes imposed under this part. The Scholarshare trust is established and shall be maintained as a qualified state tuition program as defined in Section 529 of the Internal Revenue Code.

27712. Section 530 of the Internal Revenue Code, relating to Coverdell education savings accounts, shall apply, except as otherwise provided.

(a) Section 530(a) of the Internal Revenue Code is modified as follows:

(1) By substituting the phrase “under Part 10 (commencing with Section 17001) and this part” in lieu of the phrase “under this subtitle.”

(2) By substituting “Article 2 (commencing with Section 27731)” in lieu of “section 511.”

(b) Section 530(d) of the Internal Revenue Code is modified as follows:

(1) By substituting the phrase “under Part 10 (commencing with Section 17001) in the manner as provided in Section 72(b) of the Internal Revenue Code, as modified by Part 10” in lieu of the phrase “in the manner as provided in Section 72(b)” in Section 530(d)(1) of the Internal Revenue Code.

(2) (A) By substituting the phrase “tax imposed by Part 10 (commencing with Section 17001)” in lieu of the phrase “tax imposed by this chapter” in Section 530(d)(4)(A) of the Internal Revenue Code.

(B) By substituting the phrase “increased by 2 1/2 percent” in lieu of the phrase “increased by 10 percent” in Section 530(d)(4)(A) of the Internal Revenue Code.

(C) By substituting the phrase “shall be included in the contributor’s gross income under Part 10 (commencing with Section 17001) or this part” in lieu of the phrase “shall be included in gross income” in Section 530(d)(4)(C) of the Internal Revenue Code.

(c) For purposes of Part 10 (commencing with Section 17001) and this part, in the case of a custodial account treated as a trust by reason of Section 530(g) of the Internal Revenue Code, the custodian of that account shall be treated as the trustee thereof.

(d) A copy of the report, which is required to be filed with the Secretary of the Treasury under Section 530(h) of the Internal Revenue Code, shall be filed with the

Franchise Tax Board at the same time and in the same manner as specified in that section.

Article 2. Taxation of Unrelated Business Net Receipts of Certain Article 1
Organizations

27731. Every organization or trust exempt under this chapter, except as provided in this article, is subject to the tax imposed upon its unrelated business net receipts, as defined in Section 27732, as follows:

(a) Business entities, including business trusts, are subject to the tax imposed under Section 27101.

(b) Trusts, other than business trusts, are subject to the tax imposed by subdivision (e) of Section 17041.

27732. Section 512 of the Internal Revenue Code, relating to unrelated business taxable income, shall apply, except as otherwise provided.

(a) (1) Section 512(a)(1) of the Internal Revenue Code shall be modified as follows:

(A) By substituting “gross business receipts,” as defined in this part, for “gross income” each place it appears.

(B) By substituting “deductions allowed by this part” for “deductions allowed by this chapter.”

(2) Section 512(a)(2) of the Internal Revenue Code, relating to special rules for foreign organizations, shall not be applicable.

(b) Section 512(a)(3) of the Internal Revenue Code, relating to special rules applicable to certain organizations, shall be modified as follows:

(1) The reference to Section 501(c)(7) of the Internal Revenue Code, relating to clubs organized for pleasure, recreation, and other non-profitable purposes, shall be modified to refer to Section 27701g.

(2) The reference to Section 501(c)(9) of the Internal Revenue Code, relating to voluntary employees' beneficiary associations, shall be modified to refer to Section 27701i.

(3) The reference to Section 501(c)(17) of the Internal Revenue Code, relating to trusts providing for payment of supplemental unemployment compensation benefits, shall be modified to refer to Section 27701n.

(4) The reference to Section 501(c)(20) of the Internal Revenue Code, relating to qualified group legal services plans, shall be modified to refer to Section 27701q.

(c) Section 512(d) of the Internal Revenue Code, relating to treatment of dues of agricultural or horticultural organizations, shall be modified by substituting "Section 27701a" in lieu of "Section 501(c)(5)" of the Internal Revenue Code.

27734. (a) Section 513 of the Internal Revenue Code, relating to unrelated trade or business, shall apply, except as otherwise provided.

(b) Section 513(g) of the Internal Revenue Code, relating to certain pole rentals, shall not apply.

27735. (a) Section 514 of the Internal Revenue Code, relating to unrelated debt-financed income, shall apply, except as otherwise provided.

(b) An interest in a participation agreement, as defined in subdivision (i) of Section 69980 of the Education Code, shall not be treated as debt.

27736. Sections 27736.1 to 27736.4, inclusive, shall apply to any organization described in Section 27701d or Section 27701n except the following:

(a) A religious organization (other than a trust).

(b) An educational organization that normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on.

(c) An organization that normally receives a substantial part of its support (exclusive of income received in the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under Section 27701d) from the United States or any state or political subdivision thereof or from direct or indirect contributions from the general public.

(d) An organization that is operated, supervised, controlled, or principally supported by a religious organization (other than a trust) that is itself not subject to this article.

(e) An organization the principal purposes or functions of which are the providing of medical or hospital care or medical education or medical research.

27736.1. (a) For the purposes of this article, the term "prohibited transaction" means any transaction in which an organization subject to this article--

(1) Lends any part of its income or corpus, without the receipt of adequate security and a reasonable rate of interest, to;

- (2) Pays any compensation, in excess of a reasonable allowance for salaries or other compensation for personal services actually rendered, to;
- (3) Makes any part of its services available on a preferential basis, to;
- (4) Makes any substantial purchase of securities or any other property, for more than adequate consideration in money or money's worth, from;
- (5) Sells any substantial part of its securities or other property, for less than an adequate consideration in money or money's worth, to; or
- (6) Engages in any other transaction that results in a substantial diversion of its income or corpus to;

The creator of the organization (if a trust); a person who has made a substantial contribution to the organization; a member of the family (as defined in Section 267(c)(4) of the Internal Revenue Code) of an individual who is the creator of that trust or who has made a substantial contribution to that organization; or a corporation controlled by that creator or person through the ownership, directly or indirectly, of 50 percent or more of the total combined voting power of all classes of stock entitled to vote or 50 percent or more of the total value of shares of all classes of stock of the corporation.

(b) For purposes of subdivision (a), a bond, debenture, note, or certificate or other evidence of indebtedness (hereinafter in this section referred to as "obligation") acquired by a trust described in Section 27701n shall not be treated as a loan made without the receipt of adequate security if:

- (1) The obligation is acquired:
 - (A) On the market, either (i) at the price of the obligation prevailing on a national securities exchange that is registered with the Securities and Exchange Commission,

or (ii) if the obligation is not traded on a national securities exchange, at a price not less favorable to the trust than the offering price for the obligation as established by current bid and asked prices quoted by persons independent of the issuer.

(B) From an underwriter, at a price (i) not in excess of the public offering price for the obligation as set forth in a prospectus or offering circular filed with the Securities and Exchange Commission, and (ii) at which a substantial portion of the same issue is acquired by persons independent of the issuer.

(C) Directly from the issuer, at a price not less favorable to the trust than the price paid currently for a substantial portion of the same issue by persons independent of the issuer.

(2) Immediately following acquisition of that obligation both of the following apply:

(A) Not more than 25 percent of the aggregate amount of obligations issued in that issue and outstanding at the time of acquisition is held by the trust.

(B) At least 50 percent of the aggregate amount referred to in subparagraph (A) is held by persons independent of the issuer.

(3) Immediately following acquisition of the obligation, not more than 25 percent of the assets of the trust is invested in obligations of persons described in subdivision (a).

(4) In the application of paragraph (1) of subdivision (a), if a trust described in Section 27701n forming part of a supplemental unemployment compensation benefit plan lends any money to another trust described in Section 27701n forming part of the

same plan, that loan shall not be treated as an indebtedness of the borrowing trust, except to the extent that the loaning trust:

(A) Incurs any indebtedness in order to make that loan.

(B) Incurred indebtedness before the making of that loan which would not have been incurred but for the making of that loan.

(C) Incurred indebtedness after the making of that loan which would not have been incurred but for the making of that loan and that was reasonably foreseeable at the time of making that loan.

(c) Subdivision (a) shall not apply to a loan made by a trust described in Section 27701n to the employer (or to a renewal of that loan or, if the loan is repayable upon demand, to a continuation of that loan) if the loan bears a reasonable rate of interest, and if (in the case of a making or renewal) all of the following apply:

(1) The employer is prohibited (at the time of that making or renewal) by any law of the United States or regulation thereunder from directly or indirectly pledging, as security for the loan, a particular class or classes of his or her assets the value of which (at that time) represents more than one-half of the value of all his or her assets.

(2) The making or renewal, as the case may be, is approved in writing as an investment that is consistent with the exempt purposes of the trust by a trustee who is independent of the employer, and no other independent trustee had previously refused to give that written approval.

(3) Immediately following the making or renewal, as the case may be, the aggregate amount loaned by the trust to the employer, without the receipt of adequate security, does not exceed 25 percent of the value of all the assets of the trust.

(4) For purposes of paragraph (2) the term “trustee” means, with respect to any trust for which there is more than one trustee who is independent of the employer, a majority of those independent trustees. For purposes of paragraph (3), the determination as to whether any amount loaned by the trust to the employer is loaned without the receipt of adequate security shall be made without regard to subdivision (b).

27736.2. An organization described in Section 27701d that is subject to this article, except any specified in Section 27736, shall not be exempt from taxation under Article 1 of this chapter if it has engaged in a prohibited transaction after January 1, 1951; and an organization described in Section 27701n that is subject to this article shall not be exempt from taxation under Article 1 if it has engaged in a prohibited transaction after December 31, 1960.

27736.3. An organization described in Section 27701n or Section 27701d, except as specified in Section 27736, shall be denied exemption under Section 27736.2 only for taxable years subsequent to the taxable years during which it is notified by the Franchise Tax Board that it has engaged in a prohibited transaction, unless such organization entered into the prohibited transaction with the purpose of diverting corpus or income of the organization from its exempt purposes, and the transaction involved a substantial part of the corpus or income of the organization.

27736.4. Any organization denied exemption under Section 27701d or Section 27701n by reason of the provisions of Section 27736.2 with respect to any taxable year following the taxable year in which notice of denial of exemption was received, may, under regulations prescribed by the Franchise Tax Board, file claim for exemption, and if the Franchise Tax Board pursuant to the regulations, is satisfied that the

organizations will not knowingly again engage in a prohibited transaction, the organization shall be exempt with respect to taxable years subsequent to the year in which the claim is filed.

27737. In the case of any organization described in Section 27701d to which this article is applicable, exemption under Article 1 (commencing with Section 27701) shall be denied for the taxable year if the amounts accumulated out of income during the taxable year or any prior taxable year and not actually paid out by the end of the taxable year are either of the following:

(a) Are unreasonable in amount or duration in order to carry out the charitable, educational, or other purpose or function constituting the basis for such organization's exemption under Section 27701d.

