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Background Information On California's Bank and Corporation Tax Volume I: Federal Conformity Issues

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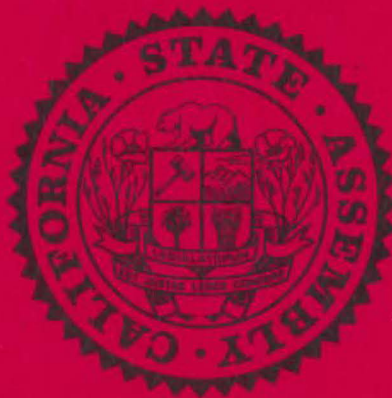
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BACKGROUND INFORMATION ON

CALIFORNIA'S BANK AND CORPORATION TAX

Volume I

FEDERAL CONFORMITY ISSUES



Prepared by Staff of the
ASSEMBLY REVENUE AND TAXATION COMMITTEE

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Chairman

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PREFACE

This report is Volume I of a two-volume series released by the Assembly Revenue and Taxation Committee, on the Bank and Corporation Tax. Volume I provides an overview of the tax, including its fiscal effects and taxpayer incidence, an analysis of the major areas of difference between state and federal law, and an indepth analysis of 4 subjects: carryover/carryback of net operating losses, graduated tax rates investment tax credit, and "Subchapter S" treatment for small business corporations. Each of the latter analyses contains a detailed history of and rationale for the federal law and an explanation of that law, the fiscal implications of state conformity, and discussion of advantages, problems and policy issues associated with conformity.

(Volume II provides an exhaustive analysis of the "unitary method" of apportioning corporate income for California tax purposes.)

This report results from the work of several people. Kevin Bacon of the Assembly Office of Research wrote Chapters 3 through 6, to which the staff of the Franchise Tax Board contributed the fiscal estimates and some of the policy comments. The FTB staff also wrote Chapter 2 and provided some background materials incorporated by committee staff into Chapter 1. The report was prepared by Bob Leland of the Assembly Revenue and Taxation Committee staff.

CHAPTER 1
BACKGROUND AND BRIEF DESCRIPTION
OF THE
BANK AND CORPORATION TAX

Summary

California is one of 46 states imposing net income taxes on corporations. Every bank and corporation doing business in this state with certain exceptions is subject to a franchise tax of 9.6 percent measured by its NET income, or \$200, whichever is greater, beginning in 1980.* (For a comparison to the tax rates of other states, see Table I.)

Banks and financial institutions are also subject to a special tax rate, which is in lieu of personal property taxes and local business license taxes. For 1980, the bank tax rate will be 11.6%; for 1981 the rate will be 2% higher than the general rate for other corporations. For 1982 and thereafter, the rate will be based on the personal property tax and business license taxes paid by other corporations, but cannot exceed 12%. If the tax computed is less than \$200, the tax will be \$200.

As shown in Table II, it is estimated that California will receive \$2.64 billion in revenue from this tax source in 1979-80. This makes the Bank and Corporation Tax the state's third leading revenue producer, behind the sales and personal income taxes, accounting for 16.1% of General Fund revenues. All of the rate increases in the tax since 1968 have been to produce revenue for

* For 1981 the rate could range between 9.6% and 9.4%, depending on corporation tax collections. For 1982, the rate could range between 9.6% and 9.35%, depending on corporate tax collections and for 1983 and thereafter, the rate could range between 9.6% and 9.3% depending on corporate tax collections.

TABLE I
RANGE OF STATE CORPORATE INCOME TAX RATES*
As of January 1, 1978

State or other jurisdiction	Tax rate† (percent)	Federal income tax deductible	State or other jurisdiction	Tax rate† (percent)	Federal income tax deductible
Alabama		*	Michigan	(ac)	...
Business corporations	5		Minnesota		...
Banks & financial corps.	6		Business corporations	12(m)	...
Alaska		...	Banks	12	...
Business corporations	5.4(a)		Mississippi		...
Banks & financial corps.	7(b)		\$0 to \$5,000	3	...
Arizona		*	Over \$5,000	4(2)	...
\$0 to \$1,000	2.5		Missouri		*
Over \$6,000	10.5(7)		Business corporations	5	...
Arkansas		...	Banks & trust companies	7	...
\$0 to \$3,000	1		Montana	6.75(n)	...
Over \$25,000	6(5)		Nebraska		...
California		...	\$0 to \$25,000	4(o)	...
Business corporations	9(c)		Over \$25,000	4.4(2)(o)	...
Banks & financial corps.	9-13(d)		New Hampshire	8(p)	...
Colorado	5	...	New Jersey	7.5(q)	...
Connecticut	10(e)	...	New Mexico		...
Delaware	8.7	...	Business corporations	5	...
Florida	5(f)	...	Banks & financial insts.	6(r)	...
Georgia	6	...	New York		...
Hawaii		...	Business corporations	10(s)	...
Business corporations:			Banks & financial corps.	12(t)	...
\$0 to \$25,000	5.85(g)		North Carolina		...
Over \$25,000	6.435(2)		Business corporations	6	...
Banks & financial corps.	11.7		Building & loan assoc.	7.5	...
Idaho	6.5(h)	...	North Dakota		*
Illinois	4	...	Business corporations:		
Indiana	6	...	\$0 to \$3,000	3(u)	...
Iowa		(j)	Over \$15,000	6(4)(u)	...
Business corporations:			Banks & financial corps.	5(v)	...
\$0 to \$25,000	6		Ohio		...
Over \$100,000	10(3)		\$0 to \$25,000	4(w)	...
Banks:			Over \$25,000	8(2)(w)	...
\$0 to \$25,000	5		Oklahoma	4	...
Over \$100,000	8(4)		Oregon	7.5(x)	...
Kansas		...	Pennsylvania	10.5	...
Business corporations	4.5(k)		Rhode Island	8(y)	...
Banks	5(k)		South Carolina		...
Trust companies & savings & loan assoc.	4.5(k)		Business corporations	6	...
Kentucky		...	Banks	4.5	...
\$0 to \$25,000	4		Financial associations	8	...
Over \$25,000	5.8(2)		South Dakota		*
Louisiana		*	Banks & financial corps.	5.5(z)	...
\$0 to \$25,000	4		Tennessee	6	...
Over \$200,000	8(5)		Utah	4(aa)	...
Maine		...	Vermont		...
\$0 to \$25,000	5		\$0 to \$10,000	5(ab)	...
Over \$25,000	7(2)		Over \$250,000	7.5(4)(ab)	...
Maryland	7	...	Virginia	6	...
Massachusetts		...	West Virginia	6	...
Business corporations	9.4962(1)		Wisconsin		...
Banks & trust companies	12.54		\$0 to \$1,000	2.3	...
Utility corporations	6.5		Over \$6,000	7.9(7)	...
			Dist. of Col.	9(ab)	...

* Prepared by the Federation of Tax Administrators on the basis of legislation enacted at 1977 sessions.

† Figure in parentheses is number of steps from lowest to highest tax rate.

(a) Plus a surcharge of 4 percent of taxable income; the state surcharge exemption follows the federal surcharge exemption.

(b) Banks and other financial institutions are subject to a license tax.

(c) Minimum tax is \$200.

(d) Rate adjusted annually: maximum, 13 percent—minimum, 9 percent; minimum tax is \$200.

(e) Or 0.31 mills per dollar (maximum \$100,000) of capital stock and surplus, or \$50, whichever is greater.

(f) An exemption of \$5,000 is allowed.

(g) Taxes capital gains at 3.08 percent.

(h) An additional tax of \$10 is imposed on each return.

(i) Consists of 3 percent basic rate plus a 3 percent supplemental tax.

(j) Fifty percent of federal income tax deductible.

(k) Plus a surtax of 2.25 percent of taxable income in excess of \$25,000.

(l) Rate includes a 14 percent surtax, as does the following: a tax of \$2.60 per \$1,000 on taxable tangible property (or net worth allocable to state, for intangible property corporations). Minimum tax of \$228 including surtax. Corporations engaged exclusively in interstate or foreign commerce are taxed at 5 percent of net income and are not subject to surtax.

(m) Minimum tax is \$100.

(n) Minimum tax is \$50; for small business corporations, \$10.

(o) Twenty-five and 27.5 percent of individual income tax rate, determined annually by state board of equalization and assessment, imposed on net taxable income.

(p) Business profits tax imposed on both corporations and unincorporated business.

(q) This is the corporation business franchise tax rate, plus a net worth tax at millage rates ranging from 2 mills to 0.2 mill; minimum tax is \$250. Corporations not subject to the franchise tax are subject to a 7.25 percent income tax.

(r) Minimum tax is \$100.

(s) Or \$250; 1.78 mills per dollar of capital; or 10 percent of 30 percent of net income plus salaries and other compensation to officers and stockholders owning more than 5 percent of the issued capital stock less \$15,000 and any net loss, if any of these is greater than the tax computed on net income.

(t) Minimum tax is \$250 or 1.6 mills per dollar of capital stock; for savings institutions, the minimum tax is \$250 or 2 percent of interest credited to depositors in preceding year. A 30 percent surcharge, less \$50,000, is imposed on 1978 tax years.

(u) In addition to the tax shown, imposes a privilege tax of 1 percent on income in excess of \$2,000 on corporations not subject to personal property (or in lieu) taxes.

(v) Minimum tax is \$50; plus an additional 2 percent tax.

(w) Or 5 mills times the value of the taxpayer's issued and outstanding shares of stock as determined according to the total value of capital surplus, undivided profits, and reserves; minimum tax \$50.

(x) Minimum tax is \$10.

(y) Or, for business corporations, the tax is 40 cents per \$100 of corporate excess, if greater than the tax computed on net income. For banks, if a greater tax results, the alternative tax is \$2.50 per \$10,000 of capital stock; minimum tax is \$100.

(z) Minimum tax is \$200 per authorized location.

(aa) Minimum tax is \$25.

(ab) Minimum tax is \$50.

(ac) Michigan imposes a single business tax (sometimes described as a business activities tax or value added tax) of 2.35 percent on the sum of federal taxable income of the business, compensation paid to employees, dividends, interest, and royalties paid, and other items.

Source: Book of the States, 1978-1979, The Council of State Governments. Lexington, Kentucky. p. 312

TABLE II

HISTORY OF BANK AND CORPORATION TAX
REVENUES AND TAX RATES, 1936-1980

<u>Income Year</u>	<u>Rate</u>	<u>Minimum Tax Paid</u>	<u>Revenue</u> (in millions)
1980 (est.)	9.6%	\$200	\$2,640
1979 (est.)	9	200	2,370
1978	9	200	2,082
1977	9	200	1,642
1976	9	200	1,287
1975	9	200	1,254
1974	9	200	1,057
1973	9	200	866
1972	7.6	200	663
1971	7	100	532
1970	7	100	587
1969	7	100	592
1968	7	100	577
1967	7	100	453
1966	5.5	100	436
1965	5.5	100	416
1964	5.5	100	405
1963	5.5	100	311
1962	5.5	100	291
1961	5.5	100	273
1960	5.5	100	241
1959	5.5	100	174
1958	4	25	174
1957	4	25	167
1956	4	25	157
1955	4	25	133
1954	4	25	125
1953	4	25	119
1952	4	25	120
1951	4	25	98
1950	4	25	74
1949	3.4	25	76
1948	3.4	25	69
1947	3.4	25	59
1946	3.4	25	56
1945	3.4	25	48
1944	3.4	25	57
1943	3.4	25	63
1942	4	25	54
1941	4	25	34
1940	4	25	20
1939	4	25	16
1938	4	25	15
1937	4	25	19
1936	4	25	16

*Includes corporation franchise tax and corporation income tax on banks and corporations, except for years 1936-1945, which do not include figures for bank tax or corporation income tax.

Source: Governor's Budget, 1979 and 1980 figures from Department of Finance's May 1978 Revise

state funding of the business inventory exemption. The table shows the tax rate and revenue history since 1936.

Who Pays The Tax

The distribution of the corporation tax base by industry for the 1976 income year, as estimated by the Department of Finance, appears in Table III. The largest share is manufacturing, at 36.4 percent, followed by retail and wholesale trade at 20.8 percent, banks and savings and loans 10.1 percent, services 8.0 percent, utilities 7.6 percent; real estate, insurers and other financials 6.7 percent, mining and oil production 5.8 percent, construction 3.4 percent, and agriculture 1.4 percent. These figures constitute taxable income and are therefore net of any losses.

TABLE III

Taxable Corporate Profits in California *
(In millions)

Industry	1976 Actual	1977		1978	
		Preliminary	Percent change	Estimated	Percent change
Agriculture	\$289	\$293	1.4	\$313	6.8
Mining and oil production	1,388	1,150	-17.1	1,317	14.5
Construction	549	738	34.4	758	2.7
Manufacturing	5,463	6,579	20.4	8,225	25.0
Trade	3,301	4,095	24.1	4,686	14.4
Service	1,190	1,494	25.5	1,808	21.0
Financials subject to the bank tax	1,304	2,008	54.0	2,270	13.0
Real estate and other financials	946	1,294	36.8	1,483	14.6
Utilities	973	1,178	21.1	1,710	45.2
Totals	\$15,403	\$18,829	22.2	\$22,570	19.9

* These figures represent income of corporations with accounting periods ending from August of the year shown through July of the following year. This method of reporting approximates the federal system of reporting corporate profits in the year earned.

Source: 1979-80 Governor's Budget, p.A-101

Table IV shows 184,326 total franchise tax returns filed by banks and general corporations for 1976. Returns with taxable State net incomes totaled 113,614, constituting \$14.8 billion in total net income and nearly \$1.4 billion in self-assessed franchise taxes.

TABLE IV

Bank and Corporation Franchise Tax Statistics
 COMPARISON BY STATE NET INCOME CLASS
 1976 Income Year

NET INCOME TAXABLE IN CALIFORNIA	NUMBER OF RETURNS	INCOME REPORTED FOR TAXATION		TAX ASSESSED
		FEDERAL	STATE	
NET LOSS.....	54,249	-5,090,294,600	-2,891,881,640	\$11,200,200
NO INCOME OR LOSS.....	16,463	—	—	3,258,475
SUBTOTALS.....	70,712	-5,090,294,600	-2,891,881,640	\$14,458,675
NET INCOME				
\$1 UNDER	14,101	126,960,400	6,167,872	2,809,668
1,000 UNDER	8,554	45,235,751	12,676,518	1,711,426
2,000 UNDER	7,188	69,395,556	17,669,214	1,611,669
3,000 UNDER	5,000	66,026,270	17,403,430	1,571,505
4,000 UNDER	4,178	39,368,129	18,711,751	1,686,849
5,000 UNDER	3,477	62,234,309	19,087,928	1,718,825
6,000 UNDER	3,083	57,303,653	19,990,992	1,800,218
7,000 UNDER	2,765	54,340,340	20,701,984	1,866,019
8,000 UNDER	2,591	48,706,355	22,014,376	1,983,616
9,000 UNDER	2,254	58,770,241	21,374,356	1,924,203
10,000 UNDER	2,171	73,577,396	22,778,908	2,051,917
11,000 UNDER	1,959	85,787,676	22,528,826	2,031,210
12,000 UNDER	1,848	86,541,411	23,080,772	2,077,644
13,000 UNDER	1,750	47,657,225	23,601,275	2,124,491
14,000 UNDER	1,637	56,443,004	23,706,878	2,135,543
15,000 UNDER	6,906	273,856,051	120,002,772	10,810,514
20,000 UNDER	5,443	290,519,084	122,053,745	10,999,343
25,000 UNDER	4,434	295,607,242	121,422,881	10,936,740
30,000 UNDER	6,598	711,985,374	228,706,918	20,603,965
40,000 UNDER	5,500	785,410,883	248,244,264	22,358,546
50,000 UNDER	4,415	622,273,663	239,491,114	21,571,682
60,000 UNDER	2,167	304,636,295	140,211,046	12,642,779
70,000 UNDER	1,658	354,016,001	123,973,150	11,196,552
80,000 UNDER	1,270	379,100,073	107,621,356	9,685,840
90,000 UNDER	1,035	333,685,644	98,229,350	8,874,087
100,000 UNDER	3,315	1,363,541,259	405,000,246	36,606,481
150,000 UNDER	1,793	1,298,326,846	308,671,510	27,884,583
200,000 UNDER	1,103	1,131,104,719	246,784,068	22,369,882
250,000 UNDER	796	1,080,082,171	217,880,338	19,815,848
300,000 UNDER	996	1,836,391,661	346,199,750	31,518,231
400,000 UNDER	647	2,119,193,343	289,787,098	26,389,942
500,000 UNDER	852	3,207,768,537	518,303,348	47,400,546
750,000 UNDER	498	2,564,615,458	429,889,414	39,469,780
1,000,000 UNDER	504	5,976,906,204	618,559,965	56,847,662
1,500,000 UNDER	245	2,738,597,424	419,601,466	38,738,283
2,000,000 UNDER	291	7,011,773,020	698,825,754	65,001,789
3,000,000 UNDER	137	4,146,977,561	474,772,147	43,668,776
4,000,000 UNDER	87	2,290,744,506	386,877,629	35,300,103
5,000,000 UNDER	185	14,475,713,963	1,271,926,212	116,960,966
10,000,000 AND OVER	183	45,811,684,920	6,333,229,062	599,021,912
SUBTOTALS.....	113,614	\$102,382,859,818	\$14,807,759,683	\$1,375,779,635
GRAND TOTALS.....	184,326	\$97,292,565,210	\$11,915,878,043	\$1,390,238,310

FOOTNOTES † Corporations sustaining losses and those which "broke even" (mostly inactive corporations and cooperatives) are included in this table. Figures in the column headed "Number of Returns" include (a) approximately 904 corporations which have changed their income years and filed "short-period" returns and (b) approximately 22 mergers and consolidations occurring during the income year, a return for each surviving corporation and one for each of the dissolved corporations.

Just over 54,000 corporations reported State net losses of \$2.9 billion, down from the previous year's \$3.3 billion. Another 16,000 corporations reported no State net income or loss (cooperatives and inactive corporations). Taxes shown for these corporations represent the \$200 minimum and any preference tax liability.

Table IV also indicates the degree of concentration of very high State net incomes among a few corporations. Corporations reporting \$1 million or more in State net income accounted for less than one percent of all returns filed, but made up nearly 70 percent of total State net income and taxes assessed. On the other hand, corporations with less than \$50,000 in State net income comprised 88 percent of all returns filed, but only eight percent of total State net income and taxes assessed.

There is no clear-cut answer, however, to the question of who ultimately pays the tax: corporation or consumer. Of course the corporation may recoup up to half of the tax from the federal government, by virtue of the deductibility of the state tax. Beyond that, it is assumed that a merchant or manufacturer often takes into account, at least indirectly, the amount of income tax he will have to pay and, if the market conditions permit, fixes his prices at such a level as would yield him a certain minimum net income. Aside from the complications introduced by the corporate form of business, however, most economic opinion has in the past been to the effect that "market conditions" usually do not permit the addition of the tax to the price in the short run. Any shifting that takes place does not come about by a straightforward shifting from seller to buyer, but does so through a complex, indirect, and roundabout process.

In the Post Commission task force report entitled "Principal Tax Burdens in California" (Project II - 2), it is stated on page 39 that:

There is considerable debate as to who ultimately bears the corporation tax; i.e., to what extent is the tax shifted to labor, forward to consumers, or directly absorbed by equity capital. Data from empirical studies are not particularly revealing mainly because cause-effect relationships are difficult to substantiate. It is, however, reasonably safe to conclude that shifting does occur in various proportions, especially over the longer run, the degree depending on a number of factors, such as elasticity of demand, alternative rates of return on investments, and the bargaining position of organized labor.

Finally, in a report* prepared for the Assembly Revenue and Taxation Committee in 1964, Prof. Harold M. Somers, chairman of the Economics Department at UCLA, concluded:

In general, we may conclude that in the short run there is little likelihood of business income tax being shifted under the rigorous assumption of profit maximization in the literal sense. Departures from this assumption, such as maximization of gross sales (or size of the business) subject to a profit constraint, lead to the conclusion that prices will change under the impact of an income tax in some instance, e.g., where the company has been operating right at the profit constraint. Various other situations in which price changes may occur have been mentioned above.

There is some recent empirical evidence that tends to support the conclusion that the business income tax is shifted. It has been shown that an increase in the corporation income tax is shifted through shortrun adjustments to prevent a decline in the net rate of return, and that these adjustments are maintained subsequently. This suggests that strict profit maximization had not been followed and that a business firm has much leeway in terms of buying and selling prices and internal efficiency. An increased tax prompts changes which will leave the profit rate

* Taxation of Corporate Income in California; Part of A Major Tax Study; Assembly Revenue and Taxation Committee; December 1964; p. 28

unimpaired. The reluctance of management to alter dividend policy abruptly as a result of changes in profits after taxes strengthens the notion that shareholders, at any rate, do not bear the burden of changes in corporate income taxation in the short run. (footnotes omitted)

History

Prior to 1910, state revenues were derived mainly from a direct ad valorem property tax upon all taxable property within the State. The method was unsatisfactory and burdensome, and it came to be recognized as inequitable as well.

In 1905 a joint legislative committee was established to study the situation and suggest a remedy. It submitted its report to the Legislature in 1906, which at first was rejected. It was continued in existence and its program was accepted in 1910.

Its basic recommendation was a separation of tax sources. This came into being in 1911 after the adoption in 1910 of Constitutional "Amendment Number One." Among other things under this amendment corporations were placed in a separate class and their franchises were taxed exclusively for state purposes.

The franchise tax on banks and corporations was not measured by income. Banks were taxed under what was known as the "share-tax" method and general corporations were taxed on a percentage of the "actual cash value" of their franchise.

Under this method, the real estate of banks was taxed locally at the ordinary property tax rate, and the State taxed their shares of capital stock at a fluctuating rate. The base, however, consisted of capital, surplus and undivided profits, minus the assessed value of real estate.

The real estate of general corporations was also taxed locally. The franchise tax base consisted of the total market value of all outstanding securities, minus the assessed value of any visible or tangible property which belong to the corporation.

This tax was criticized as an arbitrary tax which was impossible to anticipate and accrue. There were also serious doubts as to whether or not the Bank Tax Act was constitutional. As a result of these doubts, in 1927 a Tax Commission was created to investigate the systems of revenue and taxation in force, and to submit to the Governor its report and recommendations to him for submission to the Legislature at its 1929 session. In 1928 the commission, in a special report, recommended the submission of a constitutional amendment so as to permit a tax to be imposed on banks and general corporations "measured by net income." A special session was called which approved the constitutional amendment, and the proposal was adopted on November 6, 1928. Following this approval the Legislature in 1929 carried out the recommendation of the commission and enacted the Bank and Corporation Franchise Tax Act. That act was the predecessor of the current law.

At the time of adoption, the amendment contained a 4 percent limit on the corporation tax rate and a provision that a tax could be imposed under the provisions of the amendment only by two-thirds vote of each house of the Legislature. The rate limit was subsequently removed but the two-thirds vote requirement is still in effect, having been removed by Proposition 5 of 1976 but restored by Proposition 13 of June, 1978.

Corporation Franchise Tax

The franchise tax is a prepaid tax. It is paid in advance for the privilege of doing business in California in the ensuing year. In 1963, the Legislature provided for accelerated collections of the bank and corporation franchise tax.

The franchise tax differs in many important respects from the income tax. First, it is a privilege tax. That is, the tax is imposed for the privilege of exercising corporate franchise within the State. Second, it is a tax "measured" by income. These differences are more than labels.

A franchise tax is not necessarily "measured by or imposed on income." The tax may be measured by the amount of capital stock paid-up or outstanding capital stock, capital stock employed in the State, a percentage of the cash or market value of the shares of a corporation's capital, by capital and surplus or various other means. Since the California tax is "measured by income", all income may be included, even income which is otherwise exempt--such as interest received from U.S. obligations. This is why banks and corporations are required to include in the measure of their tax income received from federal obligations owned by them.

Franchise taxes also differ from income taxes in that they usually impose a minimum fee or tax. In this State the minimum fee for corporations is \$200. In many other states the minimum fee is based on the value of assets owned by the corporation.

Since the franchise tax is a privilege tax, it may be imposed only against corporations which have been granted the right to do

business in this State, i.e., incorporated or doing intrastate business in this State. The franchise tax therefore, may not be imposed upon foreign corporations which are engaged exclusively in interstate commerce, regardless of the extent of their activities.

The corporation income tax was enacted in 1937 to remove an inequity in the taxation of interstate corporations which were not taxable under the Franchise Tax Act. As this tax is an income tax rather than a franchise tax, corporations subject to it are not required to pay a minimum tax nor are they required to include in income interest from United States obligations.

Corporations subject to this law have been reduced in number by the enactment of P.L. 86-272, effective September 14, 1959. This federal law provides that a net income tax may not be imposed on income derived from interstate commerce if the only business activity within the state is:

- (1) the solicitation of orders by a corporation, or its representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State; and,
- (2) the solicitation of orders by a corporation, or its representative, in such State in the name of or for the benefit of a prospective customer of such corporation, if orders by such customer to such corporation to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1).

A major problem encountered with corporations engaged in business in a number of states is to determine the portion of income subject to tax by this State. The basic requirement is that such

income shall be determined by a method calculated to determine the net income derived from or attributable to sources within the State.

When a corporation is engaged in business in more than one state, the first step is to separate the income into two classes. The first class consists of business income. This is usually referred to as unitary income, and is the income subject to apportionment. The remainder is referred to as non-business income and is apportioned by situs. This means that if the corporation is a local corporation all of its non-business income is subject to tax, but if it is a foreign corporation none of its income is subject to tax.

If the income is subject to apportionment; a formula is used to determine California taxable income.

This formula consists of:

- (a) Average value of real and tangible personal property owned (property)
- (b) Wages, salaries, commissions, and other compensation of employees (wages)
- (c) Gross sales, less returns and allowances (sales).

As to each factor, the total within and without the State and the total amount within the State are computed. From these figures, the percentage of each factor within this State is determined. The three percentages are then totaled and the average is computed. This average percentage is then applied to the unitary income. Under this or other formulas income is often allocated to this State, although separate accounting records may establish that the California operations resulted in a loss.

For a further discussion of this "unitary method", see Volume II.

Preference Income Tax

Beginning in 1971, California has imposed a tax on "preference" income at a rate of 2.5%.

Preference income from three sources is subject to the tax:

- Accelerated depreciation of real property, to the extent it exceeds depreciation allowable for the year under the straight-line method.
- Excess deductions for bad debt reserves consisting of additions to reserves for bad debts in excess of loss experience.
- Percentage depletion in excess of the adjusted cost (before depletion) of the resource-producing property at the end of the year.

Before application of the preference tax rate, preference income is reduced by a \$30,000 exclusion and any net losses incurred for the year. As shown in Table V, the tax on preference income produced \$4.7 million in revenue from corporations for the 1976 income year.

TABLE V

BANK AND CORPORATION TAXES
TAX ON PREFERENCE INCOME BY MAJOR INDUSTRIAL GROUPS
1975 and 1976 Income Years

MAJOR INDUSTRIAL GROUP	1975 INCOME YEAR	1976 INCOME YEAR		
	Net Preference Income Subject to Taxation * (\$ Millions)	Net Preference Income Subject to Taxation * (\$ Millions)	Percent Of Total	Preference Tax Paid (\$ Thousands)
Agriculture, Forestry & Fishery	\$3.2	\$1.6	.9	\$41
Mining, Petroleum & Natural Gas	31.5	30.4	16.1	760
Construction	4.2	6.1	3.2	153
Manufacturing	42.5	54.3	28.8	1,358
Services	4.6	4.2	2.2	105
Trade	5.7	5.0	2.6	124
Finance, Insurance & Real Estate	49.6	82.8	43.8	2,069
Public Utilities	6.2	4.6	2.4	114
Totals	\$147.5	\$189.0	100.0	\$4,724

* Total Preference Income Less Exclusion And Any Net Operating Losses.

Exempt Organizations

A substantial and growing number of corporations pay no tax at all. These are the so-called exempt organizations of which there are currently about 70,000 filing with the department. (The number of taxable corporations is about 230,000.) These organizations are created for various charitable, religious, educational, civic and social purposes. While tax exempt, they are required to file information returns and are subject to audit to determine if they are operating within the ambit of their exempt purpose. Failure to so operate can result in the loss of exempt status and resulting taxation as a general corporation. Exempt organizations are also subject to tax on "unrelated business income" or income earned from an activity not related to their exempt purpose.

Prepared by David R. Doerr, October 1979

MAJOR DIFFERENCES IN FEDERAL AND
CALIFORNIA TAX LAWS

California law and federal law regarding the taxation of income of corporations differs in a number of significant areas. The most important differences are outlined below.

1. Jurisdiction to Tax

California Tax Law

Every bank located in California and every corporation doing business in California is subject to the franchise tax, unless specifically exempted. The law defines "doing business" as "actively engaging in any transaction for the purpose of financial or pecuniary gain or profit."

A foreign corporation not doing business in this state is not subject to the franchise tax, but is subject to the income tax if it realizes any income from sources within the state. If a foreign corporation is qualified in the state, it is required to pay the minimum franchise tax even though it does not engage in business in the state.

The scope of the California income tax is limited by federal legislation enacted in 1959. The federal law (Public Law 86-272) prohibits a state from imposing a tax on income derived from interstate commerce, provided: (1) the activities within the state are limited to the solicitation of orders for sales of tangible personal property by employees or other representatives; and (2) orders are sent outside the state for approval; and (3) orders are filled from stocks of goods maintained outside the state.

The prohibition against tax applies also to a corporation with sales through a sales office maintained within the state by independent contractors whose activities consist solely of making sales, or soliciting orders.

Federal Tax Law

Every domestic corporation not expressly exempt from tax must file an annual income tax return. As a general rule, a domestic corporation (when organized under the laws of one of the states or of the District of Columbia) is taxed on its worldwide income. No distinction is made between income from sources inside and income from sources outside the United States, except that the U.S. tax on foreign income may be reduced by the foreign tax credit. An exception to the U.S. taxation of foreign income exists, however, in the case of a domestic international sales corporation (DISC). A foreign corporation is taxed in the same manner as a domestic corporation on all income which is "effectively connected" with its conduct of a trade or business in the U.S. In determining whether income is effectively connected with the U.S. business, two factors are used. The first is: Whether the income is derived from assets used in, or held for the use in, the conduct of a U.S. business, and the second factor is: Whether the activities of the U.S. business were a material factor in the realization of the income.

2. Banks and Financial Corporations

California Tax Law

Banks and other financial institutions pay a higher tax rate than do general corporations. The higher rate is designed to

equalize the total tax burden between the financial institutions and other taxpayers. The rate on financial institutions is determined by a computation of all franchise taxes and personal property taxes paid by other corporations (excluding certain public utilities) in the preceding year. For this purpose, all corporate taxpayers are required to report on their franchise tax returns the amount of personal property taxes required to be paid during the year. The total personal property taxes paid are compared with the total income of such corporations (with certain adjustments), and the resulting percentage is the rate applicable to financial institutions. Currently, the rate may not be more than 4 percent above the general franchise tax rate. The determination of the special rate (commonly called the "bank rate") must be made by the Franchise Tax Board no later than December 31 of each year, applicable to the preceding income year.

In general, a "financial corporation" is one that deals in money, as distinguished from other commodities, and is in substantial competition with national banks. It is not necessary for the "financial corporation" classification that such activities constitute the principal business of the corporation. Financial classification may result when only a portion of a corporation's income is derived from financial activities, but the financial corporation rate will nevertheless apply to its entire taxable income.

Financial corporations, however, are permitted to offset against their bank rate tax liability the following: (1) personal property taxes paid; (2) license fees and certain excise taxes paid; (3) use tax paid for the storage, use or consumption of personal property by savings and loan associations.

Federal Tax Law

Under federal law, banks and other financial institutions are taxed at the same rates and in the same manner as are general corporations.

3. Domestic International Sales Corporations

California Tax Law

Under California tax law, no special treatment is afforded domestic international sales corporations (DISC).

Federal Tax Law

A domestic international sales corporation (DISC) may defer paying tax on a portion of income derived from export sales and rentals. For a corporation to qualify as a DISC, it must meet the following requirements: (1) at least 95 percent of its gross receipts must be qualified export receipts; (2) at least 95 percent of its assets must be qualified export assets; (3) it must not have more than one class of stock; (4) it must have a minimum capital of at least \$2,500 on each day of its taxable year; and (5) it must have an election to be classified as a DISC in effect for the tax year.

The tax-deferred income of a DISC is not taxed to the DISC. It is taxed to the shareholders when distributed, when a shareholder sells its stock, or when the corporation no longer qualifies as a DISC.

4. Capital Gains and Losses

California Tax Law

Capital gain and loss provisions are not applicable to banks and corporations, only to individual taxpayers.

Federal Tax Law

Under federal tax law, the full amount of all gains and losses is taken into income and then a deduction is allowed for 60 percent (50 percent before November 1, 1978) of the excess of net long-term gain over net short-term loss. The federal capital gain and loss provisions apply to both individuals and corporations.

5. Deductions

a. Taxes

California Tax Law

California law provides for the deduction of certain categories of taxes, as follows: (1) state, local and foreign real property taxes; (2) state and local personal property taxes; (3) state and local general sales taxes; (4) state and local taxes on gasoline, diesel fuel, and other motor fuels; and (5) other state, local, and foreign taxes relating to a trade or business, or to property held for the production of

income. California does not allow deduction of income taxes; the law contains a specific prohibition against deduction of a tax "on or according to or measured by income or profits."

Federal Tax Law

With respect to the deductibility of taxes, federal tax law is substantially the same as California law, except that the federal deductions include one additional category: state, local, and foreign income taxes.

b. Charitable Contributions

California Tax Law

Corporations are allowed a deduction for contributions paid to certain organizations, up to a limit of 5 percent of net income, computed without the benefit of this deduction or certain other special deductions.

There is no provision for carrying over excess contributions as there is in the Personal Income Tax Law.

Federal Tax Law

The contributions deduction of a corporation is limited to 5 percent of its taxable income, computed without regard to (1) the deduction for contributions, (2) the deductions for dividends received and for dividends paid on certain preferred stock of public

utilities, (3) any net operating loss carryback, and (4) any capital loss carryback of the taxable year.

A corporation is permitted to carryover to the five succeeding taxable years contributions which exceed the 5 percent limitation.

c. Depreciation

California Tax Law

In general, California law permits the use of the same depreciation rates as does the federal law, except that California does not permit use of the "ADR" ranges of 20 percent above or below the standard rate.

Where federal and California depreciation is different, California, by regulation, authorizes the taxpayer to use a method or formula for converting federal depreciation into state depreciation.

Federal Tax Law

The major area in which federal law differs from California law concerns the federal class life asset depreciation range system (ADR) which was introduced into federal law in 1971. The ADR is based on broad industry classes of assets. For asset classes covering land improvements, a class life is given. All other classes have a range of years that extends 20 percent above and below the class life. Depreciation on land

improvements is computed by using the class life.

Depreciation for other asset classes is calculated by using a depreciation period selected from the range for the class.

A taxpayer using ADR does not have to justify retirement and replacement policies. A depreciation period selected for an asset cannot be changed by either the taxpayer or the IRS during the remaining period of the use of the asset.

d. Depletion

California Tax Law

Deduction is allowed for depletion of mines, oil and gas wells, other natural deposits, and timber. Depletion may be computed on the cost of the property, using the adjusted basis for determination of gain on sale. The California bank and corporation tax rules with respect to percentage depletion for minerals are similar and basically follow the general pattern of the federal depletion rules.

With respect to oil and gas percentage depletion, state and federal laws are substantially different. Federal law limits percentage and depletion on a barrel basis, whereas state law limitations are based on a monetary formula.

Federal Tax Law

With respect to depletable assets other than oil and gas, the minerals eligible for depletion are generally the same as those eligible under California law. However, federal law includes a few additional items and the federal percentage rates are different from the California rates on many items.

6. Credits

a. Taxes

California Tax Law

California does not allow a credit against the California tax for taxes paid to other states or countries.

Federal Tax Law

Under federal law, a credit for foreign taxes is allowed. The federal credit is allowed for income taxes generally. The federal credit is allowed only where the taxpayer elects to take the credit instead of using the foreign taxes as a deduction.

b. Solar Energy Tax Credit

California Tax Law

The solar energy tax credit is equal to 55 percent of the amount paid (subject to a \$3,000 limitation) for devices installed on premises in California owned and

controlled by the taxpayer. For devices which cost more than \$12,000 which are installed on California premises other than single family dwellings, the credit is 25 percent of the cost.

Generally, the credit is allowed only to the owner of the premises on which the system is installed. The credit may be allowed, however, to the original purchaser of a new home if the builder or developer elects not to claim the credit.

Individual units in a multiple dwelling situation are eligible for the credit.

Eligible solar energy systems include those for water heating, space conditioning, electricity production, mechanical energy, and wind energy. The system must have a useful life of at least three years. Energy conservation measures which reduce the cost or back-up energy requirements of the solar energy systems are also eligible for the credit.

The California solar energy tax credit is offset by the amount of the federal solar energy tax credit allowed. If the state credit is \$3,000 or less, the state credit is reduced so that combined federal and state credit is not over 55 percent of the cost. If the state credit is over \$3,000, the state credit is reduced by the amount of the federal credit.

Federal Tax Law

In 1978, a renewable energy source equipment credit was enacted in federal law. The law provides a credit of 30 percent on the first \$2,000 and 20 percent on the next \$8,000 of expenditures for a maximum total credit of \$2,200, for installations of (1) solar, (2) wind or (3) geothermal energy equipment in connection with a principal residence. Principal residences include condominiums and cooperative housing.

The federal law also provides a credit for insulation and other energy conserving items. This credit is equal to 15 percent on the first \$2,000 of qualifying expenditures, for a maximum credit of \$300. The credit applies with respect to the taxpayers' principal residence. The credit is allowed for installation of (1) insulation, (2) a replacement burner for oil and gas-fired furnaces, (3) a device to modify flue openings, (4) an electrical or mechanical furnace ignition system, (5) an exterior storm or thermal door or window, (6) an automatic energy saving thermostat, (7) caulking or weather stripping for an exterior door or window, and (8) an energy usage display meter.