(b) Are used to a substantial degree for purposes or functions other than those constituting the basis for such organization's exemption under Section 27701d.

(c) Are invested in such a manner as to jeopardize the carrying out of the charitable, educational, or other purpose or function constituting the basis for such organization's exemption under Section 27701d.

27740. Section 4911 of the Internal Revenue Code, relating to tax on excess expenditures to influence legislation, shall apply, except as otherwise provided.

(a) Section 4911(a)(1) of the Internal Revenue Code shall not apply.

(b) Section 4911(f)(4)(A) of the Internal Revenue Code shall include efforts to influence legislation with respect to acts, bills, resolutions, or similar items by the Legislature.

27741. Notwithstanding any other provision in this part, in the case of a church exempt from taxes imposed under this part pursuant to Article 1 (commencing with Section 27701) of Chapter 4, any rental income received, directly or indirectly, from another church exempt from taxes imposed under this part pursuant to Article 1 (commencing with Section 27701) of Chapter 4 for rental of exempt function church property is exempt from any tax imposed by this part.

Article 3. Returns of Exempt Organizations

27771. (a) Except as provided in subdivision (b), every organization, otherwise exempt under Article 1 (commencing with Section 27701), but having receipts of the character described in Article 2 (commencing with Section 27731), shall file a return, verified by an executive officer under penalty of perjury in the form prescribed by the Franchise Tax Board, on or before the 15th day of the fifth month following the close of the taxable year, reporting its net receipts from those activities and shall pay a tax as required by Section 27731 on its unrelated business net receipts as defined in Section 27732.

(b) An education IRA described in Section 27712 shall file a return described in subdivision (a) on or before the 15th day of the fourth month following the close of the taxable year.

27772. (a) For the purposes of this part:

(1) Except as provided in paragraph (2), every organization exempt from taxation under Section 27701 and every trust treated as a private foundation because of Section

4947(a)(1) of the Internal Revenue Code shall file an annual return, stating specifically the items of gross receipts and purchases, and any other information for the purpose of carrying out the laws under this part as the Franchise Tax Board may by rules or regulations prescribe, and shall keep any records, render under oath any statements, make any other returns, and comply with any rules and regulations as the Franchise Tax Board may from time to time prescribe. The return shall be filed on or before the 15th day of the fifth full calendar month following the close of the taxable year.

(2) Exceptions from filing:

(A) Mandatory exceptions, paragraph (1) does not apply to:

(i) Churches, their integrated auxiliaries, and conventions or associations of churches.

(ii) Any organization (other than a private foundation as defined in Section 27709), the gross receipts of which in each taxable year are normally not more than five hundred thousand dollars (\$500,000).

(iii) The exclusively religious activities of any religious order.

(B) Discretionary exceptions:

(i) The Franchise Tax Board may permit the filing of a simplified return for organizations based on either gross receipts or total assets, or both gross receipts and total assets.

(ii) The Franchise Tax Board may permit the filing of an information statement (without fee).

(iii) The Franchise Tax Board may permit the filing of a group return for incorporated or unincorporated branches of a state or national organization where it

determines that an information return is not necessary to the efficient administration of this part.

(3) An organization that is required to file an annual information return shall pay a filing fee of ten dollars (\$10) on or before the due date for filing the annual information return (determined with regard to any extension of time for filing the return) required by this section. In case of failure to pay the fee on or before the due date, unless it is shown that the failure is due to reasonable cause, the filing fee shall be twenty-five dollars (\$25). All collection remedies provided in Article 5 (commencing with Section 18661) of Chapter 2 of Part 10.2 are applicable to collection of the filing fee. However, the filing fee does not apply to the organization described in paragraph (4).

(4) Paragraph (3) shall not apply to:

(A) A religious organization exempt under Section 27701d.

(B) An educational organization exempt under Section 27701d, if that organization normally maintains a regular faculty and curriculum and normally has a regularly organized body of pupils or students in attendance at the place where its educational activities are regularly carried on.

(C) A charitable organization, or an organization for the prevention of cruelty to children or animals, exempt under Section 27701d, if that organization is supported, in whole or in part, by funds contributed by the United States or any state or political subdivision thereof, or is primarily supported by contributions of the general public.

(D) An organization exempt under Section 27701d, if that organization is operated, supervised, or controlled by or in connection with a religious organization described in subparagraph (A).

(b) Every organization described in Section 27701d that is subject to the requirements of subdivision (a) is required to furnish annually information, at the time and in the manner as the Franchise Tax Board may by rules or regulations prescribe, setting forth all of the following:

- (1) Its gross income for the year.
- (2) Its expenses attributable to gross income and incurred within the year.
- (3) Its disbursements within the year for the purposes for which it is exempt.
- (4) A balance sheet showing its assets, liabilities, and net worth as of the beginning of that year.
- (5) The total of the contributions and gifts received by it during the year, and the names and addresses of all substantial contributors.
- (6) The names and addresses of its foundation manager (within the meaning of Section 4946 of the Internal Revenue Code) and highly compensated employees.
- (7) The compensation and other payments made during the year to each individual described in paragraph (6).
- (8) In the case of an organization with respect to which an election under Section 27704.5 is effective for the taxable year, the following amounts for that organization for that taxable year:
 - (A) The lobbying expenditures (as defined in Section 4911(c)(1) of the Internal Revenue Code).

(B) The lobbying nontaxable amount (as defined in Section 4911(c)(2) of the Internal Revenue Code).

(C) The grassroots expenditures (as defined in Section 4911(c)(3) of the Internal Revenue Code).

(D) The grassroots nontaxable amount (as defined in Section 4911(c)(4) of the Internal Revenue Code). For purposes of this paragraph, if Section 27740 applies to the organization for the taxable year, the organization shall furnish the amounts with respect to the affiliated group as well as with respect to the organization.

(9) Other information with respect to direct or indirect transfers to, and other direct or indirect transactions and relationships with, other organizations described in Sections 27701a to 27701w, inclusive (other than Sections 27701d, 27701k, and 27701t), as the Franchise Tax Board may require to prevent either of the following:

(A) Diversion of funds from the organization's exempt purpose.

(B) Misallocation of revenue or expense.

(10) Any other relevant information as the Franchise Tax Board may prescribe.

(c) For the purposes of this part:

(1) In the case of a failure to file a return required under this section on the date and in the manner prescribed therefor (determined with regard to any extension of time for filing), unless it is shown that the failure is due to reasonable cause, there shall be paid (on notice and demand by the Franchise Tax Board and in the same manner as tax) by the exempt organization or trust failing so to file, five dollars (\$5) for each month or part thereof during which the failure continues, but the total amount imposed

hereunder on any organization for failure to file any return may not exceed forty dollars (\$40).

(2) The Franchise Tax Board may make written demand upon a private foundation failing to file under paragraph (1) specifying therein a reasonable future date by which the filing shall be made, and if the filing is not made on or before that date, and unless it is shown that failure so to file is due to reasonable cause, there shall be paid (on notice and demand by the Franchise Tax Board and in the same manner as tax) by the person failing so to file, in addition to the penalty prescribed in paragraph (1), a penalty of five dollars (\$5) each month or part thereof after the expiration of the time specified in the written demand during which the failure continues, but the total amount imposed hereunder on all persons for the failure to file shall not exceed twenty-five dollars (\$25). If more than one person is liable under this paragraph for a failure to file, all of those persons shall be jointly and severally liable with respect to the failure. The term "person" as used herein means any officer, director, trustee, employee, member, or other individual who is under a duty to perform the act in respect of which the violation occurs.

27774. (a) Except as provided in subdivision (b), every organization exempt from filing an annual information return by reason of subdivision (a) of Section 27772, may be required to file an annual statement on or before the 15th day of the fifth calendar month following the close of the taxable year setting forth in the manner as may be required by the Franchise Tax Board the following information: the name and address of the organization, its major activities, its sources of gross receipts, and the section of the Internal Revenue Code under which it is exempt. Organizations other

than those described in clauses (i) and (iii) of subparagraph (A) of paragraph (2) of subdivision (a) of Section 23772 may also be required by the Franchise Tax Board to furnish information with respect to their gross receipts and their assets.

(b) Every religious organization exempt from filing an annual information return by reason of subdivision (a) of Section 27772, that because of sincerely held religious convictions refuses to file an annual statement as prescribed in subdivision (a), may submit in lieu thereof a notarized statement on its organizational letterhead containing the following information: the name and address of the organization, its major activities, its sources of gross receipts, and the section of the Internal Revenue Code under which it is exempt. That information shall be for the sole purpose of verifying the absence of unrelated business net receipts of the organization. The statement shall be submitted on or before the 15th day of the fifth calendar month following the close of the taxable year.

27775. Except for purposes of amending the articles of incorporation or organization to set forth a new name, under regulations prescribed by the Franchise Tax Board, the powers, rights, and privileges of an exempt domestic limited liability business entity may be suspended and the exercise of the powers, rights, and privileges of a foreign exempt limited liability entity in this state may be forfeited if the organization fails to file the annual return or statement required under Section 27772 or 27774, or pay any amount due under Section 27703 or 27772 on or before the last day of the 12th month following the close of the taxable year.

27776. (a) Any organization that has suffered the suspension or forfeiture provided for in Section 27775 may, in accordance with Section 27198a, be relieved therefrom upon the filing of all of the following:

- (1) An application for revivor.
- (2) When required by the Franchise Tax Board, a new application for exemption under Section 27701.
- (3) Any returns, statements, notifications, or amounts due under Section 27772, 27774, or 27775 that were not previously submitted or paid and which resulted in the suspension or forfeiture.
- (4) An information return or statement and the amounts specified under Section 27772 for each year, or part thereof, during the period of suspension or forfeiture in which the organization conducted any activities or received income, grants, gifts, or any other asset.

(b) Any organization exempt from tax under Section 27701 which has suffered the suspension or forfeiture provided for in Section 27191 or 27192 may be required by the Franchise Tax Board to file a new application for exemption in connection with an application for revivor under Section 27198.

27777. The exemption granted to any organization under Article 1 (commencing with Section 27701) may be revoked by the Franchise Tax Board if the organization fails to do any of the following:

- (a) File any return required under this chapter or pay any amount due under this part or Part 10.2 (commencing with Section 18401) on or before the last day of the 12th month following the close of the taxable year.

(b) Comply with Section 19504 (relating to powers of the Franchise Tax Board to examine records and subpoena witnesses).

(c) Confine its activities to those permitted by the section under which the exemption was granted.

27778. An organization whose exemption was revoked under Section 27777 may be reestablished as an exempt organization upon:

(a) The filing or payment of:

(1) A new application for exemption and payment of the filing fee required under Section 27701.

(2) Any returns, statements, or payments of any amounts due under this part or Part 10.2 (commencing with Section 18401) that were not previously submitted or paid and which resulted in the revocation.

(b) When revocation occurred under subdivision (c) of Section 27777, satisfactory proof that:

(1) The organization has corrected its nonexempt activities.

(2) That it will operate in an exempt manner in the future.