Both federal credits terminate January 1, 1986.

c. Agricultural Irrigation Equipment Credit

Corporations are allowed a limited nonrefundable tax credit for the cost of certain irrigation equipment on agricultural land. The credit is the lesser of (1) 10 percent of cost or (2) \$500. The credit applies to equipment which results in reduced water usage and was installed on land which was cultivated and irrigated during any growing season during the years 1971-1976. The land must be owned and controlled by the taxpayer, who must be a farmer (75 percent of income from farming) and whose gross income does not exceed \$500,000.

The credit is allowed in addition to any other deduction to which the taxpayer is otherwise entitled. Because the credit is designed to give double tax relief, depreciation is allowed without regard to any reduction in the basis of the property.

Federal Tax Law

There is no provision in federal law for a credit similar to the agricultural irrigation tax credit.

d. Special Employee Tax Credits

California Tax Law

Under California tax law, a disadvantaged employee tax credit is provided for employers who hire public aid recipients in these programs: Aid to Families with

Dependent Children; Supplemental Security Income/State Supplementary Program for the Aged, Blind and Disabled; General Assistance and the Work Incentive Program.

The credit is 10 percent of wages paid, with a maximum of \$300 per year per employee. The credit is in addition to the deduction allowed for wages. The Employment Development Department certifies that the person is a public aid recipient at the time of hiring.

The credit can be claimed based on wages paid in the year of hiring and the next succeeding year.

The law is "sunsetting" on December 31, 1984.

Federal Tax Law

A limited tax credit is permitted employers for wages and salaries paid to individuals placed in on-the-job training or employment through the Work Incentive Program (WIN). The credit is equal to 20 percent of the wages and salaries paid to these employees during their first 12 months of employment. The credit, however, is subject to recapture if the employer, without cause, terminates the employment at any time during the employee's first 90 days of employment or before the close of the 90th calendar day after that period (but not if termination is for lack of business).

The credit for any year may not exceed the first \$50,000 plus 50 percent of such tax liability in excess of \$50,000. Unused credits may be carried back three years and carried forward seven years.

Another federal tax credit available is the federal welfare recipient employment incentive tax credit. This credit is substantially the same as the WIN credit, and is for wages paid to federal welfare recipients qualifying for aid to dependent children.

A third federal credit is the new targeted jobs tax credit. The credit for years beginning in 1978 is 50 percent of the excess of the total unemployment insurance (FUTA) wages paid during calendar year 1978 over 102 percent of the total wages paid during the calendar year 1977.

There are four limitations on the amount of the credit. It cannot exceed; (1) 25 percent of the FUTA wages paid in the 1978 calendar year; (2) \$100,000 for any calendar year; (3) 50 percent of the increase in total wages (not FUTA wages) over 105 percent in the preceding calendar year's total wages; and (4) the tax liability for the tax year.

There is also a bonus credit for hiring the handicapped. An additional job's tax credit is allowed for each handicapped individual hired who is receiving or has completed vocational rehabilitation. The bonus credit

is 10 percent of the first \$4,200 of FUTA wages paid to the handicapped person for service rendered during the one-year period beginning with the first wage payment after rehabilitation is begun. The total bonus credit for all handicapped individuals hired cannot exceed 20 percent of the regular new job's tax credit.

7. Consolidated Return/Combined Reports

California Tax Law

California law specifically provides for the filing of a consolidated franchise tax return only by certain railroad corporations.

A somewhat similar, but not identical result is obtained through the application of the combined report provisions to unitary business under Section 25101. This is discussed elsewhere in the material for the interim hearing.

Federal Tax Law

The privilege of filing a consolidated return under federal law is extended to an affiliated group of corporations. An "affiliated group" is one or more chains of includible corporations connected through stock ownership with a common parent where at least 80 percent of the voting power of all classes of stock and at least 80 percent of each class of nonvoting stock, are owned directly by one or more of the other includible corporations, and where the common parent corporation owns

directly stock possessing at least 80 percent of the voting power of all classes of stock and at least 80 percent of each class of nonvoting stock.

Life and mutual insurance companies, foreign corporations, regulated investment companies and real estate investment trusts and DISC's or former DISC's may not file consolidated returns.

CHAPTER 3

CARRYOVER/CARRYBACK OF NET OPERATING LOSSES

SUMMARY OF THE ISSUE

Existing federal law allows taxpayers a deduction for net operating losses (NOL) incurred in the conduct of a business or trade, a provision designed to lessen the hardship often resulting from the use of the one-year accounting period. If this deduction exceeds the taxpayer's tax liability for the year in which the loss was incurred, the loss deduction may be carried back to the three preceeding tax years and carried forward to the succeeding seven tax years in order to offset taxable income. The carryback provision requires a recomputation of the taxpayer's liability for the prior year or years to which the loss was applied. The taxpayer may receive a refund if the loss carryback results in an overpayment of taxes for a prior year. These provisions of law are designed to provide a type of "income averaging" for businesses that experience wide swings in net income over a period of years.

California law does not allow net operating loss carrybacks or carryovers under either the Personal Income Tax law or the Bank and Corporation Tax law.

In previous sessions there has been legislation in this area: SB 927, Zenovich (1973-74); SB 1129, Roberti (1975-76); and AB 228, Antonovich (1977-78). The Committee now has before it three bills addressing carryover/carryback: AB 815 (Papan), AB 1479 (Naylor), and AB 874 (McVittie).

Should state law be amended to provide for carrybacks and carryovers of net operating losses?

DESCRIPTION OF FEDERAL LAW¹

Net operating loss carrybacks and carryovers provide business taxpayers with a form of averaging which, in effect, permits them to share their losses with the government by offsetting these losses against their taxable income in other years.

Almost every taxpayer, including individuals and estates as well as corporations, is allowed to use the carryback/carryover provisions that apply to net operating losses from a trade or business. Excepted are certain regulated investment companies and life and mutual insurance companies. A partnership is not allowed an NOL deduction, but each partner may take his share of the partnership losses into account in computing his own income or NOL.

A net operating loss is the excess of allowable deductions over gross income, with certain adjustments. These adjustments limit some of the types of deductions that may be included in determining the net loss and provide that capital gains and losses require special treatment when calculating net operating losses.

Under current law, the general rule is that net losses may be carried back three years and carried forward seven years from the year in which the loss occurred. In effect, this provides an eleven year period (3 prior years + loss year + 7 succeeding years) for averaging corporate net income for purposes of computing federal corporate income taxes.

A taxpayer's NOL deduction must first be carried back to the third tax year preceeding the year in which the loss was sustained. Any amount of the loss not used to offset taxable income for the third preceeding year is carried to the second preceeding year. Any amount of the loss that still remains unused is then applied to the first preceeding year. If the loss is not entirely used to offset taxable income in the three preceeding years, the balance may be carried forward to the seven succeeding tax years in order of their occurrence. It should be noted, however, that federal law allows a taxpayer to elect to forego the carryback period and to carry the entire loss forward for offsetting taxes in future years. This is of particular benefit to new businesses with little or no profit in their early years of operation.

In addition to the general rule governing carrybacks and carryovers, there are several special rules with different time periods for carrybacks and carryovers for banks, financial institutions, business development corporations, and small business investment companies. A variety of special provisions have been enacted in the past to aid specific industries and even specific companies in times of economic hardship.

The carryback provision results in the need for the taxpayer to recompute his or her tax liability for prior years. Since the loss carryback reduces prior years' taxable incomes, taxpayers may file for a refund of excess taxes paid in prior years. This aspect of the law helps to improve corporate cash flow, particularly in times of poor earnings.

HISTORY AND RATIONALE FOR FEDERAL LAW²

The operating loss carryback and carryover were first introduced by Section 204 of the Revenue Act of 1918, which permitted the net losses sustained in one year to be claimed as a deduction against income of the prior taxable year and then against the income of the succeeding year. The report of the Senate Finance Committee (Senate Report No. 617, 65th Congress, 2nd Session, 1918) indicated that a system of taxation based upon the annual accounting concept had as its chief merit simplicity of administration, but "...it does not adequately recognize the exigencies of business, and under our present high rates of taxation, may often result in grave injustice." Since that first effort at dealing with the question of the appropriate way to handle operating losses, the Internal Revenue Code sections dealing with this subject have been amended no less than 17 times. Table VI summarizes the various changes that have occurred over the last 60 years.³

Evolution of Federal Law

That 1918 Act was a temporary act which only allowed the net operating loss (NOL) deduction to be carried to the preceding and the succeeding year. In 1921, Congress reenacted and expanded the act to permit an NOL to be carried forward for two succeeding years.

With a few modifications, the 1921 version of the NOL continued in force until 1932, when many losses occurring during that period forced Congress to act to protect federal revenues. The carryover of losses was then limited to one year. In 1933, NOL's became so prevalent that Congress eliminated all carryovers of deductions.

By 1938, however, fewer businesses were experiencing losses, and many taxpayers anticipated war production profits. The 1939 Act provided for the carryover of NOL's to two succeeding years under certain conditions.

TABLE VI
FEDERAL LAW CHANGES
NET OPERATING LOSS CARRYOVER/CARRYBACK

<u>Act</u>	<u>Section</u>	<u>Carryback</u>	<u>Carryover</u>
1918.....	204.....	1	1
1921.....	204.....	0	2
1924.....	206.....	0	2
1926.....	206.....	0	2
1928.....	117.....	0	2
1932.....	117.....	0	1
1933.....	218.....	0	0
1939.....	23(s), 122.....	0	2
1942.....	23(s), 122.....	2	2
1950.....	23(s), 122.....	1	5
1951.....	23(s), 122.....	2	3
1954.....	172.....	2	5
1958.....	172.....	3	5
1963.....	172(b)(1)(A)(ii) ¹	5	5
	172(b)(1)(C) ²	3	7
1964.....	172(b)(1)(D) ³	0	10(15)
1967.....	172(b)(1)(E) ⁴ 172(b)(3)(E) ⁵	5	3
1969.....	172(b)(1)(F) ⁵	10	5
	172(b)(1)(G) ⁶	10	5
1976.....	172.....	3	7

¹ Special provision applicable to certain businesses which have been injured by imports as a result of the Trade Expansion Act of 1962.

² Special provision applicable to regulated transportation corporations.

³ Special provision applicable to foreign expropriation losses other than those attributable to Cuba. A 1971 amendment permits Cuban losses to be carried over 15 years.

⁴ Special relief measure designed for American Motors Corporation, which expired with the taxable year ended December 31, 1968.

⁵ Special provision applicable to certain financial institutions.

⁶ Special provision applicable to a Bank for Cooperatives.

The 1942 Act allowed a carryback of an NOL, the NOL being carried back to the second preceding taxable year, the unused portion then being available for use in the first preceding taxable year, and then carried over to the next two succeeding taxable years. This amendment was essentially a war relief measure. Many corporations not in war production were already experiencing declining profits and at the close of the war economy many other corporations expected to experience declining profits. The carryback provision provided, in effect, the same type of relief in periods of declining profits which the two-year carryforward provision provided in periods of increasing profits.

The 1954 Code first allowed a five-year carryforward and a two-year carryback for all taxable years ending after December 31, 1953. The Code was amended in 1957 to allow a three-year carryback and a five-year carryover for taxable years after December 31, 1957, so that the NOL could be spread over nine taxable years.

The Tax Reform Act of 1976 further amended the 1954 Code to allow a seven-year carryover for taxable years ending after December 31, 1975.

The Revenue Act of 1978 postpones the effective date of the 1976 Tax Reform Act rules regarding certain carryovers of NOL's. In general, if a corporation's assets are acquired by another corporation in certain types of reorganizations or liquidations, the acquiring corporation succeeds to the NOL carryovers of the transferor corporation. The 1976 Reform Act established stricter

requirements that the acquiring corporation must meet before the carryovers can be utilized. The 1978 Act delayed the effective date of the changes to January 1, 1980 with respect to plans of reorganization adopted on or after that date, and until June 30, 1980, with respect to acquisitions occurring in taxable years beginning after that date.

The 1978 Act also provided special tax benefits to taxpayers whose NOL's are at least in part attributable to product liability losses. First, the portion of a NOL that is attributable to product liability losses can be carried back to the ten years preceding the year of loss and then, to the extent not so used, be carried forward to the seven years following the year of loss.

Congressional Intent

It is clear that Congress has not viewed this area of tax policy as one that can be dealt with in a "once and for all" decision-making process, but rather as one that must be adjusted to changing circumstances when the existing rules no longer serve the purpose of mitigating the tax consequences of swings in business income over a number of tax years and business cycles.

One observer of this area of tax law has listed four main objectives that Congress had in mind when it enacted loss carry-back and carryover provisions.⁴ These objectives are:

- 1) To preclude the imposition of what is tantamount to an income tax on capital rather than income. (By taxing only in profitable years and denying carryovers and carrybacks the average effective rate of tax on the income of capital over a large number years would clearly exceed the nominal rate and

would reduce the rate of return on capital below what might be considered the fair market rate of return.)

2) To reinforce tax neutrality by permitting businesses with wide cyclical swings to level their incomes, thereby facilitating competition for investment capital with others whose earning levels are more stable.

3) To provide a countercyclical effect by stimulating investment in periods of recession or financial difficulty. Refunds made possible by carrybacks offsetting prior tax liabilities provide a form of economic stimulus.

4) To encourage the entry of risk or venture capital into the marketplace.

DESCRIPTION OF CALIFORNIA LAW

While losses incurred in the operation of a trade or business are deductible under California law in the year in which the losses are incurred, there are no provisions allowing taxpayers to carryback or carryover such losses to other tax years.

STATE POLICY ISSUES

In light of the complex provisions of federal law, and the varied history of NOL law, a number of issues should be considered when discussing comparable state law.

1) Conformity with federal law, where possible, makes for less taxpayer confusion over state tax laws. On the other hand, the NOL deduction provision is extremely complicated. Adopting such a provision in state law is contrary to the goal of simplifying the state tax system, and would add a complexity not presently faced by state taxpayers.

2) If the state enacts such provisions, should they conform closely to federal law so as to minimize taxpayer complications or should separate state provisions be drawn to serve special state needs? A possible example of such a special provisions involves a requirement that any refunds generated by a carryback of a net operating loss must be reinvested in the business that generated the loss. Adopting different NOL law, however, magnifies the complexities cited in the previous point.

3) NOL offers several distinct advantages to taxpayers, as follows:

A. Infusion of Cash

The carryback results in an immediate infusion of cash to the business with the loss at a time when the cash may be very valuable for guaranteeing the survival of the firm. From a macro-economic policy point of view, it is also a valuable way to channel countercyclical economic aid to industry. In times of recession when business losses are high, the refunds made possible by the carryback provide useful economic stimulus to business.

B. Business Planning

From the point of view of business, the carryback has the virtue of providing certain relief, while the carryover is essentially speculative in nature since its value depends upon future profit projections. Past tax payments are certain and the value of refunds can be calculated directly by the taxpayer and factored into future plans for the business.

C. New Businesses

The carryover is of particular value to new businesses that have large start up losses, little or no previous tax liability, and the potential for large future profits. In these cases, the carryover option provides a better tool for arriving at the appropriate measure of long-term profitability.

D. Encourages Efficiency

Another advantage of the carryover provisions is that they provide an incentive for businesses to operate in an efficient manner so as to generate future profits and tax liabilities which may be reduced by the loss carryover.

4) There is a significant disadvantage to the use of carry-back provisions. The carryback can lead to very cumbersome administrative problems, particularly as the length of the carry-back period is increased. The recordkeeping requirements and the need to be constantly recalculating prior year tax returns can lead to administrative nightmares for both the taxpayer and the administering agency.

5) A chief disadvantage of the carryover is the potential that exists for a market which trades in "tax loss" corporations to develop. Corporations with substantial loss carryovers can be attractive acquisitions for profitable corporations because of their potential for lowering the taxes of the firm that buys the tax loss. Federal law and IRS regulations attempt to limit this trafficking in tax loss corporations but no effort in this area can be totally effective. Firms that otherwise might go out of

business because of inefficiency or changing market conditions are acquired solely as a means to reduce the taxes of a profitable business. This type of behavior hardly promotes economic efficiency or the goal of fair taxation that the carryback/carry-over provisions were meant to serve.

6) Whenever the federal government has provided for the carryback or carryover of NOL's, it has always been for the purpose of giving relief to taxpayers under a federal tax which prescribed high tax rates. Congress took into consideration the fact that strict adherence to the 12 months accounting period might be detrimental to taxpayers who, even in times of prosperity, have fluctuating incomes. Given the lower California tax rate on corporate income, and the deductibility of state taxes in determining federal taxes, is there as great a need for the "income averaging" aspect of carryback/carryover provisions as there is in federal law?

7) California is required under the State Constitution to operate under a balanced budget. The allowance of carryover and carryback of NOL's would make it more difficult to predict revenue for state budget purposes, and, thus, could have a severe impact on the state budget under uncertain economic conditions. In contrast, the need for accurate predictions of revenue at the federal level is less acute since the federal government is able to operate on a deficit budget.⁵

8) Business has already received substantial tax relief from Proposition 13 and the recent elimination of the business inventory tax (AB 66). Is further tax relief appropriate?

9) Given the revenue estimates written into law in the "deflator" provisions of Chapter 282, Statutes of 1979 (AB 8-- Greene), will enactment of these provisions result in a reduction of local government fiscal relief provided by the state?

10) The adoption of NOL provisions would create administrative difficulty for the Franchise Tax Board and increase the cost of administration since employees would have to be trained to handle the complex problems created by the extremely technical NOL provisions.

11) The NOL deduction, with its carryback of excess deductions for three prior years creates administrative difficulties in determining the financial, i.e. Bank, rate. The Bank and Corporation Tax Law requires the Franchise Tax Board to determine not later than December 31, the financial rate formula. This formula is determined, in part, by using the income of general corporations for the next preceding calendar year or fiscal years ending within such year. Therefore, returns filed by March 15 must contain the entire income of general corporations for the financial rate to be determined. If a three-year carryback of excess losses was permitted for purposes of the Bank and Corporation Tax Law, it would require, at the minimum, four years before such determination would be possible. The bank tax rate has been subject to considerable litigation in the past and adoption of a net operating loss could invite additional litigation.

12) A final consideration involves the problem of special loss provisions being added to the law to aid particular industries or business. While a widely subscribed-to objective of any tax system is to treat similarly situated taxpayers in a similar manner, the existence of loss carryback/carryover provisions provides a whole new field of tax law in which special pleadings can be made for various industries, further complicating the tax law and creating new inequities in the treatment of business taxpayers.

FISCAL IMPLICATIONS OF CONFORMITY

For the 1977 income year, net losses totalling \$2.9 billion were reported on 57,949 returns. Revenue losses resulting from the adoption of an NOL have been estimated by the Franchise Tax Board staff under various maximum deduction amounts as follows:

<u>Maximum Offset</u>	<u>Revenue Loss (In Millions)</u>
\$ 50,000	\$130
100,000	155
300,000	200
500,000	215
1,000,000	240
1,500,000	250

Revenue losses attributed to individuals under the Personal Income Tax Law estimated at \$50 million at each maximum and are included in the total revenue losses shown above.

TABLE VII

SUMMARY OF STATE
NET OPERATING LOSS CARRYOVER/CARRYBACK PROVISIONS
OCTOBER 1978

<u>Net Operating Losses</u>		
<u>State</u>	<u>Carryover from Years*</u>	<u>Carryover to Years**</u>
Ala.		NA
Alas.	1973-81	1975-85
Ariz.	1973-77	1979-83
Ark.	1975-77	1979-81
Calif.		NA
Colo.	1973-81	1975-85
Conn.	1973-77	1979-83
Del.	1973-81	1975-85
D.C.		NA
Fla.	1973-77	1979-85
Ga.	1973-81	1975-85
Hawaii	1973-81	1975-83
Ida.	1973-81	1975-83
Ill.	1973-81	1975-85
Ind.	1973-81	1975-85
Iowa	1973-81	1975-85
Kan.	1973-81	1975-83
Ky.	1977 (4)	1979 (4)
La.		(2)
Maine	1973-81	1975-85
Md.	1973-81	1975-85
Mass.	1973-77(1)	1979-83(2)
Mich.		(5)
Minn.	1973-81	1975-83
Miss.	1973-77	1979-84
Mo.	1973-81	1975-85
Mont.	1973-81	1975-85
Neb.	1973-81	1975-85
N.H.		NA
N.J.		NA
N.M.	1973-81	1975-85
N.Y.	1973-81	1975-85
N.C.	1973-77(6)	1979-83(6)
N.D.	1973-81	1975-85
Ohio	1973-77	1979-83
Okla.	1973-81	1975-85
Ore.	1973-77	1979-83
Pa.		NA
R.I.	1975-81	1975-85
S.C.	1975-77(3)	1979-81(3)
Tenn.	1975-77	1979-81
Utah	1973-81	1975-83
Vt.	1973-81	1975-85
Va.	1973-81	1975-85
W. Va.	1973-81	1975-85
Wis.	1973-77	1979-83

Footnotes

NA - Not allowed

*Losses available from years in this column may be applied against 1978 income.

**Losses for 1978 may be applied against income for years in this column. The 1976 Federal Tax Reform Act allows a seven (formerly five) year carryover for losses incurred in tax years ending after 1975. Thus, states whose taxes are based on current federal law, and which do not provide their own treatment of net operating losses, automatically adopt the new seven year carryover.

(1) Beginning after 1978, a five year carryover is allowed.

(2) For the first five years, so much of the federal loss represented by net operating loss carryovers for tax years ending Dec. 31, 1973, and thereafter is deductible.

(3) Allowed only for new business during first three years of operation.

(4) Allowed only for new businesses for loss in first year of operation.

(5) Business losses may be carried forward 10 years or until used up. Any unused carry-forward of a net operating loss from the repealed corporate income tax is deductible but not for tax years ending after 12/31/80.

(6) Five year carryover of "net economic losses"; carryback not permitted.

CHAPTER 4

GRADUATED CORPORATE INCOME TAX RATES

SUMMARY OF THE ISSUE

Since almost the beginning of the federal corporate income tax, some level of profit has been exempted from the highest corporate tax rate. Current federal law, enacted in 1978, provides for graduated increases in the corporate tax rate ranging from 17 percent to 40 percent on the first \$100,000 of taxable income. The 46 percent maximum tax rate only applies to income in excess of \$100,000 during the tax year. Graduated rates are often supported as an effective way to aid small businesses because by reducing taxes on the corporation's income they allow the firm to retain more earnings for reinvestment in the firm.

California law does not provide for graduated tax rates on taxable bank and corporation income. State law contains a flat 9.6 percent tax rate on most corporate net income with a minimum annual tax of \$200 on all corporations subject to the tax. Banks and financial corporations are subject to a higher tax rate.

The committee now has before it AB 1478 (Naylor), which would provide a graduated tax for corporations, as follows:

<u>Income</u>	<u>Tax Rate</u>
\$0 or a loss	\$200 (minimum tax)
\$1 to \$25,000	3%
\$25,000 to \$50,000	4%
\$50,001 to \$75,000	6%
\$75,001 to \$100,000	8%
\$100,001 +	9%

Should state law be amended to provide graduated tax rates applicable to corporate net incomes?

DESCRIPTION OF FEDERAL LAW

Current federal corporate tax rates were enacted by the Federal Revenue Act of 1978 which are as follows:

<u>Taxable Income</u>	<u>Current Tax Rate</u>	<u>Pre-1979 Tax Rate</u>
\$0 to \$25,000	17%	20%
\$25,000 to \$50,000	20%	22%
\$50,000 to \$75,000	30%	48%
\$75,000 to \$100,000	40%	48%
Over \$100,000	46%	48%

The purpose of both the current and the prior rate schedules was to provide some form of tax relief to small businesses. In the past, however, many large businesses fragmented their operations to obtain the advantages of the lower tax rates that applied to the first increments of taxable income. As a result, remedial legislation was enacted in 1963 and 1969 which limited groups of corporations controlled by a single interest to a single surtax exemption. (The surtax was the name for the higher rate that applied to incomes over \$50,000 prior to 1979.)¹

It should be noted that the graduated rates apply to the first \$100,000 of income of all corporations, regardless of the total amount of taxable income that an individual corporation reports. A large manufacturing firm which reports a taxable income in the hundreds of millions of dollars receives the same benefit from the graduated rates as does a much smaller firm reporting a taxable income slightly over \$100,000 for the tax year.

It should also be noted that the graduated corporation income tax is based on the absolute level of corporate profits (i.e., \$25,000, \$50,000, \$75,000, \$100,000+) and not on the rate of return on investment in a corporation. For example, consider two firms,

For example, consider two firms, one earning \$ 25,000 of

income on \$250,000 of invested capital and another earning \$1 million income on \$20 million of invested capital. The rate of profit of the first firm is 10 percent and that of the second firm is only five percent, yet the first firm pays taxes based on a lower tax rate (17 percent) than does the larger firm (46 percent). If "ability to pay" is measured by rate of return on capital, then a system of graduated rates based on the absolute dollar level of profits does not really address this concern. If, on the other hand, the objective is to aid businesses that are small in absolute size, regardless of their profitability, then the system of graduated rates based on the absolute amount of net income is appropriate.

Cost of Graduated Corporate Tax Rates to the Federal Treasury

According to the Office of Management and Budget² the 1980 fiscal year revenue loss attributable to the graduated corporate rate structure will be \$7.1 billion. These tax savings may be used by corporations for any purpose legally available to them.

BACKGROUND AND HISTORY OF FEDERAL LAW

The modern history of the corporate income tax begins with the 1894 Income Tax which levied a two percent tax on corporate net income. The tax was held to be unconstitutional by the U.S. Supreme Court, primarily for reasons unrelated to the concept of a corporation tax.

The next attempt was the 1909 Corporation Tax which was one percent on corporate net income over \$5,000. This law was held to be constitutional in Flint vs Stone Tracy Company, 220 U.S. 107 (1911). With the passage of the Sixteenth Amendment to the U.S. Constitution, Congress

enacted the 1913 Income Tax setting corporate taxes at one percent of net income. With the passage of the Revenue Act of 1918, corporate taxes were set at 12 percent, with a \$2,000 exemption. An excess profits tax was also enacted in this World War I era legislation. Between 1918 and 1934 the rate fluctuated so that by 1934 the rate was 13-3/4 percent, and the \$2,000 exemption had been eliminated.

Table VIII, "History of Corporate Income Tax Rates 1936-1979," shows the large number of changes that have occurred in the rates and exemption levels that apply to corporate net income over the last 45 years. The purpose of the lower rates applied to the first increments of corporate net income was to aid small businesses by allowing them to retain more earnings after taxes. From the mid-1930's until 1975, lower rates were applicable only to the first \$25,000 of corporate net income. In the mid-1970's many advocates of tax relief for small business argued that this \$25,000 exemption from the maximum corporate tax rate had to be increased to \$100,000 or more merely to keep up with the decline in the purchasing power of the dollar since 1940.³ In response to this argument and to the general concern that the 1974-75 recession was particularly hard on small businesses, Congress provided in the Revenue Act of 1975 that lower rates would apply to the first \$50,000 of corporate income. In the Revenue Act of 1978 the Congress raised the level of corporate income subject to lower tax rates to \$100,000 and further graduated the rate structure below that level. Congressional action in 1978 was motivated not only by a desire to aid small businesses, but by a desire to motivate business investment generally by lowering all corporate tax rates, including the top rate which was lowered from 48 percent to 46 percent on net incomes over \$100,000 per year.

TABLE VIII
HISTORY OF INCOME TAX ON CORPORATIONS 1936 - 1979

<u>Revenue Act</u>	<u>Income for</u>	<u>Net Income</u>	<u>Rate (Percent)</u>
1936	1936, 1937	First \$2,000	8
		Next \$13,000	11
		Next \$25,000	13
		Remainder	15
1938	1938, 1939	First \$5,000	12 1/2
		Next \$15,000	14
		Next \$5,000	16
		Over \$25,000	19
1940	1940	First \$5,000	13 1/2
		Next \$15,000	15
		Next \$5,000	17
		Over \$25,000	24
1941	1941	First \$5,000	15
		Next \$15,000	17
		Next \$5,000	19
		Over \$25,000	to 31
1942	1942-1945	First \$25,000	15-19
		Over \$25,000	to 40
1946	1946-1949	First \$25,000	15-19
		Over \$25,000	to 38
1950	1950	First \$25,000	23
		Over \$25,000	42
1951	1951	First \$25,000	28 3/4
		Over \$25,000	50 3/4
	1952-1963	First \$25,000	30
		Over \$25,000	52
1964	1964	First \$25,000	22
		Over \$25,000	50
1965	1965-1974	First \$25,000	22
		Over \$25,000	48
1975	1975-1978	First \$25,000	20
		Next \$25,000	22
		Over \$50,000	48
1978	1979---	First \$25,000	17
		Next \$25,000	20
		Next \$25,000	30
		Next \$25,000	40
		Over \$100,000	46

The clearest statement of Congressional intent concerning the new corporate tax rate schedule is contained in the Report of the Committee on Ways and Means, U.S. House of Representatives, on H.R. 13511 (August 4, 1979).

"The committee believes that reduction of the corporate tax rates is necessary to reduce unemployment and stimulate economic growth through capital investment. In addition, the committee believes that the reduction in corporate tax rates and the application of graduated rates to corporations will encourage growth in small business and provide tax relief to those companies. Tax relief in the form of rate reductions is especially needed for small companies that are not particularly capital intensive. Of the overall corporate rate cut of \$5 billion, about \$1 billion goes to corporations with taxable income of less than \$100,000.

Graduated corporate tax rates will also reduce the abrupt jump in tax rates under present law as taxable income increases above \$50,000, under the expiring temporary provisions, and above \$25,000, under the permanent provisions in present law. The tax rate increase from 22 percent to 48 percent under present law constitutes a 118-percent increase. The committee believes that this increase imposes too great a tax burden on the increment to taxable income. A gradual increase from the lowest to highest corporate income tax rate will reduce this large increase in the marginal rate on incremental income.

Moreover, application of the graduated rates to corporations should reduce the impact of the tax laws in the selection of a form of organization for operation of a small business. Under present law, corporate tax rates increase from 22 percent to 48 percent for taxable income in excess of \$50,000. Reduction in the corporate tax rates and application of graduated rates to corporations would reduce the relative importance of the tax laws on this choice. As a result, non-tax economic factors will receive greater emphasis in selection of the corporate, partnership or sole proprietorship form for the operation of a small business." (p. 79-80)

In general, two main arguments seem to have been advanced for enacting tax rates that are favorable to small businesses. The first, and perhaps less cited reason, is the desire to extend to the taxation of business income the "ability to pay" concept that is generally accepted as a principle feature of our personal income tax system. This line of

argument ignores the issue of the proper level of taxation of the income of the ultimate owners of the corporation in question and the issue of the economic efficiency of taxing more profitable corporations at higher rates than less profitable ones. Instead, it focuses attention on the ability of a business entity to pay corporation taxes.

The second, and more sophisticated line of reasoning argues that small, new businesses have little access to established capital markets and normal commercial lenders and consequently need to rely on retained corporate earnings as the main source of investment capital to facilitate future growth. Lower corporate net income taxes are seen as a very direct means for the government to use to encourage growth in small, new businesses without the need to establish large bureaucracies (such as the Small Business Administration) to administer loan or subsidy programs for small businesses. Extensive testimony has been presented to both houses of Congress, in the context of hearings on small business tax reform and the encouragement of small business in general, emphasizing the critical importance of retained earnings as a chief source of investment capital for small business. Lower tax rates for small businesses, special depreciation deductions, favorable investment tax credits, and special inventory accounting rules have all been suggested as ways to reduce small business corporate tax payments and, thus, as ways to increase retained earnings available for reinvestment.

A major criticism of the use of graduated tax rates as a method for aiding small (as opposed to all) businesses is that such graduated rate structures channel substantial tax savings to large businesses at the same time as aid flows to small businesses. This is because the graduated rates apply to the first \$100,000 of all corporations' taxable

income. The recently enacted federal corporate net income tax rates produced a net tax savings of \$6,750 on the first \$100,000 of net income for each corporation with a net income of \$100,000 or more. Corporations with less than \$100,000 received less than \$6,750 in relief because they had less income subject to the lower rates and hence less tax savings. A simulation of the effects of this most recent change in the rate structure using 1974 data published by the Internal Revenue Service showed that, in the aggregate, slightly more tax savings flowed to corporations with net incomes over \$100,000 than to corporations with net incomes less than \$100,000.⁴ The total revenue loss to the federal government of \$1 in additional tax relief to small businesses (i.e., those under \$100,000), therefore, would be slightly over \$2, based on the application of the current tax rates to reported corporate income in 1974.

DESCRIPTION OF CALIFORNIA LAW

California law does not provide for graduated corporate income tax rates. The Bank and Corporation Tax does provide for a flat 9.6 percent tax rate on taxable corporate net income in the case of non-financial corporations and a variable rate between 11.6 percent and 13 percent for banks and financial corporations. Under the provisions of Chapter 1150, Statutes of 1979 (AB 66 - Lockyer), these tax rates will fluctuate according to a specified schedule until 1983 in order to provide sufficient additional revenue to replace that lost due to the repeal of the business inventory tax. The higher rate for banks and financial corporations reflects the "in-lieu" tax provisions designed to subject such corporations to the same overall tax burden as is applied to other non-financial corporations. This is necessary since banks and financial corporations are not subject to many other types of state and local

taxes. All corporations are subject to a minimum tax of \$200, regardless of the level of net income reported. Federal income taxes paid by corporations are not deductible for purposes of computing income subject to the Bank and Corporation Tax.

STATE POLICY QUESTIONS

In light of the issues discussed above, there are a number of considerations relative to implementation of graduated corporate net income tax rates at the state level.

- 1) Conformity with federal law, where possible, makes for less taxpayer confusion over state tax laws.
- 2) A progressive tax rate schedule is designed to lessen the burden of the lower income taxpayer. It would help those small and new businesses with low incomes.
- 3) The concept of progressive tax rates is better applied to individual income tax where the amount of taxable income is fair indicator of "ability to pay". Because of the greater flexibility of corporate economics, the amount of taxable income is much less likely to indicate ability to pay.
- 4) Firms doing business entirely in California might avoid the higher brackets by subdividing functions in several smaller corporations.
- 5) The relatively small California tax, as compared to federal tax, would probably not be determinative of the failure or success of a new or small corporate enterprise. The federal monetary policies would have a much stronger impact.

6) Since state corporate income taxes are deductible for purposes of computing federal taxable income, the effective state tax rate differs from the statutory 9.6 percent rate established by law. The following table demonstrates this phenomenon:

<u>Income Level</u>	<u>Federal Marginal Tax Rate(%)</u>	<u>Statutory State Tax Rate(%)</u>	<u>Effective State Tax Rate(%)</u>
\$0-25,000	17	9	7.97
\$25,000-50,000	20	9	7.68
\$50,000-75,000	30	9	6.72
\$75,000-100,000	40	9	5.76
over \$100,000	46	9	5.18

It should be noted that this table assumes that corporations with incomes taxable in California also have incomes that are taxable under federal law and are thus able to reduce the effective California tax burden through deductions on their federal returns which reduce federal taxes below what they otherwise would have been. It is not always the case that firms with taxable income in California also have federally taxable incomes due to the differences between federal and state corporate tax laws. In light of the differences in effective tax rates set out above, should the state attempt to equalize the effective burden of state corporate taxes for large and small corporations?

7) If the state does choose to provide tax relief to small businesses, should such relief be provided in the form of graduated rates that apply to a specified level of corporate income for all corporations, or should other means be used to target the tax reduction towards smaller firms alone? A possible means for doing this would be to allow a certain tax credit against bank and corporation taxes on income up to \$100,000 with the credit being reduced by 125 percent of the amount by which total income exceeds \$100,000. (See the treatment of the oil depletion deduction in Section 24833 of the Revenue and Taxation Code.)

- 8) Should the \$200 minimum tax be altered if small business tax reduction is decided upon? Since the state, not the federal government, charters and regulates corporations, should the \$200 minimum tax provision of the Bank and Corporation Tax be seen as a form of income taxation or as a type of licensing fee designed to regulate the use of the corporate form of organization?
- 9) Should additional business tax relief be provided in the form of general rate reductions for all corporations, graduated rates to aid smaller firms, tax credits of a general nature, or as special credits designed to reward corporate behavior that aids certain public policy goals such as manpower training for the hardcore unemployed?
- 10) The large majority of small businesses are not corporations but rather are partnerships or sole proprietorships. If aid to small business was decided upon, would it be more appropriate to seek out forms of relief that assist the non-corporate sector as well?

FISCAL IMPLICATIONS OF CONFORMITY

If California adopts a progressive graduated corporate tax rate in close conformity with current federal law, the impact on the General Fund would be a net loss of about \$104 million for the 1979-80 fiscal year and \$295 million for the 1980-81 fiscal year.

Attached are four models of a graduated corporate tax structure developed by the Franchis Tax Board staff. These models were all created with the constraint that approximately the same amount of revenue would be collected as is collected under the present law. California law.

PROGRESSIVE CORPORATE TAX STRUCTURE

Research and Statistics has developed a hypothetical corporate tax structure patterned after the Internal Revenue Service corporate tax structure. Several schedules were derived and compared with the current bank and corporation tax structure for income year 1977. The minimum tax of \$200 is retained and therefore there is no change in tax assessments for corporations with net losses and corporations with no income or loss. The tax rates were derived based on the assumption that there is no revenue impact on the overall tax assessments. The following schedules were derived and the results are shown in Table IX.

Model 1.

Tax rate of 4% on the first \$25,000 state net income
8% on the next \$25,000 state net income
10% on the state net income in excess of \$50,000

Model 2.

Tax rate of 4.4% on the first \$25,000 state net income
7.2% on the next \$25,000 state net income
10% on the state net income in excess of \$50,000

Model 3.

Tax rate of 4.2% on the first \$25,000 state net income
7.4% on the next \$25,000 state net income
10% on the state net income in excess of \$50,000

Model 4.

Tax rate of 5% on the first \$25,000 state net income
6% on the next \$25,000 state net income
10% on the state net income in excess of \$50,000

Based on the overall tax changes, schedule 4 shows the least total tax change, +\$27,000 while schedule 3 would provide for a - \$366,000 tax change.