(3) The payment of any tax for periods the organization was not qualified for exemption.

27779. For purposes of this chapter, any reference to the Internal Revenue Code or a provision thereof, means the Internal Revenue Code or provision thereof, as in effect January 1, 2005.

27780. Any reference to Chapter 4 (commencing with Section 23701) of Part 11 (commencing with Section 23001) or any provision thereof shall also be a reference

to this article or a provision of this chapter that is substantially the same as the provision referenced in Chapter 4 (commencing with Section 23701) of Part 11 (commencing with Section 23001).

CHAPTER 5. CREDITS

Article 1. Small Business Credit

27801. (a) For each taxable year beginning on or after January 1, 2012, there shall be allowed as a credit against the tax imposed under Article 2 (commencing with Section 27151) of Chapter 2 the amount determined under paragraph (1) or paragraph (2) subdivision (b).

(b) (1) If net receipts exceed purchases, the credit shall be equal to an amount determined as follows:

(A) Multiply twenty thousand dollars (\$20,000) by a fraction, the numerator of which is net receipts and the denominator of which is gross receipts.

(B) Multiply the amount by which gross receipts exceeds five hundred thousand dollars (\$500,000) by 0.008.

(C) The amount of the credit allowed under this paragraph equals the amount by which the amount determined under subparagraph (A) exceeds the amount determined in subparagraph (B).

(2) If purchases equal or exceed net receipts, the credit shall be equal to an amount determined as follows:

(A) One less a fraction, the numerator of which is purchases and the denominator of which is gross receipts, carried out to ____ decimal places.

(B) Two hundred fifty thousand dollars (\$250,000) divided by the number determined under subparagraph (A).

(C) Multiply the amount by which gross receipts exceeds the amount determined in subparagraph (B) by 0.008.

(D) The amount of the credit under this paragraph equals ten thousand dollars (\$10,000), reduced by the amount determined in subparagraph (C).

Article 2. Research and Development Credit

27811. For each taxable year beginning on or after January 1, 2012, there shall be allowed as a credit against the tax imposed under Article 2 (commencing with Section 27151) of Chapter 2 an amount determined in accordance with Section 41 of the Internal Revenue Code, relating to credit for increasing research activities, except as follows:

(a) The reference to “20 percent” in Section 41(a)(1) of the Internal Revenue Code is modified to read “____ percent.”

(b) The reference to “20 percent” in Section 41(a)(2) of the Internal Revenue Code is modified to read “____ percent.”

(c) (1) With respect to any expense paid or incurred after the operative date of Section 6378, Section 41(b)(1) of the Internal Revenue Code is modified to exclude from the definition of “qualified research expense” any amount paid or incurred for

tangible personal property that is eligible for the exemption from sales or use tax provided by Section 6378.

(2) “Qualified research” and “basic research” shall include only research conducted in California.

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

- (1) Basic research conducted outside California.
- (2) Basic research in the social sciences, arts, or humanities.
- (3) Basic research for the purpose of improving a commercial product if the improvements relate to style, taste, cosmetic, or seasonal design factors.
- (4) Any expenditure paid or incurred for the purpose of ascertaining the existence, location, extent, or quality of any deposit of ore or other mineral (including oil and gas).

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

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

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

(2) For purposes of this subdivision:

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

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

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

(g) The reference to “Section 501(a)” in Section 41(b)(3)(C) of the Internal Revenue Code, relating to contract research expenses, is modified to read “this part or Part 10 (commencing with Section 17001).”

(h) (1) (A) The reference to “2.65 percent” in Section 41(c)(4)(A)(i) of the Internal Revenue Code is modified to read “one and forty-nine hundredths of one percent.”

(B) The reference to “3.2 percent” in Section 41(c)(4)(A)(ii) of the Internal Revenue Code is modified to read “one and ninety-eight hundredths of one percent.”

(C) The reference to “3.75 percent” in Section 41(c)(4)(A)(iii) of the Internal Revenue Code is modified to read “two and forty-eight hundredths of one percent.”

(2) Section 41(c)(4)(B) shall not apply and in lieu thereof an election under Section 41(c)(4)(A) of the Internal Revenue Code may be made. That election shall apply to the taxable year for which made and all succeeding taxable years unless revoked with the consent of the Franchise Tax Board.

(3) Section 41(c)(6) of the Internal Revenue Code, relating to gross receipts, is modified to take into account only those gross receipts from the sale of property held primarily for sale to customers in the ordinary course of the taxpayer’s trade or business that is delivered or shipped to a purchaser within this state, regardless of f.o.b. point or any other condition of the sale.

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

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

(1) The last sentence shall not apply.

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

(k) For purposes of this section, references to the Internal Revenue Code mean the Internal Revenue Code, as in effect January 1, 2005.

CHAPTER 6. ACCOUNTING RULES

Article 1. Foreign Governments and International Organizations

27901. (a) Section 892 of the Internal Revenue Code, relating to income of foreign governments and of international organizations, shall apply.

(b) In applying Section 892 of the Internal Revenue Code for purposes of this part, “gross receipts” and “net receipts” shall be substituted for “income” wherever appropriate.

Article 2. Cooperatives

27904. In the case of farmers, fruit growers, or like associations organized and operated in whole or in part on a cooperative or mutual basis, (a) for the purpose of

marketing the products of members or other producers, and turning back to them the proceeds of sales, less the necessary marketing expenses, which may include reasonable reserves, on the basis of either the quantity or the value of the products furnished by them, or (b) for the purpose of purchasing, or producing, supplies and equipment for the use of members or other persons, and turning over such supplies and equipment to them at actual cost, plus necessary expenses, all net receipts resulting from or arising out of such business activities for or with their members carried on by them or their agents; or when done on a nonprofit basis for or with nonmembers. For the purposes of this section "all net receipts resulting from or arising out of such business activities for or with their members" shall include all amounts, whether or not derived from patronage, allocated to members during the taxable year. Amounts allocated include cash, merchandise, capital stock, revolving fund certificates, certificates of indebtedness, retain certificates, letters of advice, or written instruments which in some other manner disclose to each member the dollar amount allocated to him. Allocations made after the close of the taxable year and on or before the fifteenth day of the ninth month following the close of such year shall be considered as made on the last day of such taxable year to the extent the allocations are attributable to net receipts derived before the close of such year.

27905. (a) In the case of other associations organized and operated in whole or in part on a cooperative or a mutual basis, all net receipts resulting from or arising out of business activities for or with their members carried on by them or their agents, or when done on a nonprofit basis for or with nonmembers, shall be an allowable deduction. However, the deduction allowable under this section shall not apply to those

cooperative or mutual associations whose net receipts is principally derived from the sale in the regular course of business of tangible personal property other than water, agricultural products, or food sold at wholesale.

(b) For the purposes of subdivision (a), “food sold at wholesale” means a sale of food to anyone engaged in the business of selling food who holds a seller’s permit issued pursuant to Section 6066, and who at the time of purchasing the food either:

- (1) Intends to sell it in the regular course of business.
- (2) Is unable to ascertain at the time of purchase whether the food will be sold or used for some other purpose.

(c) For the purposes of subdivision (a), a credit union’s activities are “for or with” the members of the credit union if the activities involve the investment of surplus member savings capital in investments permitted for credit unions pursuant to Sections 14406, 14652, 14653, 14653.5, 14654, 14655, and 14656 of the Financial Code. “Surplus member savings capital” means the savings capital of credit union members which is in excess of the amount of savings capital which is loaned to members of the credit union. The term “savings capital” shall have the meaning set forth in subdivision (a) of Section 14400 of the Financial Code.

(d) For purposes of subdivision (a), “net receipts resulting from or arising out of business activities for or with their members” includes, but is not limited to, all net receipts resulting from reciprocal transactions with member credit unions.

27906. In the case of other associations organized and operated as cooperative corporations pursuant to Part 2 (commencing with Section 12200) of Division 3 of Title 1 of the Corporations Code, whose net receipts are principally derived from the

sale in the regular course of business of tangible personal property other than water, agricultural products, or food sold at wholesale, all patronage refunds paid or accrued to patrons if the patronage refunds are made and allocated as follows:

(a) Made pursuant to a preexisting obligation which is created by the association's bylaws or other written instrument.

(b) Made from earnings which are attributable to business done by the association with the patrons to whom the patronage refunds are made, and allocated ratably according to patronage.

(c) Allocated, and the patrons to whom the patronage refunds are to be made are notified of the allocation, on or before the due date for the filing of the association's franchise tax return, including any extension of time, pursuant to this part, for the year in which the patronage occurred.

27906.5. (a) In the case of gas producers' cooperative associations organized and operated as cooperative corporations pursuant to Chapter 1 (commencing with Section 3001) of Part 4 of Division 1 of the Public Utilities Code, whose net receipts are principally derived from the sale in the regular course of business of tangible personal property other than water, agricultural products or food sold at wholesale, all patronage refunds paid or accrued to patrons if the patronage refunds are made and allocated as follows:

(1) Made pursuant to a preexisting obligation which is created by the association's bylaws or other written instrument.

(2) Made from earnings that are attributable to business done by the association with the patrons to whom the patronage refunds are made, and allocated ratably according to patronage.

(3) Allocated, and the patrons to whom the patronage refunds are to be made are notified of the allocation, on or before the due date for the filing of the association's franchise tax return, including any extension of time, pursuant to this part, for the year in which the patronage occurred.

(b) Each cooperative corporation shall certify to the Franchise Tax Board its eligibility for the deduction provided by this section. Certification shall be made at the time and in the manner prescribed by the Franchise Tax Board in forms or instructions.

27906.6. For purposes of Sections 27904 to 27906.5, inclusive, net earnings shall not be reduced by amounts paid during the year as dividends on capital stock or other proprietary capital interests of the organization to the extent that the articles of incorporation, bylaws of the organization, or other contract with patrons provide that those dividends are in addition to amounts otherwise payable to patrons that are derived from business done for or with patrons during the taxable year.

Article 3. Certain Provisions of the Internal Revenue Code

27911. Subchapter C of Chapter 1 of Subtitle A of the Internal Revenue Code, relating to corporate distributions and adjustments, shall apply, except as otherwise provided.

27912. (a) (1) If, in connection with any exchange described in Section 332, 351, 354, 356, or 361 of the Internal Revenue Code, a taxpayer transfers property to an insurer, the insurer shall not, for purposes of determining the extent to which gain shall be recognized on that transfer, be considered to be a corporation for purposes of this part.

(2) Paragraph (1) shall not apply to any of the following types of transactions, unless that transaction has the effect (directly or indirectly) of transferring appreciated property from a taxpayer subject to tax under this part (or a member of the taxpayer's combined reporting group) to an insurer:

(A) An exchange or transfer pursuant to Section 368(a)(2)(D) or Section 368(a)(2)(E) of the Internal Revenue Code.

(B) A transfer of stock in an 80 percent-owned insurer for the purpose of filing a consolidated tax return or for financial or regulatory reporting.