TABLE IX

HYPOTHETICAL BANK AND CORPORATION GRADUATED TAX STRUCTURE
1977 INCOME YEAR

State Net Income Class	Number of Returns*	State Net Income (\$000)	TAX ASSESSED (\$000)								
			Current Law	Model 1	Tax Change	Model 2	Tax Change	Model 3	Tax Change	Model 4	Tax Change
Net Loss	57,949	-2,889,834	11,922	11,922	0	11,922	0	11,922	0	11,922	0
No Income or Loss	18,269	0	3,626	3,626	0	3,626	0	3,626	0	3,626	0
\$1 under \$5,000	40,379	76,528	9,755	8,076	-1,679	8,076	-1,679	8,076	-1,679	8,184	-1,571
5,000 under 10,000	15,213	110,845	9,989	4,434	-5,555	4,877	-5,112	4,655	-5,334	5,542	-4,447
10,000 under 15,000	10,091	124,596	11,222	4,984	-6,238	5,482	-5,740	5,233	-5,989	6,200	-4,992
15,000 under 20,000	7,494	130,297	11,734	5,212	-6,522	5,733	-6,001	5,472	-6,262	6,515	-5,219
20,000 under 25,000	6,148	137,972	12,419	5,519	-6,900	6,071	-6,348	5,795	-6,624	6,899	-5,520
25,000 under 50,000	18,848	686,535	61,827	36,075	-25,752	36,237	-25,590	35,725	-26,102	36,480	-25,347
50,000 under 100,000	12,565	838,378	75,547	58,708	-16,839	57,451	-18,096	57,451	-18,096	55,567	-19,930
100,000 under 500,000	9,941	2,093,399	189,642	189,458	-184	188,464	-1,178	188,464	-1,178	186,973	-2,669
500,000 under 1,000,000	1,554	1,084,317	99,052	105,324	+6,272	105,168	+6,116	105,168	+6,116	104,935	+5,883
1,000,000 under 5,000,000	1,508	3,147,193	292,538	311,703	+19,165	311,552	+19,014	311,552	+19,014	311,325	+18,787
5,000,000 under 10,000,000	207	1,461,382	134,865	145,724	+10,859	145,704	+10,839	146,304	+11,439	145,672	+10,807
10,000,000 and over	227	7,938,969	759,091	793,443	+34,352	793,420	+34,329	793,420	+34,329	793,386	+34,295
Totals	200,393	14,940,577	1,683,229	1,684,208	+979	1,683,783	+554	1,682,864	-366	1,683,256	+27

- *(a) Assumes No Income Splitting For Parent/Subsidiary Combined Reports
- (b) Minimum Tax Of \$200 Retained
- (c) Model 1 Tax Rate of 4% on First \$25,000 State Net Income
8% on Next \$25,000 State Net Income
10% on State Net Income in Excess of \$50,000
- Model 2 Tax Rate of 4.4% on First \$25,000 State Net Income
7.2% on Next \$25,000 State Net Income
10% on State Net Income in Excess of \$50,000
- Model 3 Tax Rate of 4.2% on First \$25,000 State Net Income
7.4% on Next \$25,000 State Net Income
10% on State Net Income in Excess of \$50,000
- Model 4 Tax Rate of 5% on First \$25,000 State Net Income
6% on Next \$25,000 State Net Income
10% on State Net Income in Excess of \$50,000

CHAPTER 5

INVESTMENT TAX CREDIT

SUMMARY OF THE ISSUE

Federal law provides for a tax credit equal to 10 percent of the cost of new equipment used for business purposes. This credit is designed to stimulate business investment in capital equipment by lowering the effective after-tax cost of business equipment. State law does not provide for any such credit.

Assembly Bill 862 providing for a 2% credit was introduced in the 1977-78 regular session of the Legislature; it died in the Assembly. The Committee now has before it AB 1555 (Filante), which provides for a 5% credit.

Should the state consider providing additional incentives for such investment by adopting state income and corporation tax investment credits?

DESCRIPTION OF FEDERAL LAW¹

A credit against the federal income tax is allowed for 10 percent of the cost of "qualified investments" acquired and placed in service or constructed during the tax year.

Qualified Investments

The provisions for the depreciable property investment tax credit are set out in IRC § 38. This section allows the tax credit where a corporation (or individual) invests in certain business facilities which are termed "Section 38" property.

Only the "Section 38" property defined in the relevant portions of Subtitle B is treated as qualified investment. A qualified investment is generally an expenditure for new machinery or equipment used in a business enterprise. Generally, but not in

all cases, land, buildings, and components of buildings are not eligible for the investment credit. Investment goods produced in a foreign country are generally eligible for this credit. Up to \$100,000 per year of used equipment expenditures are also eligible for the investment tax credit.

In order to qualify for the full 10 percent investment tax credit, the investment goods must have a useful life of seven years or more. For equipment with a useful life of between five and seven years, a taxpayer may claim only 2/3 of the full 10 percent credit. For equipment with a useful life of between three and five years, the taxpayer may claim only 1/3 of the full 10 percent credit. Equipment with a useful life of less than three years is not eligible for the investment tax credit. These limitations were added to the law in order to prevent a bias towards the purchase of equipment with very short useful lives.

The property must also be a type as to which there is allowable depreciation, or amortization in lieu of depreciation, and the property must be tangible personal property. If the property is not tangible personal property it must be "other tangible property" as defined in the IRC and associated regulations.

The present law provides special treatment for investment credit for certain utilities, railroads and airlines. Different rates and definitions are applied in these cases.

Who May Claim the Credit

The investment tax credit is available to individual taxpayers (through sole proprietorships, partnerships, and Sub-Chapter S corporations), corporations, estates and trusts.

Limitations on the Amount of the Credit

The amount of the investment tax credit may not exceed the taxpayer's tax liability for the tax year. If liability exceeds \$25,000, the investment tax credit may not exceed \$25,000 plus a percentage of the tax liability above \$25,000. The Revenue Act of 1978 (P.L. 95-600) provides that this limitation on the investment credit will be gradually relaxed over the next four years. The maximum limit on the credit will be altered as follows:

1979	\$25,000 plus 60%	of the tax liability above \$25,000						
1980	\$25,000 plus 70%	" " " " " "	"	"	"	"	"	"
1981	\$25,000 plus 80%	" " " " " "	"	"	"	"	"	"
1982	\$25,000 plus 90%	" " " " " "	"	"	"	"	"	"

Carryback and Carryover of Unused Credit

Any part of the investment credit which is not used because of the limitations discussed above may be carried back three years and carried forward for seven years. Provisions are made for refunds of taxes previously paid when an investment credit carryback to an earlier year results in an overpayment of federal income tax.

ESOP

The law also provides for an additional 1% credit where an employer contributes its securities to an Employee Stock Ownership Plan (ESOP) an amount equal to 1% of the qualifying property. Further, where the employer qualifies for the 1% credit, it may qualify for an additional 1/2% credit if it contributes employer stock to an ESOP an amount equal to 1/2% of the qualifying investment and the employees of that employer also contribute an amount equal to 1/2% of the value of the qualifying property to the ESOP.

Cost of the Investment Tax Credit to the Federal Treasury

Table X shows the federal experience with the investment tax credit, using 1977 IRS data (estimates for 1978-1980 were made by Franchise Tax Board staff based on this old data). For 1980, however, the Office of Management and Budget² currently projects that the revenue loss from the investment credit will be \$15.3 billion from corporate returns and \$3.1 billion from individual tax returns. This represents a total federal tax expenditure of over \$18.4 billion directed towards encouraging investment in business equipment.

HISTORY AND RATIONALE FOR FEDERAL LAW

Most industrial nations provide special tax incentives, besides depreciation allowances, to encourage investment and economic growth. In his tax message to Congress on April 20, 1961, President John F. Kennedy proposed that an investment tax credit be enacted. The purpose of the proposed legislation was to stimulate the domestic economy and to make it more effective in competition with foreign products by modernizing and expanding both plant and equipment.

The investment tax credit was first enacted in October 1962 as part of the Revenue Act of 1962, P.L. 87-834, and provided for an income tax credit equal to 7 percent of the cost of qualified capital equipment. The credit was suspended for five months in fiscal year 1966-67 as part of the response to the revenue requirements of the Vietnam War and the need to control domestic inflation due to excess demand in the U.S. economy. The credit was repealed in 1969 as part of the Nixon Administration's program to restrain domestic spending in order to control inflation as well as in an

TABLE X

INVESTMENT TAX CREDIT
US EXPERIENCE
(Dollars in Thousands)

INCOME YEAR	TAX CREDIT RATE	CORPORATIONS		INDIVIDUALS	
		NUMBER	TAX LOSS	NUMBER	TAX LOSS
<u>Actual</u>					
1965	7%	N/A	\$1,710,728	1,977,589	\$374,824
1966	7%	N/A	2,018,757	2,085,916	434,861
1967	7%	N/A	2,075,041	2,069,235	440,270
1968	7%	N/A	2,357,068	2,179,155	498,275
1969	--	N/A	1,936,239 ¹	1,085,572	243,526 ¹
1970	--	N/A	900,743 ¹	143,409	29,751 ¹
1971	7%	N/A	1,549,607 ²	1,458,283	361,679 ²
1972	7%	N/A	2,956,427	2,306,157	699,785
1973	7%	N/A	3,753,016	2,869,068	1,077,655
1974	7%	N/A	4,221,389	3,003,749	1,198,972
1975	10%	559,789	6,414,413	2,963,510	1,582,623
1976	10%	592,375	9,016,658	3,310,020	1,892,763
1977	10%	N/A	N/A	3,368,995	1,984,465
<u>Estimate</u>					
1978	10%	657,547	10,465,046	3,438,219	2,015,178
1979	10%	690,133	11,528,981	3,589,562	2,142,758
1980	10%	722,719	12,592,915	3,740,905	2,270,348

¹Amounts represent carry-over credit only since law rescinded for 1969 and 1970.

²Amounts represent phase-in of new credit.

effort to raise additional revenues for the federal government. The credit was reinstated in 1971 at the seven percent rate and was increased to ten percent in 1975 as part of the Ford Administration's anti-recession program of economic stimulus. The Revenue Act of 1978 made permanent the ten percent rate for the credit and provided for a relaxation in the limitations of the maximum amount of the credit that may be claimed in a given year.

The investment tax credit was enacted as a means to increase business investment in capital equipment and, by so doing, spur economic growth in the U.S. and improve the productivity and international competitive position of the U.S. economy in general. When first enacted in 1962, the investment credit represented a major program of the federal government designed to stimulate economic growth through government tax policy.

Since its inception, there has been continuous debate as to the effectiveness of the investment tax credit. Proponents argue that the credit has been responsible for increasing investment in production equipment and facilities. Critics argue that the credit may not be cost-effective when revenue loss due to the credit is compared with the amount of extra investment stimulated by the credit. Other critics argue that the credit distorts the market mechanism and that policymakers should refrain from specific interventions (i.e., altering the price of capital equipment relative to all other prices) and should rely on the general stimulus provided by cuts in individual and corporate income tax rates.

Proponents counter this argument by pointing out that inflation may be partly due to inadequate supply of goods and services

in the economy and that a tax cut focused on investment spending may do more to increase industrial capacity and supply than would more general forms of tax relief for business.

U.S. General Accounting Office (GAO) Study

In 1978, the General Accounting Office (GAO) prepared a study which surveyed major academic studies that assessed the impact of the investment tax credit.³ The following were among the significant observations in the GAO report:

- The investment tax credit (and the liberalization of depreciation rules) did not increase the percentage of Gross National Product (GNP) devoted to investment in the U.S. For the period 1950 to 1961, gross private domestic investment was 15.3 percent of GNP. For the period 1962 to 1967 (the first five years after the credit was enacted) the figure was 15 percent of GNP.
- The investment tax credit did increase the percentage of domestic private investment devoted to plants and equipment. This was done at the expense of investment in residential housing.
- In essence, the tax credit succeeded in shifting investment towards productive equipment. It did not increase the overall level of investment. The reason for this was that the credit did nothing to increase the overall level of savings in the economy. Unless the level of savings is increased, it is impossible to increase the overall level of investment spending in the economy. The level of savings in the economy and the percentage amount of savings available for pri-

private business investment depend crucially upon how the federal government adjusts taxes on income and on the level and method of financing government budget deficits. If investment tax credits are increased while total government spending and all other taxes remain unchanged, then the government will incur a larger budget deficit. This deficit can be financed either by creating additional money or by additional borrowing. If additional borrowing is used, there will be no increase in the total amount of savings available to finance investment.

- Due to the two- to four-year decision-making period for private investment decisions, the investment credit is not a very effective tool for short term economic stimulus.
- A large portion of the tax credit goes to reward investment that would have been undertaken anyway. For example, the existence of the credit may cause a company to expand its investment spending by five percent over what it otherwise would have been without the credit, but it receives the tax credit on the total amount it invests.
- The main role of the credit is in fostering long term economic growth by encouraging investment in new equipment.
- The investment tax credit leads to the more extensive use of capital at the expense of labor. This, of course, is the idea behind capital investments raising labor productivity, thus enhancing economic growth. It should be noted, however, that this may reduce employment opportunities for labor in the short run.

- The investment tax credit tends to bypass those businesses which do not require large amounts of capital investment. Labor intensive businesses are placed at a competitive disadvantage as a result.

DESCRIPTION OF CALIFORNIA LAW

California law does not provide for an investment tax credit. Since federal income taxes are not deductible for state income and bank and corporation tax purposes, the state does not realize any revenue gain due to lower federal tax liabilities as a result of the investment tax credit.

STATE POLICY QUESTIONS

In light of these findings concerning experience with the federal investment credit, a number of issues should be considered when discussing a state counterpart to the federal credit.

- 1) Conformity with federal law, where possible, makes for less taxpayer confusion over state tax laws.
- 2) State investment credits might stimulate the California economy. However, recent indications are that the state economy is already faring better than the rest of the country in the present nationwide economic downturn. Existing federal credits have not prevented this recession nationally.
- 3) The policies which first created the investment tax credit were largely national ones, particularly those involving international competition. Is it appropriate for the state to engage in macro-economic policymaking (i.e., stimulating growth and investment), an area traditionally left to fed-

eral control? Could California meaningfully affect these areas in any event?

- 4) Due to relatively low state tax rates and the deductibility of the state tax in computing federal tax (reverse revenue sharing), it is apparent that such a state credit would not significantly affect corporate decisions on investment. As such, state tax credits which duplicate federal law amount to a windfall for taxpayers already motivated by the considerably higher federal tax benefits. Where no federal credits exist, a state tax credit may have some impact on taxpayer decisions, although it still represents a windfall for those who would have behaved thusly in any event.
- 5) Application of the credit to multistate corporations would benefit investments other than in California.
- 6) Given the fiscal constraints of the state, would any feasible amount of state investment tax incentives provide a significant economic stimulus for the California economy?
- 7) Business has already received substantial tax relief from Proposition 13 and the recent elimination of the business inventory tax (AB 66). Is further tax relief appropriate?
- 8) Given the revenue estimates written into law in the "deflator" provisions of Chapter 282, Statutes of 1979 (AB 8 - Greene), will enactment of these provisions result in a reduction of

local government fiscal relief provided by the state?

- 9) Would it be a more effective form of economic stimulus to lower the overall state corporate tax rate rather than to provide tax relief only to firms investing in capital equipment? Should tax incentives be concentrated in order to provide more stimulus to small businesses?
- 10) Should investment tax incentives be structured in a fashion which rewards only expanded investment rather than all investment, including that which would occur without a special credit?
- 11) Should additional tax incentives be provided to expand investment in capital equipment or should incentives be provided for investment in "human capital" (i.e. employee training programs)?

FISCAL IMPLICATIONS OF CONFORMITY

If the investment credit provisions of AB 1555 were adopted, the Franchise Tax Board staff estimates a General Fund revenue loss of approximately \$750 million. If the federal law were incorporated entirely, the loss would be about \$1.5 billion.

CHAPTER 6

SUBCHAPTER S (TAX OPTION) CORPORATIONS

SUMMARY OF THE ISSUE

Since 1958, federal law has contained provisions, commonly known as "Subchapter S", which allow corporations engaged in active trades or businesses to voluntarily choose to be treated for income tax purposes in a manner somewhat similar to that accorded to partnerships. When an eligible corporation elects to be treated under these provisions, the income or loss (except for certain capital gains) is not subject to the corporation income tax, but rather, each shareholder reports a share of the corporation's income or loss each year in proportion to his or her share of the corporation's total stock. This option allows persons to have the legal advantages of the corporate form of organization (chiefly, limited liability) without facing the tax consequences.

California law contains no such provisions in either the Personal Income Tax or in the Bank and Corporation Tax law. Income of such corporations is subject to the normal 9.6 percent corporate tax rate and any dividends actually paid by such corporations to shareholders would be taxed at the personal income tax rate applicable to each shareholder.

AB 1861 (Knox) and AB 810 (Knox) proposed Subchapter S treatment under state law in the 1971 and 1972 regular legislative sessions, respectively; both failed passage. The committee now has before it AB 874 (McVittie) and AB 1470 (Kelley) on this subject.

Should state law be amended to provide a similar option for California personal and corporate taxpayers?

DESCRIPTION OF FEDERAL LAW¹

Current federal law, as amended by the Federal Revenue Act of 1978, provides taxpayers and corporations with the option of using the special provisions relating to small business corporations, also known as tax option corporations.

A tax option corporation is one that has elected, by unanimous consent of its shareholders under the provisions of Subchapter S, not to pay corporation tax on its income and, instead, to have the shareholders pay taxes on the income even though it may not actually be distributed to the shareholders and is still retained by the corporation.

Unlike a partnership, a tax option corporation is not a "conduit". Individual items of income and deduction are not passed through to the shareholders to retain the same character for tax purposes in the hands of shareholders as they had in the hands of the corporation. Instead, taxable income is computed at the corporate level in much the same way as it is computed for any other corporation. The shareholders are then taxed directly on this amount of taxable income, even if no distribution of cash is actually made.

To the extent the corporation's current income remains undistributed, it is taxed to persons who are shareholders on the last day of the corporation's taxable year, as if on that last day there had been a pro rata distribution as a dividend of the corporation's undistributed taxable income. Subsequent

distribution of such undistributed income to the same shareholder is permitted as a nontaxable distribution. Basis adjustments to the shareholder's stock accompany these events, basis being increased for undistributed income to the shareholder and decreased for distribution from that income.

The only exception to this "no-conduit rule" involves capital gains. The tax option corporation's net capital gain is passed through to the shareholders and is treated by them as a long term capital gain.

In determining the taxable income of a Subchapter S corporation, its operating loss deductions and certain miscellaneous deductions are disregarded. Operating losses, as well as net capital gains, are reported directly by the shareholders, as though incurred or realized by them. With respect to the corporation's excess of net long-term capital gain over net short-term capital loss, each shareholder is considered to have received a portion which is proportionate to his share of corporate income, but the total amount passed through to the stockholders cannot exceed the corporation's taxable income computed without these capital gains.

Some of the more important specific aspects of Subchapter S are discussed below.

Eligibility

To qualify for Subchapter S treatment, a corporation must meet the following requirements:

- (1) It must be a domestic corporation organized under the laws of the U.S. or any of the states.

(2) It must not be a member of an affiliated group of corporations.

(3) It must have only one class of stock.

(4) It must not have more than 15 shareholders.

(5) It must have only individuals or estates as shareholders. (An exception is made for certain trusts.)

(6) It must not have a nonresident alien as a shareholder.

Election

A corporation may elect to come under the provisions of Subchapter S if all stockholders unanimously agree to the election, beginning with a particular taxable year, either in the last month in the preceding year or in the first month of that taxable year. The election must have the consent of all persons who are the shareholders at the beginning of the first year to which the election applies, if the election is made before that time, or all the shareholders on the date the election is made if that takes place after the beginning of the first year to which it applies.