(C) A transfer or exchange of publicly owned stock of the parent corporation.

(3) If a transaction described in paragraph (2) would qualify under that paragraph but for the fact that the transaction has the effect (directly or indirectly) of transferring appreciated property from a taxpayer subject to tax under this part (or a member of the taxpayer's combined reporting group) to an insurer, then, if the property is used in the active trade or business of the insurer, subdivision (b) shall be deemed to apply to that transfer.

(4) For purposes of this subdivision, "appreciated property" means property whose fair market value, as of the date of the transfer subject to this section, exceeds its adjusted basis as of that date.

(b) (1) Except as provided in subdivision (c), or as otherwise provided by regulations prescribed by the Franchise Tax Board, if property subject to paragraph (1) of subdivision (a) or to subdivision (g) is transferred to an insurer for use in the active conduct of a trade or business of the insurer, then any gain otherwise required to be recognized under that subdivision shall be deferred until the date that the property is no longer owned by an insurer in the taxpayer's commonly controlled group (or a member of the taxpayer's combined reporting group), or the property is no longer used in the active conduct of the insurer's trade or business (or the trade or business of another member in the taxpayer's combined reporting group), or the holder of the property is no longer held by an insurer in the commonly controlled group of the transferor (or a member of the taxpayer's combined reporting group).

(2) Any of the events described in paragraph (1) shall be treated as a disposition of the property under this subdivision, irrespective of whether any other provision in this part or in the Internal Revenue Code would otherwise permit nonrecognition treatment of the transaction described in this subdivision.

(3) Notwithstanding paragraph (2), an insurer that becomes a member of the taxpayer's commonly controlled group or a corporation that becomes a member of the taxpayer's combined reporting group, as a result of a transaction of which a transfer referred to in this subdivision is a part, shall be treated as a member of the taxpayer's commonly controlled group or a member of the taxpayer's combined reporting group at the time of the transfer for purposes of this subdivision.

(4) For purposes of this subdivision, stock of an insurance subsidiary constitutes property used in the active trade or business of the insurer.

(5) If the deferred gain required to be taken into account under this subdivision is business income (as defined by subdivision (a) of Section 28120), the gain shall be apportioned using the apportionment percentage for the taxable year that the gain is required to be taken into account under this subdivision. Except as provided in regulations under Section 28137, for purposes of the sales factor for that taxable year, the transaction giving rise to that gain shall be treated as a sale occurring in the taxable year the gain is taken into account. The amount of any gain required to be recognized under this subdivision upon any disposition described in this subdivision shall not exceed the lesser of the deferred gain or the gain realized in the transaction in which gain is required to be recognized under this subdivision.

(6) For purposes of computing the amount of gain required to be recognized under this subdivision, appropriate adjustments may be made, pursuant to regulations issued by the Franchise Tax Board, to the basis of stock to reflect the disallowance of any expenses under this part.

(c) The Franchise Tax Board may prescribe regulations providing for an annual reporting requirement in the form of a statement or other form, to be attached to the transferor taxpayer's return, regarding the current ownership of any property for which any gains were previously deferred pursuant to subdivision (b). If the transferor taxpayer fails to provide any information required by the Franchise Tax Board pursuant to the preceding sentence, the Franchise Tax Board may, in lieu of the year described by subdivision (b), require that the transferor taxpayer take those gains into account in the first taxable year in which the current ownership of the property is not reported. The preceding sentence shall not apply so long as the property is still owned by the

transferee and the failure to provide the information was due to reasonable cause and not willful neglect. Notwithstanding any other law, if a taxpayer fails to satisfy the reporting requirements of this subdivision, then a notice of proposed deficiency assessment resulting from adjustments attributable to gains previously deferred pursuant to subdivision (b) with respect to which the reporting requirements were not satisfied may be mailed to the taxpayer within four years from the date on which the reporting requirements are satisfied by the taxpayer.

(d) Subdivision (b) shall not apply to any property described by Section 367(a)(3)(B) of the Internal Revenue Code.

(e) Except as provided by regulations prescribed by the Franchise Tax Board, a transfer by a taxpayer of an interest in a partnership to an insurer in a transaction described in subdivision (a) shall be treated as a transfer to that insurer of the taxpayer's pro rata share of the assets of the partnership.

(f) For purposes of this section, any distribution described by Section 355 of the Internal Revenue Code (or so much of Section 356 of the Internal Revenue Code as it relates to Section 355 of the Internal Revenue Code) shall be treated as an exchange under this section, whether or not the distribution is an exchange. This subdivision shall not apply to any distribution in which either of the following applies:

- (1) The distributing corporation is an insurer.
- (2) The distributee is a person other than an insurer.

(g) For purposes of this part, any transfer of property to an insurer as a contribution to capital of that insurer by one or more persons who, immediately after the transfer, own (within the meaning of Section 318 of the Internal Revenue Code)

stock possessing at least 80 percent of the total combined voting power of all classes of stock of that insurer that are entitled to vote shall be treated as an exchange of that property for stock of the insurer equal in value to the fair market value of the property transferred.

(h) (1) In the case of any distribution described in Section 355 of the Internal Revenue Code (or so much of Section 356 of the Internal Revenue Code as it relates to Section 355 of the Internal Revenue Code) by a taxpayer to an insurer, to the extent provided in regulations prescribed by the Franchise Tax Board, gain shall be recognized under principles similar to the principles of this section.

(2) In the case of any liquidation to which Section 332 of the Internal Revenue Code applies, except as provided in regulations prescribed by the Franchise Tax Board, both of the following shall apply:

(A) Sections 337(a) and 337(b)(1) of the Internal Revenue Code shall not apply, where the 80 percent distributee is an insurer.

(B) Where the distributor is an insurer, the distributee shall treat the distribution as a distribution from the insurer's earnings and profits, to the extent thereof.

(3) For purposes of the preceding paragraph, the deemed distribution from earnings and profits shall be treated as if actually distributed as a dividend.

(i) For purposes of this section, the following definitions shall apply:

(1) An insurer is any insurer within the meaning of Section 28 of Article XIII of the California Constitution, whether or not the insurer is engaged in business in California.

(2) The phrase “commonly controlled group” shall have the same meaning as that phrase has under Section 28105.

(3) The phrase “combined reporting group” means those corporations whose income is required to be included in the same combined report pursuant to Section 28101 or 28110.

(j) The Franchise Tax Board may prescribe any regulations that may be appropriate to carry out the purpose of this section, which purpose is to prevent the removal of gain inherent in property at the time of a transfer from taxation under this part. Those regulations may provide for appropriate adjustments to the amount of deferred income described in subdivision (b) to avoid the double inclusion of income for situations, including but not limited to, the property transferred to an insurer member of the commonly controlled group is later acquired by a noninsurer member of the taxpayer’s combined reporting group.

(k) Upon an adequate showing by a taxpayer that a transaction referred to in subdivision (a) or (h) would not violate the purposes of this section to prevent the removal of gain inherent in property at the time of a transfer from taxation under this part, the Franchise Tax Board may grant relief from the application of this section. In an appeal filed with the State Board of Equalization, or an action filed under Section 19382 or 19385, the State Board of Equalization or the court, as the case may be, shall have jurisdiction to grant that relief only upon a specific finding that the transfer did not remove gain inherent in property at the time of transfer from taxation under this part.

(l) This section applies to transactions entered into on or after January 1 through June 23, 2004, or transactions entered into after June 23, 2004, pursuant to a binding written contract in existence on June 23, 2004. For purposes of this subdivision, transactions entered into on or after June 23, 2004, that were given final approval by a regulatory insurance commissioner before June 23, 2004, shall be considered a transaction entered into before June 23, 2004, pursuant to a binding written contract in existence on June 23, 2004.

27913. Section 381(c) of the Internal Revenue Code, relating to items of the distributor or transferor corporation, is modified to provide that, in lieu of paragraph (24), relating to credit under Section 38, and paragraph (25), relating to credit under Section 53, the acquiring corporation shall take into account (to the extent proper to carry out the purposes of Section 381 of the Internal Revenue Code) the items required to be taken into account for purposes of each credit allowable under this part with respect to the distributor or transferor corporation.

27914. Section 383 of the Internal Revenue Code, relating to special limitations on certain excess credits, etc., is modified to apply to credits allowable under Chapter 5 (commencing with Section 27801).

Article 4. Accounting Periods and Methods of Accounting

27921. (a) Receipts shall be computed on the basis of the taxpayer's taxable year.

(b) For purposes of this part, the term "taxable year" means any of the following:

(1) The taxpayer's annual accounting period, if it is a calendar year or a fiscal year.

(2) The calendar year, if subdivision (g) applies.

(3) The period for which the return is made, if a return is made for a period of less than 12 months.

(c) For purposes of this part, the term "annual accounting period" means the annual period on the basis of which the taxpayer regularly computes its receipts in keeping its books.

(d) For purposes of this part, the term "calendar year" means a period of 12 months ending on December 31.

(e) For purposes of this part, the term "fiscal year" means a period of 12 months ending on the last day of any month other than December. In the case of any taxpayer who has made the election provided by subdivision (f), the term means the annual period (varying from 52 to 53 weeks) so elected.

(f) (1) A taxpayer who, in keeping its books, regularly computes its receipts on the basis of an annual period which varies from 52 to 53 weeks and ends always on the same day of the week and ends always:

(A) On whatever date such same day of the week last occurs in a calendar month.

(B) On whatever date such same day of the week falls which is nearest to the last day of a calendar month, may (in accordance with the regulations prescribed under paragraph (3)) elect to compute its receipts for purposes of this part on the basis of such annual period.

(2) (A) In any case in which the effective date or the applicability of any provision of this part is expressed in terms of taxable years beginning or ending with reference to a specified date which is the first or last day of a month, a taxable year described in paragraph (1) shall be treated as either of the following:

(i) As beginning with the first day of the calendar month beginning nearest to the first day of such taxable year.

(ii) As ending with the last day of the calendar month ending nearest to the last day of such taxable year, as the case may be.

(B) In the case of a change from or to a taxable year described in paragraph (1):

(i) If such change results in a short period (within the meaning of Section 27924) of 359 days or more, or less than seven days, Section 27926 shall not apply.

(ii) If such change results in a short period of less than seven days, such short period shall, for purposes of this part, be added to and deemed a part of the following taxable year.

(iii) If such change results in a short period to which Section 24634 applies, the income for such short period shall be placed on an annual basis for purposes of such subsection by multiplying such income by 365 and dividing the result by the number of days in a short period, and the tax shall be the same part of the tax computed on the annual basis as the number of days in the short period is of 365 days.

(3) The Franchise Tax Board shall prescribe those regulations as it deems necessary for the application of this subsection.

(g) Except as provided in Section 27924 (relating to returns for periods of less than 12 months), the taxpayer's taxable year shall be the calendar year if any of the following applies:

- (1) The taxpayer keeps no books.
- (2) The taxpayer does not have an annual accounting period.
- (3) The taxpayer has an annual accounting period, but such period does not qualify as a fiscal year.