An election is binding for all future years, unless it is terminated through the addition of new stockholders or it is revoked or the corporation ceases to be a "small business corporation". If a new shareholder affirmatively declares that he or she does not wish to be treated under Subchapter S, then the election is terminated for the corporation as a whole and for all other shareholders.

In addition to the above provision, a corporation may lose its Subchapter S status if more than 80 percent of its gross

receipts are from royalties, rents, dividends, interest, annuities, or sales of stocks or securities. (The latter requirement does not apply to the first taxable year in which the corporation began active conduct of business or the next taxable year, if the amount of this type of income for such taxable year is less than \$3,000.)

Effect of Election on Shareholders

If the election of Subchapter S status is correctly made, the corporation will not be subject to the income tax on corporations. All income and net operating losses are passed on to the shareholders, whether or not the income is actually distributed. A net corporate operating loss is treated by the shareholders in the same manner as a loss from a trade or business under the personal income tax law. A shareholder may deduct his or her pro rata share of the loss, but the amount deducted cannot exceed the shareholder's adjusted basis in the corporation. Excess net operating losses may not be carried over to other tax years.

Long term corporate capital gains are subject to a special tax at the corporate level if the long-term capital gain: (1) exceeds any short-term capital losses by more than \$25,000; (2) exceeds 50 percent of the total corporate taxable income; and (3) corporate income exceeds \$25,000. The excess of capital losses over capital gains is not passed on to the shareholders but may be carried over to future years by the corporation. Income from long-term capital gains of the corporation retains its capital gains character when passed on to the shareholder and, hence, is taxable at the more favorable capital gains rates allowed under the personal income tax law.

HISTORY AND RATIONALE FOR FEDERAL LAW

As early as the end of World War II, alternatives for the taxation of small, closely held corporations were discussed. In 1954, Congress enacted legislation (Subchapter R) which allowed partnerships and sole proprietorships to elect to be taxed as corporations. Subchapter S provisions were first enacted as part of the Technical Amendments Act of 1958.

Congress passed this legislation in the belief that "... it permits businesses to select the form of business organization desired, without the necessity of taking into account major differences in tax consequence."⁵ In addition, Congress believed that "...permitting shareholders to report their proportionate share of the corporate income, in lieu of a corporate tax, will be a substantial aid to small business....The provision will also be of substantial benefit to small corporations realizing losses for a period of years where there is no way of offsetting these losses against taxable income at the corporate level, but the shareholders involved have other income which can be offset against these losses."⁶

The chief advantage of the corporate form of doing business is the limited liability of the managers and shareholders of the business in question. Limited liability encourages risk-taking in economic ventures and makes it easier for small businesses to attract investment dollars from potential investors.

In the original version, the Subchapter S provisions contained a number of restrictions on the use of the tax option corporation in an attempt to limit this option to small businesses.

Chief among these restrictions was the provision which limited to ten the number of shareholders a corporation might have. This restriction, only recently changed to 15 shareholders, made it difficult for some small businesses to raise outside capital, since fewer investors could join the firm and still have the corporation retain its status as a tax option corporation. This restriction also caused problems when a shareholder died and the number of heirs who were entitled to shares in the corporation pushed the total number of shareholders over the limit. Again, recent amendments to the Internal Revenue Code have reduced some of the problems caused by this restriction, particularly in the treatment of inherited stock in Subchapter S corporations with respect to the limit on the total number of shareholders.

Due to these restrictions and IRS rulings dealing with other aspects of Subchapter S, such as the requirements for the distribution of previously taxed income in the form of cash only, involuntary revocation of the election to Subchapter S status, and limitations on the sources of income allowable for such a corporation, the literature of accountancy and tax law are filled with articles discussing the pitfalls of Subchapter S. While the law in this area has been constantly amended over the last 20 years to correct some of these problems, it still seems true that election of Subchapter S status is not as simple a decision as Congress intended when it enacted these provisions. In addition to these considerations, many tax practitioners note that state taxes on the corporate form are higher than those on partnerships and, hence, a major deterrent to the choice of Subchapter S status.

Extent of Subchapter S Activity

The following statistics drawn from publications of the Internal Revenue Service provide a profile of the nature and extent of Subchapter S activity in the U. S. in 1974, the last year for which such data is available.²

Economic Activity of Subchapter S Corporations

Number of Subchapter S Returns	333,099
Number of Shareholders	832,493
Business Receipts	\$120,960,889,000
Net Income (Less losses)	\$ 3,549,831,000
Net Worth	\$ 14,986,003,000
Income Distributed to Shareholders	\$ 2,108,297,000

Percent of Firms with:

1 Shareholder	31.2%
2 Shareholders	33.6%
3 Shareholders	15.2%
4 Shareholders	9.7%
5 or More Shareholders	10.3%

Primary Activity of Corporations Electing Subchapter S Status

Agriculture, Forestry, Fishing	5.1%
Mining	.7%
Construction	11.3%
Manufacturing	10.3%
Transportation and Public Utility	4.4%
Wholesale and Retail Trade	35.5%
Finance, Insurance, Real Estate	11.5%
Services	<u>21.2%</u>
	100%

By way of comparison, there were 10,881,969 sole proprietorships and 1,073,147 partnerships involving 4,950,576 partners in the entire U.S. in 1975. As can readily be seen, Subchapter S corporations are only a small part of the small business community in the United States.³

California taxpayers have not participated in the use of the Subchapter S option in proportion to their share of the total population of the U.S. In the 1976 tax year, 642,980 individual tax

returns in the entire U.S. reported net income or a loss from a small business corporation electing Subchapter S treatment. Only 4.1 percent of these individual returns were from California taxpayers, a total of 26,226. In comparison, a year earlier in 1975, there were 1,105,976 sole proprietorships and 156,817 partnerships involving 794,171 partners in California.⁴ Whether the limited use of the tax option corporation by California businesses was due to the lack of corresponding provisions in state law is hard to determine without in-depth examination of the circumstances in individual cases. Clearly, however, the rather substantial state corporation tax rate (9.6 percent), has some deterrent effect upon California businesses' choice of a legal form of doing business.

DESCRIPTION OF CALIFORNIA LAW

California law contains no provision similar to either the 1954 Subchapter R legislation (which was repealed from federal law, January 1, 1969) or the 1958 Subchapter S legislation, in either the Personal Income Tax Law or in the Bank and Corporations Tax law. Corporations electing Subchapter S status are subject to the Bank and Corporation Tax on net corporate income at the standard 9.6 percent rate of tax for corporations and the higher rate for banks and financial corporations.

STATE POLICY ISSUES

In light of the federal provisions, a number of issues should be considered when discussing a state counterpart to Subchapter S.

(1) Conformity with federal law, where possible, makes for less taxpayer confusion over state tax laws. However, jurisdictional problems and differences in the way corporations are taxed federally and by the state makes it impossible for federal Subchapter S provisions to be adopted intact by the state. Thus, at best only partial conformity could be achieved, and this runs counter to the goal of tax simplicity.

(2) Are the types of businesses that are most likely to make use of Subchapter S (retailing, finance, insurance, real estate and services) in need of additional favorable state tax treatment? Should it be state policy to encourage these types of businesses?

(3) Is giving taxpayers all benefits of doing business in corporate form (e.g., limited liability) plus all benefits of not acting in corporate form an appropriate policy?

(4) If the state should decide to enact provisions similar to the Subchapter S provisions in federal law, is it appropriate to exempt Subchapter S corporations from the minimum tax (\$200) features of the California Bank and Corporation Tax Law?

(5) Subchapter S affords several major advantages, to taxpayers, as follows:

A. Avoidance of Double Tax

The right to elect Subchapter S tax treatment permits the owners of a business to operate in a corporate form without fear of a double tax on income, i.e., one tax at the corporate level and another at the shareholder level.

B. Ordinary Income Deduction for Losses

The Subchapter S election makes it feasible for the owners to immediately incorporate a new business which anticipates losses in its early years. The election may be made after incorporation and the losses passed through to the shareholders to be deducted by them on their returns. The election may be terminated when the corporation becomes profitable.

C. Employees' Benefits

The Subchapter S election permits stockholders, in general, to receive partnership-type treatment with respect to income, and, at the same time, to take advantage of many of the benefits available under the Internal Revenue Code to employees but not to self-employed persons.

D. Method of Splitting Income

An electing corporation may be used as a method of dividing income among a family group; that is, of shifting income from higher to lower tax brackets and thereby reducing the total family tax burden. This may be accomplished by transferring stock to lower income members of the family such as minor children.

E. Deferring Income

Undistributed taxable income of a Subchapter S corporation is included by a shareholder for his

taxable year in which the taxable year of the corporation ends. Therefore, it is possible to defer the reporting of income by adopting a taxable year for the corporation different from that of the shareholder.

F. Avoidance of Tax on Unreasonable Accumulations

An election under Subchapter S may be made by an existing corporation to avoid the threat of tax on unreasonable accumulations. If an election is made, the earnings will be taxed directly to the shareholders. Since the corporation is exempt from tax, there is no possibility of a double tax.

(6) Subchapter S may cause taxpayers to experience one or more of the following difficulties (which of course already are posed by existing federal law, but the consequences of which would be magnified by adoption of state provisions):

A. Problem in Withdrawing Previously Taxed Income

The major problem peculiar to operating under Subchapter S concerns the difficulties in withdrawing previously taxed income. Income of an electing corporation that is not distributed during the taxable year is taxed to the shareholders at the end of the year as a constructive dividend. This income cannot be withdrawn tax-free in a later year, unless all current earnings and profits for that year are first distributed.

B. Unintended Disqualification

There is the risk that an electing corporation may be disqualified from operating under Subchapter S, against the wishes of the majority of the shareholders. If the election is terminated, the corporation becomes a separate tax entity subject to rules applicable to corporations. In addition to subjecting the owners to general corporate rules, the determination will deny them the right to make tax-free withdrawals of any previously taxed income.

C. Corporation and Shareholder on Different Taxable Years

If the electing corporation and shareholders are on different taxable years, the shareholder, at the time he files his individual return, may not know how certain distributions from the corporation are to be reported.

(7) The method of taxing individuals and corporations under federal law differs from state law. Under federal law, tax on individuals and corporations is on a current year basis. Under state law, tax on individuals is on a current basis but the tax on corporations is on a prospective basis. This difference causes difficult problems in tax imposition whenever the Subchapter S election or election to withdraw from Subchapter S status occurs. In addition, the state law imposes a minimum tax of \$200 on corporations whereas federal law does not.

(8) California could lose tax from nonresident shareholders of Subchapter S corporations which would not be lost if the entity

were taxed as a corporation. The treatment of capital gains present a problem under state law because, under the Bank and Corporation Tax Law capital gains are not given special treatment, while under the Personal Income Tax Law they are.

(9) High federal tax rates may provide some justification for Subchapter S treatment at the federal level. State tax rates, by comparison, are much lower, and arguably have little material effect on whether a business will be conducted as a corporation or otherwise in California.

(10) Subchapter S was enacted to allow small corporations an election not to be taxed as corporations. The legislation is not really limited to "small" business corporations, however, as it is available to a business of any size as long as the business has 15 or fewer shareholders. For Subchapter S purposes, then, the term "small business", relates to the number of shareholders and not the size of the business. Therefore, a very successful corporation could escape tax as a corporation simply because it has 15 or fewer shareholders.

FISCAL IMPLICATIONS OF CONFORMITY

A preliminary estimate by the Franchise Tax Board staff of the financial ramifications of full conformity with Subchapter S of the Internal Revenue Code is as follows (1977 income year estimates):

- (1) Corporate net income of small business corporations would be exempt from the corporate income tax: \$29 million loss
- (2) Corporation net losses would flow through to personal income tax returns and would reduce personal income tax: \$18 million loss
- (3) Corporation long-term capital gains would flow through to the personal income tax returns and receive preferential treatment: \$6 million loss

- (4) Personal income tax returns would report additional income from reduced corporation taxes: \$3 million gain
- (5) Subchapter S corporations would be exempt from the minimum tax: \$1 million loss

The above estimates net a \$51 million loss in state revenues for the 1977 income year. If full conformity were enacted beginning with the 1980 income year, estimated losses would be as follows:

<u>Income Year</u>	<u>Revenue Loss (Millions)</u>	<u>Fiscal Year</u>	<u>Revenue Loss (Millions)</u>
1980	\$59	1980/81	\$62
1981	\$64	1981/82	\$65
1982	\$68		

FOOTNOTES

THE INVESTMENT TAX CREDIT

1. 1979 U.S. Master Tax Guide, Commerce Clearing House, Inc., pp. 448-452.
2. Special Analysis G, the Budget for Fiscal Year 1980, Office of Management and Budget, pp. 183-209.
3. Investment Tax Credit: Unresolved Issues, United States General Accounting Office, 1978.

GRADUATED CORPORATE INCOME TAX RATES

1. Tax Expenditures: Compendium of Background Material on Individual Provisions, Committee on the Budget, United States Senate, March 17, 1976, pp. 41-42.
2. Special Analysis G, The Budget for Fiscal Year 1980, Office of Management and Budget, pp. 183-209.
3. Small Business Tax Reform, Joint Hearings Before the Select Committee on Small Business and the Subcommittee on Financial Markets of the Committee on Finance of the United States Senate, July 17, 18 and 19, 1975, pp. 242-254.
4. Calculation performed by Assembly Office of Research based on the Statistics of Income 1974, Corporation Income Tax Returns, U.S. Internal Revenue Service, Publication 16 (11-78) November 1978, p. 106.

SPECIAL PROVISIONS AFFECTING SMALL BUSINESS CORPORATIONS

1. 1979 U.S. Master Tax Guide, Commerce Clearing House, Inc., pp. 107-114.
2. Statistics of Income, 1974, Corporate Income Tax Returns, U.S. Internal Revenue Service, Publication 16 (11-78) November 1978, p. 165.
3. Statistics of Income, 1975, Business Income Tax Returns: Sole Proprietorships and Partnerships. U.S. Internal Revenue Service, Publication 438 (7-78) July 1978, p. 52, 54, 240, 242.
4. Ibid.
5. Senate Report No. 1983, 85th Congress, 2nd Session, p. 87.
6. Ibid.

FOOTNOTES - continued

CARRYOVER/CARRYBACK OF NET OPERATING LOSSES

1. 1979 U.S. Master Tax Guide, Commerce Clearing House, Inc., pp. 407-410.
2. Tax Reform, Public Hearings Before the Committee on Ways and Means, U.S. House of Representatives, 94th Congress, 1st Session, Part 5, July 1975, pp. 3625-3631.
3. Ibid.
4. Ibid.
5. Capital Formation, Joint Committee on Internal Revenue Taxation for the Committee on Ways and Means, October 7, 1975, p. 57.

APPENDIX I

Revenues From Taxes on Corporation Net Income

Of State and Local Government:

California Compared with the Balance of the United States

<u>Fiscal Year</u>	<u>California</u>	<u>Balance Of U.S.</u>	<u>California % of Balance Of U.S.</u>
1966-67	\$ 6.98	\$ 3.45	202.3%
1971-72	7.02	4.96	141.6
1972-73	8.45*	5.47	154.3
1973-74	9.41*	5.32	177.0
1974-75	9.98	5.28	189.1
1975-76	9.21	5.40	170.6
1976-77	10.57	6.18	171.0

% Change:

1966-67 to 1976-77	+ 51.4%	+ 79.2%
1971-72 to 1976-77	+ 50.5	+ 24.7
1973-74 to 1976-77	+ 12.3	+ 16.2
1974-75 to 1976-77	+ 5.9	+ 17.1
1975-76 to 1976-77	+ 14.7	+ 14.4

Computed from data tabulated and reported by the Bureau of the Census, U. S. Department of Commerce.

*Not exactly comparable with the other figures shown. Figure derived from a different source. Discrepancy believed to be negligible.

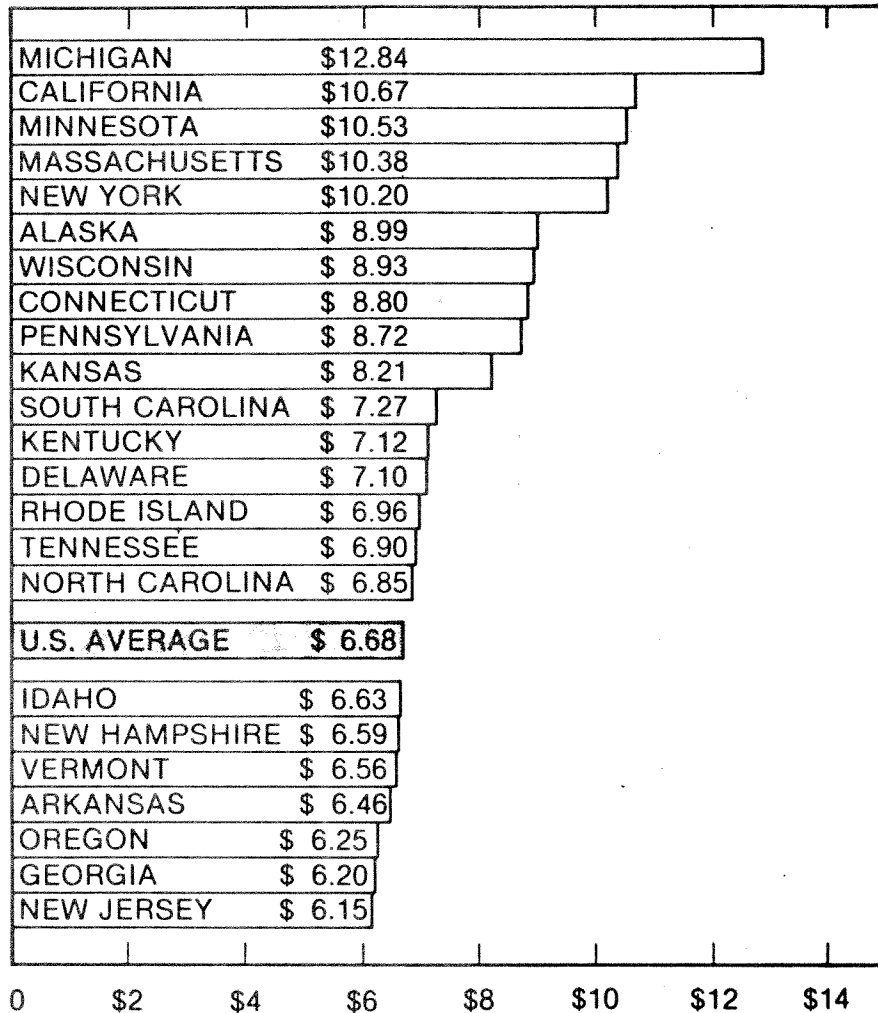
Source: Tables in this Appendix from California Tax Study, by Conrad Jamison, Security Pacific National Bank, February 1979

Revenue of State and Local Governments
From Taxes on Corporation Net Income
Per \$1,000 of Personal Income
Fiscal Year 1976-77

<u>Rank</u>	<u>State</u>		<u>% of U.S. Average</u>
	1. Michigan	\$ 12.84	192.2
→	2. California	10.67	159.8
	3. Minnesota	10.53	157.7
	4. Massachusetts	10.38	155.4
	5. New York	10.20	152.7
	6. Alaska	8.99	134.6
	7. Wisconsin	8.93	133.7
	8. Connecticut	8.80	131.8
	9. Pennsylvania	8.72	130.6
	10. Kansas	8.21	122.9
	11. South Carolina	7.27	108.8
	12. Kentucky	7.12	106.6
	13. Delaware	7.10	106.3
	14. Rhode Island	6.96	104.2
	15. Tennessee	6.90	103.3
	16. North Carolina	6.85	102.6
	UNITED STATES average	6.68	100.0
	17. Idaho	6.63	99.3
	18. New Hampshire	6.59	98.7
	19. Vermont	6.56	98.2
	20. Arkansas	6.46	96.7
	21. Oregon	6.25	93.6
	22. Georgia	6.20	92.8
	23. New Jersey	6.15	92.1
	24. Maine	6.13	91.8
	25. Montana	5.83	87.3
	26. North Dakota	5.80	86.8
	27. Iowa	5.13	76.8
	28. Virginia	4.99	74.7
	29. Colorado	4.84	72.5
	30. Illinois	4.66	69.8
	31. Ohio	4.60	68.9
	32. Louisiana	4.59	68.7
	33. Oklahoma	4.47	66.9
	34. Hawaii	4.45	66.6
	35. Nebraska	4.44	66.5
	36. Mississippi	4.30	64.4
	37. New Mexico	4.09	61.2
	38. Alabama	4.05	60.6
	39. Maryland	4.04	60.5
	40. Arizona	3.93	58.8
	41. Florida	3.83	57.3
	42. Utah	3.78	56.6
	43. Missouri	3.71	55.5
	44. Indiana	2.61	39.1
	45. West Virginia	2.35	35.2
	46. South Dakota .....	.71	10.6
	47. Nevada .....	.00	.0
	48. Texas .....	.00	.0
	49. Washington .....	.00	.0
	50. Wyoming .....	.00	.0
	51. District of Columbia .....	.00	.0

Source: U. S. Department of Commerce, Bureau of the Census.