27922. The taxable year of a taxpayer may not be different than the taxable year used for purposes of the Internal Revenue Code, unless initiated or approved by the Franchise Tax Board, or otherwise required under Section 27924.

27923. If a taxpayer changes its annual accounting period, the new accounting period shall become the taxpayer's taxable year only if the change is approved by the Franchise Tax Board. For purposes of this part, if a taxpayer to whom subdivision (g) of Section 27921 applies adopts an annual accounting period (as defined in subdivision (c) of Section 27921) other than a calendar year, the taxpayer shall be treated as having changed its annual accounting period.

27924. (a) A return for a period of less than 12 months (referred to in this article as "short period") shall be made under any of the following circumstances:

- (1) When the taxpayer, with the approval of the Franchise Tax Board, changes its annual accounting period. In such a case, the return shall be made for the short period beginning on the day after the close of the former taxable year and ending at the close of the day before the day designated as the first day of the new taxable year.

(2) When the taxpayer is in existence during only part of what would otherwise be its taxable year, except if the taxpayer's existence terminates as a result of a reorganization described in Section 368(a)(1)(F) of the Internal Revenue Code.

(3) When the Franchise Tax Board terminates the taxpayer's taxable year under Sections 19081 and 19082 (relating to tax in jeopardy).

(4) When the taxpayer is required to make a federal return for a period of less than 12 months.

(b) This section shall apply whether or not a federal return is required to be filed for a period of less than 12 months.

(c) If a return is required to be filed under this section for a period of less than 12 months, that period shall be deemed to be a taxable year.

27926. (a) If a separate return is made by a taxpayer under Section 27924 on account of a change in the accounting period, the net receipts computed on the basis of the period for which the separate return is made, referred to in this section as "the short period," shall be placed on an annual basis by multiplying the amount thereof by 12, and dividing by the number of months in the short period. The Franchise Tax Board shall compute the amount of a tax on the receipts placed on such annual basis. The tax due under this section shall be such part of the tax computed on such annual basis as the number of months in the short period is of 12 months.

(b) If a taxpayer subject to the tax imposed by Chapter 2 establishes the amount of its net receipts for the period of 12 months beginning with the first day of the short period, computed as if such 12-month period were a taxable year, under the law applicable to such year, then the tax for the short period shall be reduced to an amount

which is such part of the tax computed on the net receipts for such 12-month period as the net receipts computed on the basis of the short period is of the net receipts for the 12-month period. The taxpayer (other than a taxpayer to which the next sentence applies) shall compute the tax and file its return without the application of this section. If the taxpayer has disposed of substantially all its assets prior to the end of such 12-month period, then in lieu of the net receipts for such 12-month period there shall be used for the purposes of this section the net receipts for the 12-month period ending with the last day of the short period. The tax computed under this section shall in no case be less than the tax computed on the net receipts for the short period without placing such receipts on an annual basis. The benefits of this section shall not be allowed unless the taxpayer, at such time as regulations prescribed hereunder require (but not after the time prescribed for the filing of the return for the first taxable year which ends on or after 12 months after the beginning of the short period), makes application therefor in accordance with such regulations. Such application, in case the return was filed without regard to this section, shall be considered a claim for credit or refund with respect to the amount by which the tax is reduced under this section. The Franchise Tax Board shall prescribe such regulations as it may deem necessary for the application of this section.

27927. Section 444 of the Internal Revenue Code, relating to election of taxable year other than required taxable year, shall be applicable, except that Section 444(c)(1), relating to effect of election, shall not apply.

Article 5. Methods of Accounting

27931. (a) Receipts shall be computed under the method of accounting on the basis of which the taxpayer regularly computes its receipts in keeping its books.

(b) If no method of accounting has been regularly used by the taxpayer, or if the method used does not clearly reflect receipts, the computation of receipts shall be made under such method as, in the opinion of the Franchise Tax Board, does clearly reflect receipts.

(c) Subject to subdivisions (a) and (b) and Section 27974, a taxpayer may compute receipts under any of the following methods of accounting:

- (1) The cash receipts and disbursements method.
- (2) An accrual method.
- (3) Any other method permitted by this part.
- (4) Any combination of the foregoing methods permitted under regulations prescribed by the Franchise Tax Board.

(d) A taxpayer engaged in more than one trade or business may, in computing receipts, use a different method of accounting for each trade or business.

(e) Except as otherwise expressly provided in this part, a taxpayer who changes the method of accounting on the basis of which it regularly computes its receipts in keeping its books shall, before computing its receipts under the new method, secure the consent of the Franchise Tax Board.

(f) If the taxpayer does not file with the Franchise Tax Board a request to change the method of accounting, the absence of the consent of the Franchise Tax Board to a change in the method of accounting shall not be taken into account for either of the following:

(1) To prevent the imposition of any penalty, or the addition of any amount to tax, under this part.

(2) To diminish the amount of that penalty or addition to tax.

27932. Section 447 of the Internal Revenue Code, relating to method of accounting for corporations engaged in farming, shall apply, except as otherwise provided.

27934. Section 448 of the Internal Revenue Code, relating to limitation on use of cash method of accounting, shall apply, except as otherwise provided.

Article 6. Year of Inclusion

27941. Section 451 of the Internal Revenue Code, relating to the general rule for taxable year of inclusion, shall apply, except as otherwise provided.

27942. Where a business entity subject to the tax imposed by Chapter 2 is engaged in the performance of a contract in this state which will require more than a year to complete, the Franchise Tax Board may require that the gross receipts from the contract be reported on the basis of percentage of completion unless the business entity furnishes bond or other security guaranteeing the payment of a tax measured by the gross receipts received on the completion of the contract even though the business entity is not doing business in this state in the year subsequent to the year of completion.

27943. (a) Section 460 of the Internal Revenue Code, relating to special rules for long-term contracts, shall apply, except as otherwise provided.

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

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

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

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

(d) (1) The amendments to Section 460 of the Internal Revenue Code made by Section 5041 of Public Law 100-647, relating to a reduction in the percentage of items taken into account under the completed contract method, shall apply to each taxable year beginning on or after January 1, 1990.

(2) In the case of a contract entered into after June 20, 1988, during a taxable year beginning before January 1, 1990, an adjustment to income shall be made upon

completion of the contract, if necessary, to correct any underreporting or overreporting of income, for purposes of this part, resulting from differences between state and federal law for each taxable year beginning prior to January 1, 1990.

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

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

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

27944. Section 461 of the Internal Revenue Code, relating to the general rule for taxable year of deduction of purchases, shall apply, except as otherwise provided.

27945. Section 481 of the Internal Revenue Code, relating to adjustments required by changes in method of accounting, shall apply, except as otherwise provided.

27946. The provisions of Section 482 of the Internal Revenue Code, relating to allocation of income and deductions among taxpayers, shall be applicable, except as provided in Article 2 (commencing with Section 28110) of Chapter 7.

Article 7. Regulated Investment Companies, Real Estate Investment Trusts, and Real Estate Mortgage Investment Trusts

27950. Subchapter M of Chapter 1 of Subtitle A of the Internal Revenue Code, relating to regulated investment companies, real estate investment trusts, real estate mortgage investment conduits, and financial asset securitization investment trusts, shall apply, except as otherwise provided in this part.

27951. Section 852(b)(1) of the Internal Revenue Code, relating to imposition of tax on regulated investment companies, does not apply.

27952. (a) A real estate investment trust shall be deemed to have satisfied the distribution requirements of Section 857(a)(1) of the Internal Revenue Code for purposes of this part if it satisfies the distribution requirements of Section 857(a)(1) of the Internal Revenue Code for federal purposes.

(b) (1) Section 857(b)(1) of the Internal Revenue Code, relating to imposition of tax on real estate investment trusts, shall not apply.

(2) Every real estate investment trust shall be subject to the taxes imposed under Chapter 2 (commencing with Section 27151).

(c) Section 857(b)(4)(A) of the Internal Revenue Code, relating to the imposition of tax on income from foreclosure property, shall not apply.

(d) Section 857(b)(5) of the Internal Revenue Code, relating to the imposition of tax in case of failure to meet certain requirements, shall not apply.

(e) Section 857(b)(6)(A) of the Internal Revenue Code, relating to the imposition of tax on income from prohibited transactions, shall not apply.

(f) Section 857(b)(7) of the Internal Revenue Code, relating to income from redetermined rents, redetermined deductions, and excess interest, shall not apply.

(g) (1) A corporation, trust, or association that is a real estate investment trust for any taxable year for federal purposes under Part II (commencing with Section 856) of Subchapter M of Chapter 1 of Subtitle A of the Internal Revenue Code (as applicable for federal purposes for the taxable year) shall be a real estate investment trust for purposes of this part for the same taxable year.

(2) A corporation, trust, or association that is not a real estate investment trust for any taxable year for federal purposes under Part II (commencing with Section 856) of Subchapter M of Chapter 1 of Subtitle A of the Internal Revenue Code (as applicable for federal purposes for the taxable year) shall not be a real estate investment trust for purposes of this part for the same taxable year.

(h) (1) An election to be a real estate investment trust for federal purposes under Section 856(c)(1) of the Internal Revenue Code (as applicable for federal purposes for the taxable year) shall be treated, for purposes of Part 10 (commencing with Section 17001), Part 10.2 (commencing with Section 18401), and this part, as an election to be a real estate investment trust for state purposes for the same taxable year and a separate election shall not be allowed.

(2) The termination or revocation of an election described in paragraph (1) for federal purposes under Section 856(g) of the Internal Revenue Code (as applicable for federal purposes for the taxable year) shall be treated, for purposes of Part 10 (commencing with Section 17001), Part 10.2 (commencing with Section 18401), and this part, as a termination or revocation, as the case may be, of an election described in paragraph (1) for state purposes and a separate termination or revocation of an election shall not be allowed.

27953. Section 860F(a) of the Internal Revenue Code, relating to the 100 percent tax on prohibited transactions, shall not apply.

27954. (a) Section 860H(b) of the Internal Revenue Code, relating to the taxation of holder of ownership interest, shall be modified as follows:

(1) All activities of a FASIT shall be treated as activities, including for purposes of Section 27101, of the holder of the ownership interest in the FASIT.

(2) Section 860H(b)(3) of the Internal Revenue Code, shall not apply.

(b) Section 860J(d) of the Internal Revenue Code, relating to affiliated groups, shall not apply.

(c) A reference to the “rate of tax specified in Section 27151” shall be substituted for “highest rate of tax specified in Section 11(b)(1)” of the Internal Revenue Code, contained in Section 860K of the Internal Revenue Code, relating to treatment of transfers of high-yield interests to disqualified holders.

(d) Section 860L(b)(1)(A) of the Internal Revenue Code is modified by substituting the phrase “on or after the startup date” for the phrase “after the startup date.”