REVENUE OF STATE AND LOCAL GOVERNMENT FROM TAXES ON CORPORATION NET INCOME PER \$1,000 OF PERSONAL INCOME FISCAL YEAR 1976-1977



Per Capita Revenue of State and Local Governments

From Taxes on Corporation Net Income

Fiscal Year 1976-77

<u>Rank</u>	<u>State</u>		<u>% of U.S. Average</u>
1.	Alaska	\$ 87.89	207.3
2.	Michigan	86.47	203.9
→ 3.	California	74.97	176.8
4.	New York	72.25	170.4
5.	Massachusetts	68.70	162.0
6.	Minnesota	64.93	153.1
7.	Connecticut	64.91	153.1
8.	Pennsylvania	56.51	133.3
9.	Wisconsin	54.11	127.6
10.	Kansas	52.76	124.4
11.	Delaware	49.89	117.6
12.	New Jersey	45.41	117.1
13.	Rhode Island	43.68	103.0
	UNITED STATES average	42.41	100.0
14.	New Hampshire	38.35	90.4
15.	Oregon	38.34	90.4
16.	Kentucky	37.96	89.5
17.	South Carolina	37.07	87.4
18.	North Carolina	36.98	87.2
19.	Tennessee	36.30	85.6
20.	Idaho	36.21	85.4
21.	Vermont	34.99	82.5
22.	Illinois	34.18	80.6
23.	Georgia	33.85	79.8
24.	North Dakota	33.38	78.7
25.	Montana	32.80	77.3
26.	Maine	32.44	76.5
27.	Iowa	31.92	75.3
28.	Arkansas	31.35	73.9
29.	Virginia	30.99	73.1
30.	Hawaii	30.84	72.7
31.	Colorado	30.77	72.6
32.	Ohio	29.48	69.5
33.	Maryland	27.86	65.7
34.	Nebraska	26.87	63.4
35.	Oklahoma	25.13	59.3
36.	New Mexico	24.78	58.4
37.	Louisiana	24.29	57.3
38.	Florida	22.98	54.2
39.	Arizona	22.56	53.2
40.	Missouri	22.03	52.0
41.	Alabama	20.56	48.5
42.	Utah	19.61	46.2
43.	Mississippi	19.20	45.3
44.	Indiana	16.17	38.1
45.	West Virginia	12.55	29.6
46.	South Dakota	3.63	8.6
47.	Nevada .....	.00	.0
48.	Texas .....	.00	.0
49.	Washington .....	.00	.0
50.	Wyoming .....	.00	.0
51.	District of Columbia .....	.00	.0

Source: U. S. Department of Commerce, Bureau of the Census.

Table 3†
Bank and Corporation Franchise Tax Statistics
STATE NET INCOME BY INDUSTRY
1976 Income Year

NET INCOME TAXABLE IN CALIFORNIA	AGRICULTURE, FORESTRY AND FISHING				CRUDE PETROLEUM AND NATURAL GAS PRODUCTION			
	NUMBER OF RETURNS	INCOME REPORTED FOR TAXATION		TAX ASSESSED	NUMBER OF RETURNS	INCOME REPORTED FOR TAXATION		TAX ASSESSED
		FEDERAL	STATE			FEDERAL	STATE	
NET LOSS.....	1,566	-\$76,782,443	-\$82,742,627	\$315,000	230	\$294,735,534	-\$79,885,282	\$57,200
NO INCOME OR LOSS.....	415			84,200	83			16,600
SUBTOTALS.....	1,981	-\$76,782,443	-\$82,742,627	\$399,200	313	\$294,735,534	-\$79,885,282	\$73,800
NET INCOME								
\$1 UNDER \$5,000	618	16,757,931	1,130,272	150,381	87	-164,410	178,130	21,709
5,000 UNDER 10,000	269	2,545,757	1,954,328	175,897	30	6,852,623	219,950	19,791
10,000 UNDER 15,000	208	8,009,756	2,535,155	228,164	21	275,670	267,458	24,070
15,000 UNDER 20,000	180	3,821,906	3,152,219	283,701	11	376,887	183,238	16,491
20,000 UNDER 25,000	142	3,572,048	3,168,458	285,157	18	14,258,096	418,126	36,030
25,000 UNDER 30,000	131	3,267,929	3,586,269	322,770	11	464,711	297,253	26,755
30,000 UNDER 40,000	240	8,268,482	8,366,053	752,541	19	730,638	649,920	58,493
40,000 UNDER 50,000	215	8,913,764	9,751,481	877,428	23	2,190,663	1,045,358	93,883
50,000 UNDER 100,000	494	31,935,190	33,555,784	3,019,427	55	22,517,347	3,911,249	351,007
100,000 UNDER 200,000	221	29,746,324	30,356,395	2,730,282	20	20,003,148	2,957,084	266,136
200,000 UNDER 500,000	143	69,045,757	42,903,677	3,860,537	23	60,517,411	7,058,511	634,469
500,000 UNDER 1,000,000	40	45,633,938	27,481,552	2,481,552	5	56,908,125	4,290,518	386,147
1,000,000 UNDER 2,000,000	16	21,234,855	21,986,576	1,977,593	8	352,830,006	10,358,664	932,354
2,000,000 UNDER 5,000,000	1	2,431,996	2,563,635	230,727	10	275,081,026	29,808,198	2,678,337
5,000,000 AND OVER.....	4	51,374,552	55,867,703	5,022,094	18	14,043,003,178	1,287,338,242	115,798,639
SUBTOTALS.....	2,922	\$306,560,185	\$248,466,370	\$22,398,251	359	\$14,855,845,119	\$1,348,981,899	\$121,344,311
GRAND TOTALS.....	4,903	\$229,777,742	\$165,723,743	\$22,797,451	672	\$15,150,580,653	\$1,269,096,617	\$121,418,111
	OTHER MINING AND QUARRYING				CONSTRUCTION			
NET INCOME TAXABLE IN CALIFORNIA	NUMBER OF RETURNS	INCOME REPORTED FOR TAXATION		TAX ASSESSED	NUMBER OF RETURNS	INCOME REPORTED FOR TAXATION		TAX ASSESSED
		FEDERAL	STATE			FEDERAL	STATE	
NET LOSS.....	174	-\$8,990,145	-\$8,216,763	\$41,800	5,095	-\$182,423,653	-\$140,185,966	\$1,034,400
NO INCOME OR LOSS.....	125			16,950	948			189,600
SUBTOTALS.....	299	-\$8,990,145	-\$8,216,763	\$58,750	6,043	-\$182,423,653	-\$140,185,966	\$1,224,000
NET INCOME								
\$1 UNDER \$5,000	42	323,150	87,898	10,313	2,930	42,391,545	5,639,384	709,353
5,000 UNDER 10,000	14	1,337,120	110,200	9,919	1,188	10,391,916	8,641,109	777,520
10,000 UNDER 15,000	11	130,388	141,618	12,744	798	13,118,371	9,857,972	887,209
15,000 UNDER 20,000	8	142,708	134,494	12,105	598	43,279,738	10,482,797	943,463
20,000 UNDER 25,000	9	180,854	198,093	17,829	499	11,029,234	11,149,610	1,003,462
25,000 UNDER 30,000	7	172,205	190,449	17,140	369	13,230,114	10,076,256	906,661
30,000 UNDER 40,000	16	528,025	549,002	49,410	557	33,163,372	19,314,779	1,738,139
40,000 UNDER 50,000	5	6,716,348	226,714	20,405	518	24,831,697	23,336,664	2,099,311
50,000 UNDER 100,000	18	5,433,717	1,293,398	116,008	877	92,797,833	58,008,238	5,219,766
100,000 UNDER 200,000	9	4,167,458	113,427	113,240	326	96,688,419	44,549,459	4,008,249
200,000 UNDER 500,000	7	37,939,486	1,922,851	172,858	202	130,308,396	60,786,033	5,467,345
500,000 UNDER 1,000,000	2	1,420,932	1,341,832	120,764	58	87,919,294	40,224,846	3,619,635
1,000,000 UNDER 2,000,000	2	20,746,586	3,278,160	295,034	6	8,817,921	9,134,727	822,126
2,000,000 UNDER 5,000,000	1	3,254,762	3,445,256	310,073	11	180,344,983	31,764,048	2,826,963
5,000,000 AND OVER.....	1	12,565,496	7,277,552	654,980	11	650,596,031	165,543,459	14,878,510
SUBTOTALS.....	152	\$95,059,235	\$21,457,944	\$1,932,822	8,948	\$1,438,908,864	\$508,509,381	\$45,917,712
GRAND TOTALS.....	451	\$86,069,090	\$13,241,181	\$1,991,572	14,991	\$1,256,485,211	\$368,323,415	\$47,141,712

Source: Tables in this Amendment from 1977 Franchise Tax Return

APPENDIX II

Table 3 (continued) †

Bank and Corporation Franchise Tax Statistics

STATE NET INCOME BY INDUSTRY

1976 Income Year

NET INCOME TAXABLE IN CALIFORNIA	MFG. OF BEVERAGES, FOOD, AND KINDRED PRODUCTS				MANUFACTURE OF TEXTILE-MILL PRODUCTS			
	NUMBER OF RETURNS	INCOME REPORTED FOR TAXATION		TAX ASSESSED	NUMBER OF RETURNS	INCOME REPORTED FOR TAXATION		TAX ASSESSED
		FEDERAL	STATE			FEDERAL	STATE	
NET LOSS.....	395	-\$225,549,324	-\$95,514,577	\$89,200	74	-\$42,139,437	-\$17,836,149	\$17,400
NO INCOME OR LOSS.....	80			16,000	5			1,000
SUBTOTALS.....	475	-\$225,549,324	-\$95,514,577	\$105,200	79	-\$42,139,437	-\$17,836,149	\$18,400
NET INCOME								
\$1 UNDER \$5,000	146	778,988	311,279	36,317	25	77,689	53,411	6,396
5,000 UNDER 10,000	61	1,193,248	457,810	41,201	9	124,826	62,566	5,630
10,000 UNDER 15,000	50	2,596,152	612,924	55,162	8	101,686	101,836	9,165
15,000 UNDER 20,000	50	3,049,765	866,914	78,020	7	109,505	116,162	10,454
20,000 UNDER 25,000	34	2,081,981	762,065	68,585	5	181,748	112,197	10,098
25,000 UNDER 30,000	30	1,170,691	813,823	73,245	5	138,430	131,241	11,812
30,000 UNDER 40,000	62	2,431,920	2,156,811	194,118	8	270,310	282,042	25,384
40,000 UNDER 50,000	71	2,941,633	3,186,327	286,769	13	337,406	571,550	51,440
50,000 UNDER 100,000	139	12,485,772	9,706,006	873,340	17	3,836,295	1,029,018	92,610
100,000 UNDER 200,000	102	30,459,447	14,823,360	1,331,906	10	1,384,957	1,439,578	129,362
200,000 UNDER 500,000	119	103,783,913	37,590,417	3,379,536	10	15,628,523	3,402,763	306,249
500,000 UNDER 1,000,000	55	113,187,802	38,168,432	3,434,962	9	18,862,234	6,338,460	570,459
1,000,000 UNDER 2,000,000	47	263,993,758	67,718,795	6,089,091	5	87,425,872	7,094,565	636,511
2,000,000 UNDER 5,000,000	29	840,676,686	94,762,008	8,518,976	3	159,308,603	9,649,145	868,423
5,000,000 AND OVER.....	37	3,599,895,483	496,792,484	44,682,921	1	172,572,193	12,745,066	1,147,055
SUBTOTALS.....	1,032	\$4,980,727,239	\$768,729,455	\$69,144,149	135	\$460,560,277	\$43,129,600	\$3,881,248
GRAND TOTALS.....	1,507	\$4,755,177,915	\$673,214,878	\$69,249,349	214	\$418,420,840	\$25,293,451	\$3,899,648
NET INCOME TAXABLE IN CALIFORNIA	MFG. OF APPAREL AND PRODUCTS MADE FROM FABRIC				MFG. OF WOOD PRODUCTS, EXCEPT FURNITURE			
	NUMBER OF RETURNS	INCOME REPORTED FOR TAXATION		TAX ASSESSED	NUMBER OF RETURNS	INCOME REPORTED FOR TAXATION		TAX ASSESSED
		FEDERAL	STATE			FEDERAL	STATE	
NET LOSS.....	413	-\$33,761,429	-\$22,702,237	\$85,600	278	-\$22,430,082	-\$31,320,620	\$57,800
NO INCOME OR LOSS.....	40			8,000	30			6,000
SUBTOTALS.....	453	-\$33,761,429	-\$22,702,237	\$93,600	308	-\$22,430,082	-\$31,320,620	\$63,800
NET INCOME								
\$1 UNDER \$5,000	227	649,772	485,323	56,660	124	414,453	267,243	30,925
5,000 UNDER 10,000	89	802,335	642,721	57,847	65	434,974	474,292	42,691
10,000 UNDER 15,000	64	876,007	784,698	70,626	39	1,345,111	484,104	43,569
15,000 UNDER 20,000	39	653,887	667,268	60,053	32	703,881	557,016	50,133
20,000 UNDER 25,000	41	962,637	911,187	82,011	27	560,434	610,052	54,906
25,000 UNDER 30,000	36	1,294,841	1,002,474	90,220	33	804,855	884,721	79,626
30,000 UNDER 40,000	55	3,055,171	1,926,211	173,361	42	1,359,948	1,471,294	132,416
40,000 UNDER 50,000	75	5,464,469	3,443,033	309,674	37	1,569,141	1,678,587	151,070
50,000 UNDER 100,000	152	20,955,592	10,305,987	926,936	86	8,919,896	5,556,184	499,852
100,000 UNDER 200,000	67	18,287,520	9,242,232	831,603	41	8,815,260	5,729,962	514,901
200,000 UNDER 500,000	56	31,085,386	17,597,400	1,583,370	34	31,807,399	11,057,763	994,799
500,000 UNDER 1,000,000	29	29,691,772	19,616,340	1,763,668	12	25,785,025	8,326,618	748,995
1,000,000 UNDER 2,000,000	11	16,736,379	16,081,994	1,446,179	9	76,818,850	12,921,325	1,161,918
2,000,000 UNDER 5,000,000	14	49,876,517	43,933,774	3,952,838	1	2,167,881	2,293,861	206,447
5,000,000 AND OVER.....	3	211,545,767	43,881,979	3,947,778	10	1,109,066,140	140,774,061	12,656,664
SUBTOTALS.....	958	\$391,938,052	\$170,522,621	\$15,352,824	592	\$1,270,573,248	\$193,087,083	\$17,368,912
GRAND TOTALS.....	1,411	\$358,176,623	\$147,820,384	\$15,446,424	900	\$1,248,143,166	\$161,766,463	\$17,432,712

FOOTNOTES FOLLOW THIS SECTION.