(e) Section 860L(d)(2) of the Internal Revenue Code is modified by substituting a reference to Section 860I(b)(2) of the Internal Revenue Code in lieu of the reference to Section 860I(c)(2) of the Internal Revenue Code.

(f) Section 860L(e) of the Internal Revenue Code, relating to tax on prohibited transactions, shall not apply.

(g) For purposes of Chapter 4 of Part 10.2 (commencing with Section 19001) the taxes imposed by this section shall be treated as taxes to which the deficiency procedures of that article apply.

Article 8. Gain or Loss on Disposition of Property

27961. (a) The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in Section 27971 for determining gain, and the loss shall be the excess of the adjusted basis provided in that section for determining loss over the amount realized.

(b) The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received. In determining the amount realized:

(1) There shall not be taken into account any amount received as reimbursement for real property taxes.

(2) There shall be taken into account amounts representing real property taxes.

(c) In the case of a sale or exchange of property, the extent to which the gain or loss determined under this section shall be recognized for purposes of this part shall be determined under Section 27962.

(d) Nothing in this section shall be construed to prevent (in the case of property sold under contract providing for payment in installments) the taxation of that portion of any installment payment representing gain or profit in the year in which that payment is received.

(e) (1) In determining gain or loss from the sale or other disposition of a term interest in property, that portion of the adjusted basis of that interest which is determined pursuant to Sections 27974 and 27975 (to the extent that the adjusted basis is a portion of the entire adjusted basis of the property) shall be disregarded.

(2) For purposes of paragraph (1), the term “term interest in property” means any of the following:

- (A) A life interest in property.
- (B) An interest in property for a term of years.
- (C) An income interest in a trust.

(3) Paragraph (1) shall not apply to a sale or other disposition which is a part of a transaction in which the entire interest in property is transferred to any person or persons.

27962. On the sale or exchange of property, the following rules shall apply:

(a) In the case of the sale or exchange of property acquired prior to January 1, 2012, the entire amount of the gain or loss, determined under Section 27961, shall be recognized and included in gross receipts.

(b) In the case of the sale or exchange of property acquired after December 31, 2011, the entire amount of money or other property received shall be included in gross receipts.

27965. (a) Section 988 of the Internal Revenue Code, relating to treatment of certain foreign currency transactions, shall apply, except as otherwise provided.

(b) Section 988(a)(3) of the Internal Revenue Code, relating to source, shall not apply.

Article 9. Basis for Computation of Gain or Loss

27971. The adjusted basis for determining the gain or loss from the sale or other disposition of property acquired prior to January 1, 2012, shall be the basis (determined under Section 27912) or other applicable sections of Article 8 (relating to gain or loss on disposition of property) and Article 3 (relating to corporate distributions and adjustments), adjusted as provided in Sections 27976 and 27977.

27972. The basis of property shall be the cost of the property, except as otherwise provided in Chapter 8 (commencing with Section 27911), relating to corporate distributions and adjustments, and this chapter. The cost of real property shall not include any amount in respect of real property taxes which are treated as imposed on a taxpayer.

27973. If the property should have been included in the last inventory, the basis shall be the last inventory value thereof.

27974. (a) If the property was acquired by gift after December 31, 1920, the basis shall be the same as it would be in the hands of the donor or the last preceding owner by whom it was not acquired by gift, except that if such basis (adjusted for the period before the date of the gift as provided in Sections 27976 and 27977) is greater than the fair market value of the property at the time of the gift, then for the purpose of determining loss the basis shall be such fair market value. If the facts necessary to determine the basis in the hands of the donor or the last preceding owner are unknown to the donee, the Franchise Tax Board shall, if possible, obtain such facts from such donor or last preceding owner, or any other person cognizant thereof. If the Franchise Tax Board finds it impossible to obtain such facts, the basis in the hands of such donor or last preceding owner shall be the fair market value of such property as found by the Franchise Tax Board as of the date or approximate date at which, according to the best information that the Franchise Tax Board is able to obtain, such property was acquired by such donor or last preceding owner.

(b) If the property was acquired after December 31, 1920, by a transfer in trust (other than by a transfer in trust by a gift, bequest, or devise), the basis shall be the same as it would be in the hands of the grantor increased in the amount of gain or decreased in the amount of loss recognized to the grantor on such transfer under the law applicable to the year in which the transfer was made.

27975. (a) If the property is acquired by gift on or after the date of the enactment of this section, the basis shall be the basis determined under Section 27974, increased (but not above the fair market value of the property at the time of the gift) by the amount of federal gift tax paid with respect to such gift or the property was acquired by gift

before the date of the enactment of this section and has not been sold, exchanged, or otherwise disposed of before such date, the basis of the property shall be increased on such date by the amount of federal gift tax paid with respect to such gift, but such increase shall not exceed an amount equal to the amount by which the fair market value of the property at the time of the gift exceeded the basis of the property in the hands of the donor at the time of the gift.

(b) For purposes of subdivision (a), the amount of federal gift tax paid with respect to any gift is an amount which bears the same ratio to the amount of gift tax paid under Chapter 12 of Subtitle B of the Internal Revenue Code with respect to all gifts made by the donor for the calendar year in which such gift is made as the amount of such gift bears to the taxable gifts (as defined in Section 2503(a) of the Internal Revenue Code but computed without the deduction allowed by Section 2521 of the Internal Revenue Code) made by the donor during such calendar year. For purposes of the preceding sentence, the amount of any gift shall be the amount included with respect to such gift in determining (for the purposes of Section 2503(a) of the Internal Revenue Code) the total amount of gifts made during the calendar year, reduced by the amount of any deduction allowed with respect to such gift under Section 2522 of the Internal Revenue Code (relating to charitable deduction) or under Section 2523 of the Internal Revenue Code (relating to marital deduction).

(c) For purposes of subdivision (a), where the donor and his or her spouse elected, under Section 2513 of the Internal Revenue Code to have the gift considered as made one-half by each, the amount of gift tax paid with respect to such gift under Chapter 12 of Subtitle B of the Internal Revenue Code shall be the sum of the amounts of tax

paid with respect to each half of such gift (computed in the manner provided in subdivision (b)).

(d) For purposes of Section 27977, an increase in basis under subdivision (a) shall be treated as an adjustment under Section 27976.

(e) With respect to any property acquired by gift before 1955, references in this section to any provision of this part shall be deemed to refer to the corresponding provision of the Internal Revenue Code or prior revenue laws which was effective for the year in which such gift was made.

27976. In the case of any property acquired prior to January 1, 2012, proper adjustment with regard to the property shall in all cases be made as follows:

(a) For expenditures, receipts, losses, or other items properly chargeable to capital account.

(b) For exhaustion, wear and tear, obsolescence, amortization, and depletion:

(1) In the case of taxpayers subject to the tax imposed by Chapter 2 (commencing with Section 27101), to the extent sustained prior to January 1, 1928, and to the extent allowed (but not less than the amount allowable) under this part, except that no deduction shall be made for amounts in excess of the amount that would have been allowable had depreciation not been computed on the basis of January 1, 1928, value and amounts in excess of the adjustments required by Section 113(b)(1)(B) of the Federal Revenue Act of 1938 for depletion prior to January 1, 1932.

(2) In the case of a taxpayer subject to the tax imposed by Chapter 3 (commencing with Section 27501), to the extent sustained prior to January 1, 1937, and for periods

thereafter to the extent allowed (but not less than the amount allowable) under the provisions of this part.

(3) If a taxpayer has not claimed an amortization deduction for an emergency facility, the adjustment under paragraph (1) shall be made only to the extent ordinarily provided.

(c) In the case of stock (to the extent not provided for in the foregoing subdivisions) for the amount of distributions previously made which, under the law applicable to the year in which the distribution was made, either were tax free or were applicable in reduction of basis (not including distributions made by a corporation, which was classified as a personal service corporation under the provisions of the Federal Revenue Act of 1918 or 1921, out of its earnings or profits which were taxable in accordance with the provisions of Section 218 of the Federal Revenue Act of 1918 or 1921).

(d) (1) In the case of corporations subject to the tax imposed by Chapter 2 (commencing with Section 27101), in the case of any bond, to the extent of the deductions allowable with respect thereto.

(2) In the case of taxpayers subject to the tax imposed by Chapter 3 (commencing with Section 27501), in the case of any bond, the interest on which is wholly exempt from the tax imposed by this part, to the extent of the amortizable bond premium disallowable as a deduction, and in the case of any other bond, to the extent of the deductions allowable with respect thereto.

(3) In the case of property pledged to the Commodity Credit Corporation, to the extent of the amount received as a loan from the Commodity Credit Corporation and

treated by the taxpayer as a gross receipt for the year in which received, and to the extent of any deficiency on that loan with respect to which the taxpayer has been relieved from liability.

(e) For amounts allowed as deductions as deferred expenses under Section 616(b) of the Internal Revenue Code, relating to certain expenditures in the development of mines, and resulting in a reduction of the taxpayer's tax, but not less than the amounts allowable under that section for the taxable year and prior years.

(f) For amounts allowable as deductions as deferred expenses under Section 617(a) of the Internal Revenue Code, relating to certain exploration expenditures, and resulting in a reduction of the taxpayer's tax, but not less than the amounts allowable under that section for the taxable year and prior years.

(g) For amounts allowed as deductions as deferred expenses, relating to research and experimental expenditures, and resulting in a reduction of the corporation's taxes under this part, but not less than the amounts allowable under that section for the taxable year and prior years.

(h) (1) To the extent provided in Section 179A(e)(6)(A) of the Internal Revenue Code, relating to basis reduction for clean-fuel vehicles and certain refueling property.

(2) This subdivision shall apply to property placed in service after June 30, 1993, without regard to taxable year.

(i) In the case of property the acquisition of which resulted under Section 1044 of the Internal Revenue Code, relating to rollover of publicly traded securities gain into specialized small business investment companies, in the nonrecognition of any

part of the gain realized on the sale of other property, to the extent provided in Section 1044(d) of the Internal Revenue Code, relating to basis adjustments.

27976.2. Notwithstanding the provisions of Section 27976, no adjustment shall be made for (a) abandonment fees paid in respect of property on which the open-space easement is terminated under Section 51061 or 51093 of the Government Code or (b) tax recoupment fees paid under Section 51142 of the Government Code.

27977. Whenever it appears that the basis of property in the hands of the corporation is a substituted basis, then the adjustments provided in Section 27976 shall be made after first making in respect of that substituted basis proper adjustments of a similar nature in respect of the period during which the property was held by the transferor, donor, or grantor, or during which the other property was held by the person for whom the basis is to be determined. A similar rule shall be applied in the case of a series of substituted bases.

27978. (a) Section 1017 of the Internal Revenue Code, relating to discharge of indebtedness, shall apply, except as otherwise provided.

(b) References to affiliated groups which file a consolidated return under Section 1501 of the Internal Revenue Code shall be treated as meaning members of the same unitary group which file a combined report under Article 1 (commencing with Section 28101) of Chapter 7.

27979. Neither the basis nor the adjusted basis of any portion of real property shall, in the case of the lessor of such property, be increased or diminished on account of income derived by the lessor in respect of such property and excludable from gross income under Section 24309 (relating to improvements by lessee on lessor's property).

If an amount representing any part of the value of real property attributable to buildings erected or other improvements made by a lessee in respect of such property was included in gross income of the lessor for any taxable year beginning before January 1, 1942, the basis of each portion of such property shall be properly adjusted for the amount so included in gross income.

Article 10. Exchanges and Special Rules

27981. Part III of Subchapter O of Chapter 1 of Subtitle A of the Internal Revenue Code, relating to common nontaxable exchanges, shall not apply.

27982. If the basis of an asset acquired by a taxpayer before the operative date of this part is relevant for determining the tax imposed under this part, the basis of that asset, as of the last day of the last taxable year of that taxpayer subject to Part 11 (commencing with Section 23001) shall be the basis of that asset, as of the first day of the first taxable year of the taxpayer subject to this part.

27983. Section 1060 of the Internal Revenue Code, relating to special allocation rules for certain asset acquisitions, shall apply, except as otherwise provided.

27988. Subchapter P of Chapter 1 of Subtitle A of the Internal Revenue Code, relating to capital gains and losses, shall apply, except as otherwise provided.

CHAPTER 7. ALLOCATION OF BUSINESS NET RECEIPTS

Article 1. Basis of Allocation

28101. When the net receipts of a taxpayer subject to the tax imposed under this part is derived from or attributable to sources both within and without this state, the tax shall be measured by the net receipts derived from or attributable to sources within this state in accordance with the provisions of Article 3 (commencing with Section 28120). If the Franchise Tax Board reapportions net receipts upon its examination of any return, it shall, upon the written request of the taxpayer, disclose to it the basis upon which its reapportionment has been made.

28101.15. If the net receipts of two or more taxpayers derived solely from sources within this state and their business activities are such that if conducted within and without this state a combined report would be required to determine their business net receipts derived from sources within this state, then such taxpayers shall be allowed to determine their business net receipts in accordance with Section 28101.

28102. In the case of two or more persons, as defined in Section 19 of this code, owned or controlled directly or indirectly by the same interests, the Franchise Tax Board may permit or require the filing of a combined report and such other information as it deems necessary and is authorized to impose the tax due under this part as though the combined entire net receipts was that of one person, or to distribute, apportion, or allocate the gross receipts or purchases between or among such persons, if it determines that such consolidation, distribution, apportionment, or allocation is necessary in order to reflect the proper net receipts of any such persons.

28103. In the case of a business entity doing business within the meaning of this part, whether under agreement or otherwise, in such manner as either directly or indirectly to benefit the owners of the business entity, or any of them, or any person

or persons, directly or indirectly interested in such business, by rendering services of any nature whatsoever, or acquiring or disposing of its products or the goods or commodities in which it deals, at less than a fair price therefor, the Franchise Tax Board, in order to prevent evasion of taxes or clearly to reflect the net receipts of such corporation, may require a report of such facts as it deems necessary, and may determine the amount which shall be deemed to be the entire net receipts allocable or apportionable to this state of the business of such business entity for the calendar or fiscal year, and compute the tax upon such net receipts. In determining the entire net receipts, the Franchise Tax Board shall have regard to the fair profits which, but for any agreement, arrangement, or understanding, might be or could have been obtained from dealing in such products, goods, or commodities.

28104. In the case of a business entity liable to report under this part owning or controlling, either directly or indirectly, another business entity, or other business entities, and in the case of a business entity liable to report under this part and owned or controlled, either directly or indirectly, by another business entity, the Franchise Tax Board may require a consolidated report showing the combined net receipts or such other facts as it deems necessary. The Franchise Tax Board is authorized and empowered, in such manner as it may determine, to assess the tax against either of the business entities whose net receipts is involved in the report upon the basis of the combined entire net receipts and such other information as it may possess, or it may adjust the tax in such other manner as it shall determine to be equitable if it determines it to be necessary in order to prevent evasion of taxes or to clearly reflect the net receipts earned by said business entity or business entities from business done in this state.

28105. (a) For purposes of this article, other than Section 28102, the net receipts and sales factors of two or more business entities shall be included in a combined report only if the business entity, otherwise meeting the requirements of Section 28101 or 28101.15, are members of a commonly controlled group.

(b) For purposes of this section, the words “common controlled group” shall mean that more than 50 percent of the voting control of each member of the group is directly or indirectly owned by a common owner or owners, either corporate or noncorporate, whether or not the owner or owners are members of the combined group. A group of corporations under common ownership may be engaged in one or more unitary businesses.

(c) Any business conducted by a partnership shall be treated as the business of the partners, whether the partnership interest is directly held or indirectly held through a series of partnerships, to the extent of the partner’s distributive share of the partnership’s income, regardless of the magnitude of the partner’s ownership interest or its distributive share of partnership income.

(d) A business conducted directly or indirectly by one corporation is unitary with that portion of a business conducted by another, commonly owned corporation through its direct or indirect interest in a partnership if the activities conducted by the former corporation and the partnership are unitary, regardless of the magnitude of the partner’s ownership interest or its distributive or any other share of partnership income.

28105.5. The Franchise Tax Board may adopt regulations necessary to ensure that the tax liability or net receipts of any taxpayer whose net receipts derived from or attributable to sources within this state which is required to be determined by a combined

report pursuant to Section 28101 or 28110 of this chapter, and of each entity included in the combined report, both during and after the period of inclusion in the combined report is properly reported, determined, computed, assessed, collected, or adjusted.

Article 2. Water's-Edge Combined Reporting

28110. (a) Business entities that comprise a unitary business shall file a combined report on a water's-edge basis.

(b) The term "unitary business" shall mean the activities of a group of two or more entities under common control that are sufficiently interdependent, integrated, or interrelated through their activities so as to provide mutual benefit and produce a significant sharing or exchange of value among them or a significant flow of value between the separate parts. The term unitary business shall be construed to the broadest extent permitted under the United States Constitution.

(c) A taxpayer that is a member of a water's-edge group shall combine the business net receipts of each business entity in the group, so as to allow the offset of the excess business purchases (from other businesses) of one entity against the net business receipts of another entity in the same group.

(d) A taxpayer that is a member of a water's-edge group shall take into account the net receipts and sales factor of the following affiliated entities to the extent provided below:

(1) The entire business net receipts and single sales factor of any of the following:

(A) Domestic international sales corporations, as described in Sections 991 to 994, inclusive, of the Internal Revenue Code and foreign sales corporations as described in Sections 921 to 927, inclusive, of the Internal Revenue Code.

(B) Any corporation or other business entity (other than a bank), regardless of the place where it is incorporated if the average of its property, payroll, and sales factors within the United States is 20 percent or more.

(C) Corporations and other business entities that are incorporated or formed in the United States, excluding corporations making an election pursuant to Sections 931 to 936, inclusive, of the Internal Revenue Code.

(D) Export trade corporations, as described in Sections 970 to 972, inclusive, of the Internal Revenue Code.

(E) (i) Subject to clause (ii), any business entity that, for any portion of the taxable year, has business net receipts derived from or attributable to, a tax haven.

(ii) If the application of subparagraph (A) results in the inclusion of a business activity in, or business net receipts derived from or attributable to, a tax haven that constitutes either a substantial economic presence or significant economic activity in that jurisdiction, the taxpayer may petition the Franchise Tax Board to treat the activity and business net receipts of that corporation as not having been conducted in, or derived from or attributable to, the tax haven.

(iii) The Franchise Tax Board shall prescribe any regulation that may be necessary or appropriate to carry out the purposes of this subparagraph, including regulations prescribing the extent to which an activity in, or business net receipts derived from or attributable to, a tax haven will be presumed to be either a substantial economic presence

or significant economic activity, and the extent to which business net receipts will be presumed to be not derived from or attributable to a tax haven.

(2) With respect to a business entity that is not described in subparagraphs (A), (B), (C), and (D) of paragraph (1):

(A) The business net receipts and single sales factor of such business entity to the extent of its business net receipts derived from or attributable to sources within the United States and its single sales factor assignable to a location within the United States in accordance with paragraph (2) of subdivision (d). The business net receipts of a business entity are derived from or attributable to sources within the United States if the related gross income is derived from or attributable to sources within the United States as determined by federal income tax laws.

(B) Any business entity that earns more than 20 percent of its receipts, directly or indirectly, from intangible property or service related activities that are deductible against the business receipts of other members of the combined group, to the extent of those receipts and the apportionment factors related thereto.

(3) For purposes of this section, a “tax haven” means any of the 39 jurisdictions that, as of December of ____, were identified as tax havens by the Organization for Economic Cooperation and Development (OECD).

28114. (a) The Franchise Tax Board, for purposes of administering this article, may examine all returns filed by taxpayers subject to these provisions.

(b) (1) In the case of any transfer, or license, of intangible property, within the meaning of Section 936(h)(3)(B) of the Internal Revenue Code, the net receipts with

respect to that transfer or license shall be commensurate with the net receipts attributable to the intangible property.

(2) In making distributions, apportionments, and allocations under this section, the Franchise Tax Board shall generally follow the rules, regulations, and procedures of the Internal Revenue Service in making audits under Section 482 of the Internal Revenue Code. Any of these rules, regulations, and procedures adopted by the Franchise Tax Board shall not be subject to review by the Office of Administrative Law.

(3) If the Internal Revenue Service has conducted a detailed audit pursuant to Section 482 of the Internal Revenue Code or Subchapter N of Chapter 1 of Subtitle A of the Internal Revenue Code and has made adjustments pursuant to those provisions, it shall be presumed, to the extent that the provisions relate to the determination of the amount of net receipts and amounts in the sales factor required to be taken into account pursuant to Section 28110, that no further adjustments are necessary for this state's purposes. If the Internal Revenue Service has conducted a detailed audit pursuant to Section 482 of the Internal Revenue Code or Subchapter N of Chapter 1 of Subtitle A of the Internal Revenue Code and has made or proposed no adjustments to the transactions examined, it shall be presumed, to the extent that the provisions relate to the determination of the amount of net receipts and amounts in the sales factor required to be taken into account pursuant to Section 28110, that no adjustment is necessary for this state's purposes. These presumptions apply to all Internal Revenue Service audit determinations, including determinations made by the Appeals and Competent Authority. These presumptions shall be overcome if the Franchise Tax Board or the taxpayer demonstrates that an adjustment or a failure to make an adjustment was

erroneous, if it demonstrates that the results of such an adjustment would produce a minimal tax change for federal purposes because of correlative or offsetting adjustments or for other reasons, or if substantially the same federal tax result was obtained under other sections of the Internal Revenue Code. No inference shall be drawn from an Internal Revenue Service failure to audit international transactions pursuant to Section 482 of the Internal Revenue Code or Subchapter N of Chapter 1 of Subtitle A of the Internal Revenue Code and it shall not be presumed that any of those transactions were correctly reported.

Article 3. Allocation and Apportionment of Net Receipts

28120. As used in Sections 28120 to 28139, inclusive, unless the context otherwise requires:

(a) “Business receipts” means receipts arising from transactions and activity in the regular course of the taxpayer’s trade or business and includes receipts from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer’s regular trade or business operations.

(b) “Commercial domicile” means the principal place from which the trade or business of the taxpayer is directed or managed.

(c) “Compensation” means wages, salaries, commissions, and any other form of remuneration paid to employees for personal services.

(d) “Nonbusiness receipts” means all receipts other than business receipts.

(e) (1) “Sales” means all gross receipts of the taxpayer not allocated under Sections 28123 to 28127, inclusive.

(2) “Gross receipts” means the gross amounts realized (the sum of money and the fair market value of other property or services received) on the sale or exchange of property, the performance of services, or the use of property or capital (including rents, royalties, interest, and dividends) in a transaction that produces business income, in which the income, gain, or loss is recognized (or would be recognized if the transaction were in the United States) under the Internal Revenue Code, as applicable for purposes of this part. Amounts realized on the sale or exchange of property shall not be reduced by the cost of goods sold or the basis of property sold. Gross receipts, even if business income, shall not include the following items:

(A) Repayment, maturity, or redemption of the principal of a loan, bond, mutual fund, certificate of deposit, or similar marketable instrument.

(B) The principal amount received under a repurchase agreement or other transaction properly characterized as a loan.

(C) Proceeds from issuance of the taxpayer’s own stock or from sale of treasury stock.

(D) Damages and other amounts received as the result of litigation.

(E) Property acquired by an agent on behalf of another.

(F) Tax refunds and other tax benefit recoveries.

(G) Pension reversions.

(H) Contributions to capital (except for sales of securities by securities dealers).

(I) Income from discharge of indebtedness.

(J) Amounts realized from exchanges of inventory that are not recognized under the Internal Revenue Code.

(K) Amounts received from transactions in intangible assets held in connection with a treasury function of the taxpayer's unitary business and the gross receipts and overall net gains from the maturity, redemption, sale, exchange, or other disposition of those intangible assets. For purposes of this subparagraph, "treasury function" means the pooling, management, and investment of intangible assets for the purpose of satisfying the cash flow needs of the taxpayer's trade or business, such as providing liquidity for a taxpayer's business cycle, providing a reserve for business contingencies, and business acquisitions, and also includes the use of futures contracts and options contracts to hedge foreign currency fluctuations. A taxpayer principally engaged in the trade or business of purchasing and selling intangible assets of the type typically held in a taxpayer's treasury function, such as a registered broker-dealer, is not performing a treasury function, for purposes of this subparagraph, with respect to income so produced.

(L) Amounts received from hedging transactions involving intangible assets. A "hedging transaction" means a transaction related to the taxpayer's trading function involving futures and options transactions for the purpose of hedging price risk of the products or commodities consumed, produced, or sold by the taxpayer.

(M) Where substantial amounts of gross receipts arise from an occasional sale of a fixed asset or other property held or used in the regular course of the taxpayer's trade or business, such gross receipts shall be excluded from the sales factor. For example, gross receipts from the sale of a factory, patent, or affiliate's stock will be

excluded if substantial. For purposes of this subdivision, sales of assets to the same purchaser in a single year will be aggregated to determine if the combined gross receipts are substantial.

(i) For purposes of this subparagraph, a sale is substantial if its exclusion results in a 5 percent or greater decrease in the sales factor denominator of the taxpayer or, if the taxpayer is part of a combined reporting group, a 5 percent or greater decrease in the sales factor denominator of the group as a whole.

(ii) For purposes of this subparagraph, a sale is occasional if the transaction is outside of the taxpayer's normal course of business and occurs infrequently.

(3) Exclusion of an item from the definition of "gross receipts" shall not be determinative of its character as business or nonbusiness income.

(f) "State" means any state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States, and any foreign country or political subdivision thereof.

28121. Any taxpayer having receipts from business activity which is taxable both within and without this state shall allocate and apportion its net receipts as provided in this article.

28122. For purposes of allocation and apportionment of net receipts under this article, a taxpayer is taxable in another state if (a) in that state it is subject to a value-added tax, an income tax, a franchise tax measured by income, a franchise tax for the privilege of doing business, or a corporate stock tax, or (b) that state has jurisdiction to subject the taxpayer to a value-added tax or to an income tax regardless of whether, in fact, the state does or does not.

28123. Rents and royalties from real or tangible personal property, capital gains, a patent or copyright royalties, to the extent that they constitute nonbusiness receipts, shall be allocated as provided in Sections 28124 to 28127, inclusive, of this article.

28124. (a) Rents and royalties from real property located in this state are allocable to this state.

(b) Rent and royalties from tangible personal property are allocable to this state:

- (1) If and to the extent that the property is utilized in this state.
- (2) In their entirety if the taxpayer's commercial domicile is in this state and the taxpayer is not organized under the laws of or taxable in the state in which the property is utilized.

(c) The extent of utilization of tangible personal property in a state is determined by multiplying the rents and royalties by a fraction, the numerator of which is the number of days of physical location of the property in the state during the rental or royalty period in the taxable year and the denominator of which is the number of days of physical location of the property everywhere during all rental or royalty periods in the taxable year. If the physical location of the property during the rental or royalty period is unknown or unascertainable by the taxpayer, tangible personal property is utilized in the state in which the property was located at the time the rental or royalty payer obtained possession.

28125. (a) Gross receipts from sales of real property located in this state are allocable to this state.

(b) Gross receipts from sales of tangible personal property are allocable to this state if:

(1) The property had a situs in this state at the time of the sale.

(2) The taxpayer's commercial domicile is in this state and the taxpayer is not taxable in the state in which the property had a situs.

(c) Except in the case of the sale of a partnership interest, capital gains and losses from sales of intangible personal property are allocable to this state if the taxpayer's commercial domicile is in this state.

28127. (a) Patent and copyright royalties are allocable to this state:

(1) If and to the extent that the patent or copyright is utilized by the payer in this state.

(2) If and to the extent that the patent or copyright is utilized by the payer in a state in which the taxpayer is not taxable and the taxpayer's commercial domicile is in this state.

(b) A patent is utilized in a state to the extent that it is employed in production, fabrication, manufacturing, or other processing in the state or to the extent that a patented product is produced in the state. If the basis of receipts from patent royalties does not permit allocation to states or if the accounting procedures do not reflect states of utilization, the patent is utilized in the state in which the taxpayer's commercial domicile is located.

(c) A copyright is utilized in a state to the extent that printing or other publication originates in the state. If the basis of receipts from copyright royalties does not permit allocation to states or if the accounting procedures do not reflect states of utilization, the copyright is utilized in the state in which the taxpayer's commercial domicile is located.

28128. All business receipts shall be apportioned to this state by multiplying the business net receipts by the sales factor.

28129. The property in this state means the average value of the taxpayer's real and tangible personal property owned or rented and used in this state during the taxable year.

28130. Property owned by the taxpayer is valued at its original cost. Property rented by the taxpayer is valued at eight times the net annual rental rate. Net annual rental rate is the annual rental rate paid by the taxpayer less any annual rental rate received by the taxpayer from subrentals.

28131. The average value of property shall be determined by averaging the values at the beginning and ending of the taxable year but the Franchise Tax Board may require the averaging of monthly values during the taxable year if reasonably required to reflect properly the average value of the taxpayer's property.

28133. Compensation is paid in this state if:

(a) The individual's service is performed entirely within the state.

(b) The individual's service is performed both within and without the state, but the service performed without the state is incidental to the individual's service within the state.

(c) Some of the service is performed in the state and (1) the base of operations or, if there is no base of operations, the place from which the service is directed or controlled is in the state, or (2) the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the individual's residence is in this state.

28134. The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the taxable year, and the denominator of which is the totals sales of the taxpayer everywhere during the taxable year.

28135. Sales of tangible personal property are in this state if:

(a) The property is delivered or shipped to a purchaser, other than the United States government, within this state regardless of the f.o.b. point or other conditions of the sale.

(b) The property is shipped from an office, store, warehouse, factory, or other place of storage in this state and (1) the purchaser is the United States government or (2) the taxpayer is not taxable in the state of the purchaser.

(c) For purposes of determining whether sales are in this state and included in the numerator of the sales factor, all sales of the combined reporting group properly assigned to this state under this section shall be included in the sales factor numerator for this state regardless of whether the member of the combined reporting group making the sale is subject to the business net receipts tax imposed under Section 27151. All sales not assigned to this state pursuant to subdivision (a) shall not be included in the sales factor numerator for this state if a member of the combined reporting group of the taxpayer is taxable in the state of the purchaser.

(d) The Franchise Tax Board may prescribe regulations as necessary or appropriate to carry out the purposes of this section.

28136. (a) Sales, other than sales of tangible personal property, are in this state as follows:

(1) Sales from services are in this state to the extent the purchaser of the service received the benefit of the service in this state.

(2) Sales from intangible property are in this state to the extent the property is used in this state. In the case of marketable securities, sales are in this state if the customer is in this state.

(3) Sales from the sale, lease, rental, or licensing of real property are in this state if the real property is located in this state.

(4) Sales from the rental, lease, or licensing of tangible personal property are in this state if the property is located in this state.

(b) The Franchise Tax Board may prescribe regulations as necessary or appropriate to carry out the purposes of this section.

28137. If the allocation and apportionment provisions of this article do not fairly represent the extent of the taxpayer's market in this state, the taxpayer may petition for or the Franchise Tax Board may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

(a) Separate accounting.

(b) The exclusion of any one or more of the factors.

(c) The inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state.

(d) The employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's net receipts.

SEC. 136. The amendments made by this act to Part 10.2 pertaining to Part 12 (commencing with Section 27001) of the Revenue and Taxation Code shall apply to taxable years beginning on or after January 1, 2012.

SEC. 137. No reimbursement is required by this act pursuant to Section 6 of Article XIII B of the California Constitution because the only costs that may be incurred by a local agency or school district will be incurred because this act creates a new crime or infraction, eliminates a crime or infraction, or changes the penalty for a crime or infraction, within the meaning of Section 17556 of the Government Code, or changes the definition of a crime within the meaning of Section 6 of Article XIII B of the California Constitution.

SEC. 138. This act provides for a tax levy within the meaning of Article IV of the Constitution and shall go into immediate effect.

COMMISSION MEETINGS

January 22, 2009 — University of California, San Diego

February 12, 2009 — University of California, Los Angeles

March 10, 2009 — University of California, Berkeley

April 9, 2009 — University of California, Davis

June 16, 2009 — University of California, Los Angeles

July 16, 2009 — University of California, San Francisco

August 26, 2009 — University of California, San Francisco

August 28, 2009 — University of California, Los Angeles

September 10, 2009 — University of California, Los Angeles

September 14, 2009 — University of California, Berkeley

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