Table 3 (continued) †
 Bank and Corporation Franchise Tax Statistics
 STATE NET INCOME BY INDUSTRY
 1976 Income Year

NET INCOME TAXABLE IN CALIFORNIA	MANUFACTURE OF FURNITURE AND FIXTURES				MANUFACTURE OF PAPER AND ALLIED PRODUCTS			
	NUMBER OF RETURNS	INCOME REPORTED FOR TAXATION		TAX ASSESSED	NUMBER OF RETURNS	INCOME REPORTED FOR TAXATION		TAX ASSESSED
		FEDERAL	STATE			FEDERAL	STATE	
NET LOSS.....	264	-\$19,319,899	-\$13,713,979	\$53,200	77	-\$40,875,823	-\$5,159,564	\$21,000
NO INCOME OR LOSS.....	28	—	—	5,600	8	—	—	1,600
SUBTOTALS.....	292	-\$19,319,899	-\$13,713,979	\$58,800	85	-\$40,875,823	-\$5,159,564	\$22,600
NET INCOME								
\$1 UNDER \$5,000	109	318,821	209,479	25,854	15	2,659,230	29,762	3,450
5,000 UNDER 10,000	58	637,885	424,111	38,168	9	54,865	66,219	5,959
10,000 UNDER 15,000	41	447,620	493,474	44,410	18	1,523,468	233,063	20,976
15,000 UNDER 20,000	30	489,886	516,327	46,469	11	289,841	192,949	17,366
20,000 UNDER 25,000	32	663,848	718,745	64,684	5	106,747	113,198	10,189
25,000 UNDER 30,000	28	957,563	770,986	69,386	11	844,920	299,638	26,969
30,000 UNDER 40,000	41	1,587,369	1,375,364	123,782	15	745,771	532,782	47,750
40,000 UNDER 50,000	34	1,426,087	1,536,512	138,287	15	846,135	666,568	59,993
50,000 UNDER 100,000	66	9,819,152	4,366,845	392,017	36	3,454,300	2,444,231	219,582
100,000 UNDER 200,000	47	7,288,913	6,379,800	572,982	31	12,315,015	4,354,503	391,506
200,000 UNDER 500,000	42	39,337,393	13,101,949	1,178,776	26	29,991,583	7,773,056	698,779
500,000 UNDER 1,000,000	9	8,028,829	6,396,860	575,317	11	142,463,912	7,119,843	640,787
1,000,000 UNDER 2,000,000	5	27,610,541	8,035,325	720,579	9	156,861,211	12,420,728	1,117,667
2,000,000 UNDER 5,000,000	3	84,489,510	10,410,102	936,509	8	292,568,761	24,773,209	2,228,787
5,000,000 AND OVER.....	—	—	—	—	8	1,029,891,681	98,831,811	8,892,663
SUBTOTALS.....	545	\$183,103,417	\$54,735,879	\$4,927,220	228	\$1,674,617,440	\$159,851,560	\$14,382,423
GRAND TOTALS.....	837	\$163,783,518	\$41,021,900	\$4,986,020	313	\$1,633,741,617	\$154,691,996	\$14,405,023
NET INCOME TAXABLE IN CALIFORNIA	PRINTING, PUBLISHING, AND ALLIED INDUSTRIES				MANUFACTURE OF CHEMICALS AND ALLIED PRODUCTS			
	NUMBER OF RETURNS	INCOME REPORTED FOR TAXATION		TAX ASSESSED	NUMBER OF RETURNS	INCOME REPORTED FOR TAXATION		TAX ASSESSED
		FEDERAL	STATE			FEDERAL	STATE	
NET LOSS.....	762	-\$33,644,294	-\$36,915,309	\$159,200	539	-\$370,147,070	-\$78,187,676	\$117,000
NO INCOME OR LOSS.....	88	—	—	17,600	73	—	—	14,600
SUBTOTALS.....	870	-\$33,644,294	-\$36,915,309	\$176,800	612	-\$370,147,070	-\$78,187,676	\$131,600
NET INCOME								
\$1 UNDER \$5,000	477	1,332,734	919,918	116,328	240	636,495	514,054	61,207
5,000 UNDER 10,000	203	2,122,553	1,500,218	135,022	141	5,059,665	1,030,811	92,774
10,000 UNDER 15,000	146	37,493,001	1,791,845	161,269	82	2,885,252	1,026,144	92,156
15,000 UNDER 20,000	103	1,659,457	1,782,721	160,444	55	1,099,236	959,639	86,165
20,000 UNDER 25,000	83	4,497,944	1,888,283	169,348	59	2,783,818	1,320,167	118,810
25,000 UNDER 30,000	65	2,253,215	1,801,568	160,740	54	3,790,880	1,490,609	134,156
30,000 UNDER 40,000	108	7,160,829	3,751,978	337,484	84	5,583,361	2,921,923	262,973
40,000 UNDER 50,000	76	3,846,091	3,410,878	306,773	66	8,535,488	2,995,353	269,588
50,000 UNDER 100,000	155	18,614,924	10,597,587	953,387	193	39,746,557	13,010,899	1,169,576
100,000 UNDER 200,000	83	31,840,097	11,914,089	1,071,868	106	70,891,631	15,023,565	1,350,922
200,000 UNDER 500,000	70	70,772,919	23,354,394	2,098,895	106	158,466,246	33,907,148	3,047,841
500,000 UNDER 1,000,000	30	106,093,224	22,531,444	2,026,830	48	250,515,907	33,715,486	3,031,397
1,000,000 UNDER 2,000,000	15	81,274,784	21,238,974	1,909,906	33	892,955,279	45,208,809	4,063,992
2,000,000 UNDER 5,000,000	11	150,496,628	31,719,864	2,850,988	36	1,793,415,914	111,137,229	9,988,147
5,000,000 AND OVER.....	12	560,131,060	158,370,563	14,245,950	25	7,597,270,230	313,218,948	28,173,903
SUBTOTALS.....	1,637	\$1,079,589,460	\$296,574,324	\$26,705,232	1,328	\$10,833,635,959	\$577,480,784	\$51,943,607
GRAND TOTALS.....	2,507	\$1,045,945,166	\$259,659,015	\$26,882,032	1,940	\$10,463,488,889	\$499,293,108	\$52,075,207

Table 3 (continued) †
 Bank and Corporation Franchise Tax Statistics
 STATE NET INCOME BY INDUSTRY
 1976 Income Year

NET INCOME TAXABLE IN CALIFORNIA	MANUFACTURE OF PETROLEUM AND COAL PRODUCTS				MANUFACTURE OF RUBBER PRODUCTS			
	NUMBER OF RETURNS	INCOME REPORTED FOR TAXATION		TAX ASSESSED	NUMBER OF RETURNS	INCOME REPORTED FOR TAXATION		TAX ASSESSED
		FEDERAL	STATE			FEDERAL	STATE	
NET LOSS.....	25	-\$98,165,234	-\$3,363,293	\$5,000	91	-\$4,610,114	-\$4,186,942	\$18,400
NO INCOME OR LOSS.....	8	—	—	1,600	5	—	—	1,000
SUBTOTALS.....	33	-\$98,165,234	-\$3,363,293	\$6,600	96	-\$4,610,114	-\$4,186,942	\$19,400
NET INCOME								
\$1 UNDER \$5,000	12	65,552	29,914	3,312	25	39,898	54,229	6,270
5,000 UNDER 10,000	1	8,490	8,490	764	16	96,889	121,313	10,919
10,000 UNDER 15,000	3	1,807,361	40,128	3,842	14	160,808	179,191	16,128
15,000 UNDER 20,000	5	76,776	90,932	8,184	9	151,092	162,491	14,623
20,000 UNDER 25,000	3	62,850	66,697	6,004	5	104,395	115,285	10,376
25,000 UNDER 30,000	1	22,743	25,431	2,289	9	225,791	246,349	22,171
30,000 UNDER 40,000	8	720,840	272,111	24,489	17	3,783,533	588,436	52,960
40,000 UNDER 50,000	1	44,586	47,262	4,254	10	432,959	463,623	41,726
50,000 UNDER 100,000	4	1,400,321	285,356	25,682	24	1,439,392	1,584,610	142,616
100,000 UNDER 200,000	7	3,883,770	963,496	86,715	22	10,260,245	3,205,100	288,259
200,000 UNDER 500,000	8	20,235,455	2,563,385	230,704	12	18,187,574	3,725,163	335,264
500,000 UNDER 1,000,000	7	17,688,612	5,009,493	447,254	10	61,519,619	6,687,452	601,271
1,000,000 UNDER 2,000,000	4	475,680,928	5,615,540	505,400	4	36,622,668	5,647,765	504,898
2,000,000 UNDER 5,000,000	8	375,551,390	28,005,374	2,511,884	2	55,879,408	4,959,880	446,389
5,000,000 AND OVER.....	4	43,778,938	43,639,238	3,926,731	3	274,551,464	17,926,643	1,613,398
SUBTOTALS.....	76	\$941,028,612	\$86,662,847	\$7,787,508	182	\$463,255,735	\$45,667,530	\$4,109,268
GRAND TOTALS.....	109	\$842,863,378	\$83,299,554	\$7,794,108	278	\$458,645,621	\$41,480,588	\$4,128,668
NET INCOME TAXABLE IN CALIFORNIA	MANUFACTURE OF STONE, CLAY, AND GLASS PRODUCTS				MANUFACTURE OF PRIMARY METALS			
	NUMBER OF RETURNS	INCOME REPORTED FOR TAXATION		TAX ASSESSED	NUMBER OF RETURNS	INCOME REPORTED FOR TAXATION		TAX ASSESSED
		FEDERAL	STATE			FEDERAL	STATE	
NET LOSS.....	189	-\$19,645,716	-\$9,082,205	\$40,400	127	-\$156,078,113	-\$15,858,030	\$26,600
NO INCOME OR LOSS.....	28	—	—	5,600	8	—	—	1,600
SUBTOTALS.....	217	-\$19,645,716	-\$9,082,205	\$46,000	135	-\$156,078,113	-\$15,858,030	\$28,200
NET INCOME								
\$1 UNDER \$5,000	82	195,833	178,427	20,613	30	701,439	70,164	7,459
5,000 UNDER 10,000	34	284,850	244,185	21,978	21	295,101	162,277	14,606
10,000 UNDER 15,000	35	364,917	423,286	38,099	15	199,700	188,809	16,995
15,000 UNDER 20,000	25	399,716	428,380	38,557	16	266,133	280,310	25,229
20,000 UNDER 25,000	20	8,348,696	445,901	41,765	10	178,606	227,147	20,444
25,000 UNDER 30,000	22	578,190	604,840	54,437	10	380,945	278,510	25,067
30,000 UNDER 40,000	34	1,498,855	1,179,419	106,149	21	1,029,001	730,772	65,770
40,000 UNDER 50,000	33	1,418,003	1,503,941	135,358	19	734,513	862,746	77,649
50,000 UNDER 100,000	75	4,812,828	5,102,180	459,199	38	8,378,527	2,688,596	241,577
100,000 UNDER 200,000	36	15,251,995	5,263,106	473,682	29	3,975,053	4,402,369	396,213
200,000 UNDER 500,000	29	47,211,683	8,611,571	774,442	37	28,813,514	11,384,367	1,022,394
500,000 UNDER 1,000,000	15	97,613,303	11,171,469	1,003,233	17	90,281,126	12,337,356	1,110,363
1,000,000 UNDER 2,000,000	6	58,583,937	7,526,239	677,361	10	168,582,156	14,626,526	1,315,387
2,000,000 UNDER 5,000,000	12	353,022,651	37,630,253	3,378,321	19	522,621,380	53,824,762	4,837,230
5,000,000 AND OVER.....	3	206,824,975	23,783,729	2,138,935	4	310,074,474	40,330,126	3,624,910
SUBTOTALS.....	461	\$796,410,432	\$104,096,926	\$9,362,129	296	\$1,136,511,668	\$142,394,837	\$12,801,293
GRAND TOTALS.....	678	\$776,764,716	\$95,014,721	\$9,408,129	431	\$980,433,555	\$126,536,807	\$12,829,493

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FOOTNOTES FOLLOW THIS SECTION.

Table 3 (continued) †
 Bank and Corporation Franchise Tax Statistics
 STATE NET INCOME BY INDUSTRY
 1976 Income Year

NET INCOME TAXABLE IN CALIFORNIA	MFG. OF ELECTRICAL MACHINERY AND EQUIPMENT				MANUFACTURE OF TRANSPORTATION EQUIPMENT			
	NUMBER OF RETURNS	INCOME REPORTED FOR TAXATION		TAX ASSESSED	NUMBER OF RETURNS	INCOME REPORTED FOR TAXATION		TAX ASSESSED
		FEDERAL	STATE			FEDERAL	STATE	
NET LOSS.....	825	-\$281,036,613	-\$238,717,800	\$190,200	422	-\$126,955,072	-\$60,585,119	\$92,200
NO INCOME OR LOSS.....	95			19,000	61			12,200
SUBTOTALS.....	920	-\$281,036,613	-\$238,717,800	\$209,200	483	-\$126,955,072	-\$60,585,119	\$104,400
NET INCOME								
\$1 UNDER \$5,000	275	529,073	548,371	66,458	140	2,468,562	301,618	34,865
5,000 UNDER 10,000	108	1,039,161	787,165	70,851	51	428,228	362,804	32,453
10,000 UNDER 15,000	82	1,121,268	1,037,702	93,401	52	11,766,274	657,055	59,137
15,000 UNDER 20,000	72	3,384,140	1,275,581	114,402	36	847,779	624,610	56,217
20,000 UNDER 25,000	74	3,026,260	1,656,991	148,928	31	777,830	695,136	62,560
25,000 UNDER 30,000	51	2,089,130	1,413,325	127,200	38	1,091,982	1,039,564	93,564
30,000 UNDER 40,000	75	3,152,763	2,643,831	237,544	37	1,916,987	1,295,561	116,412
40,000 UNDER 50,000	86	9,383,464	3,928,766	353,584	38	1,597,078	1,711,023	153,944
50,000 UNDER 100,000	171	28,524,017	11,813,741	1,061,036	103	14,887,619	7,059,070	634,920
100,000 UNDER 200,000	126	36,368,478	17,376,974	1,561,729	60	37,556,508	8,442,799	757,650
200,000 UNDER 500,000	132	115,242,079	42,304,126	3,804,769	72	197,633,616	23,038,687	2,066,084
500,000 UNDER 1,000,000	72	320,194,369	52,912,191	4,747,292	28	77,742,886	18,092,551	1,621,726
1,000,000 UNDER 2,000,000	47	274,543,411	65,486,050	5,878,542	23	223,963,773	31,385,615	2,820,306
2,000,000 UNDER 5,000,000	26	381,109,403	80,230,069	7,212,503	15	153,601,003	47,840,729	4,299,066
5,000,000 AND OVER.....	30	5,878,895,912	646,001,261	58,111,114	16	8,026,388,753	564,571,713	50,792,258
SUBTOTALS.....	1,427	\$7,058,602,928	\$929,416,144	\$83,589,353	740	\$8,752,668,878	\$707,118,665	\$63,601,212
GRAND TOTALS.....	2,347	\$6,777,566,315	\$690,698,344	\$83,798,553	1,223	\$8,625,713,806	\$646,533,546	\$63,705,612
NET INCOME TAXABLE IN CALIFORNIA	MANUFACTURE OF OTHER EQUIPMENT				MANUFACTURE OF PRECISION EQUIPMENT			
	NUMBER OF RETURNS	INCOME REPORTED FOR TAXATION		TAX ASSESSED	NUMBER OF RETURNS	INCOME REPORTED FOR TAXATION		TAX ASSESSED
		FEDERAL	STATE			FEDERAL	STATE	
NET LOSS.....	671	-\$55,885,550	-\$35,310,356	\$137,200	281	-\$141,381,882	-\$116,267,468	\$59,800
NO INCOME OR LOSS.....	61			12,200	26			5,200
SUBTOTALS.....	732	-\$55,885,550	-\$35,310,356	\$149,400	307	-\$141,381,882	-\$116,267,468	\$65,000
NET INCOME								
\$1 UNDER \$5,000	417	1,588,583	892,177	104,274	109	171,562	212,592	26,393
5,000 UNDER 10,000	193	1,369,610	1,426,147	128,359	29	689,182	208,654	18,579
10,000 UNDER 15,000	144	1,913,888	1,777,952	159,816	23	268,753	280,068	25,205
15,000 UNDER 20,000	94	2,127,715	1,642,178	147,798	23	396,108	394,356	35,489
20,000 UNDER 25,000	78	2,713,903	1,757,568	158,183	20	420,884	452,300	40,709
25,000 UNDER 30,000	79	4,536,080	2,131,282	191,613	17	433,438	462,933	41,662
30,000 UNDER 40,000	130	4,221,364	4,509,819	405,887	31	3,098,103	1,109,449	99,848
40,000 UNDER 50,000	115	14,342,299	5,205,775	468,118	28	1,200,902	1,283,952	115,156
50,000 UNDER 100,000	210	24,248,085	14,361,109	1,291,700	45	12,247,724	3,186,705	285,002
100,000 UNDER 200,000	110	46,680,527	14,978,168	1,347,640	45	17,173,030	6,992,416	627,916
200,000 UNDER 500,000	70	53,953,782	21,508,249	1,931,740	40	56,496,584	13,551,532	1,214,838
500,000 UNDER 1,000,000	29	69,439,046	21,169,953	1,903,692	15	71,723,017	10,763,914	966,751
1,000,000 UNDER 2,000,000	23	245,979,008	31,385,583	2,821,102	8	120,372,712	11,622,140	1,045,393
2,000,000 UNDER 5,000,000	17	365,617,131	54,098,566	4,864,670	9	106,825,445	24,214,149	2,177,673
5,000,000 AND OVER.....	14	1,608,037,563	138,655,206	12,473,368	7	1,652,828,307	118,652,183	10,676,896
SUBTOTALS.....	1,723	\$2,446,768,584	\$315,499,732	\$28,397,960	449	\$2,044,345,751	\$193,387,343	\$17,397,510
GRAND TOTALS.....	2,455	\$2,390,883,034	\$280,189,376	\$28,547,360	756	\$1,902,963,869	\$77,119,875	\$17,462,510

FOOTNOTES FOLLOW THIS SECTION.

Table 3 (continued) †
 Bank and Corporation Franchise Tax Statistics
 STATE NET INCOME BY INDUSTRY
 1976 Income Year

NET INCOME TAXABLE IN CALIFORNIA	MFG. OF OTHER FABRICATED METAL PRODUCTS				OTHER MANUFACTURING ⁶			
	NUMBER OF RETURNS	INCOME REPORTED FOR TAXATION		TAX ASSESSED	NUMBER OF RETURNS	INCOME REPORTED FOR TAXATION		TAX ASSESSED
		FEDERAL	STATE			FEDERAL	STATE	
NET LOSS.....	1,007	-\$93,309,441	-\$44,071,989	\$206,200	780	-\$46,535,078	-\$37,740,930	\$163,200
NO INCOME OR LOSS.....	93			18,800	107			21,400
SUBTOTALS.....	1,100	-\$93,309,441	-\$44,071,989	\$225,000	887	-\$46,535,078	-\$37,740,930	\$184,600
NET INCOME								
\$1 UNDER \$5,000	470	1,579,870	984,195	117,111	301	593,462	606,055	73,853
5,000 UNDER 10,000	233	2,711,475	1,734,574	155,914	108	1,491,187	767,977	69,119
10,000 UNDER 15,000	166	3,052,239	2,062,806	185,655	89	1,037,795	1,103,518	99,313
15,000 UNDER 20,000	158	3,266,783	2,775,569	249,604	62	1,145,362	1,062,002	95,583
20,000 UNDER 25,000	130	5,801,345	2,922,893	263,053	66	1,741,344	1,469,847	132,285
25,000 UNDER 30,000	129	4,062,286	3,513,080	316,180	53	1,737,132	1,447,353	129,661
30,000 UNDER 40,000	169	8,124,894	5,858,540	527,265	85	2,868,084	2,919,932	262,801
40,000 UNDER 50,000	170	9,934,905	7,723,924	694,357	55	5,941,080	2,485,359	223,283
50,000 UNDER 100,000	390	39,578,399	25,931,697	2,333,448	141	26,457,756	9,750,696	877,166
100,000 UNDER 200,000	208	69,951,890	29,681,542	2,670,148	59	20,175,343	8,179,879	735,990
200,000 UNDER 500,000	169	347,844,645	50,822,310	4,566,406	51	34,258,264	17,501,992	1,574,180
500,000 UNDER 1,000,000	81	290,511,861	57,399,046	5,161,315	18	36,661,799	12,390,353	1,111,931
1,000,000 UNDER 2,000,000	40	391,282,653	55,338,554	4,977,402	8	44,212,821	10,872,919	977,162
2,000,000 UNDER 5,000,000	21	275,168,502	63,259,055	5,685,115	8	117,028,530	22,105,248	1,987,672
5,000,000 AND OVER.....	9	273,949,575	98,955,512	8,893,995	2	34,072,911	16,844,125	1,513,170
SUBTOTALS.....	2,543	\$1,726,821,322	\$408,963,297	\$36,796,968	1,106	\$329,422,870	\$109,507,255	\$9,863,169
GRAND TOTALS.....	3,643	\$1,633,511,881	\$364,891,308	\$37,021,968	1,993	\$282,887,792	\$71,766,325	\$10,047,769
NET INCOME TAXABLE IN CALIFORNIA	MOTION PICTURE PRODUCTION				AMUSEMENT SERVICES ⁶			
	NUMBER OF RETURNS	INCOME REPORTED FOR TAXATION		TAX ASSESSED	NUMBER OF RETURNS	INCOME REPORTED FOR TAXATION		TAX ASSESSED
		FEDERAL	STATE			FEDERAL	STATE	
NET LOSS.....	1,034	-\$37,656,263	-\$30,593,877	\$210,800	1,421	-\$65,545,901	-\$56,892,048	\$293,600
NO INCOME OR LOSS.....	214			43,800	221			44,200
SUBTOTALS.....	1,248	-\$37,656,263	-\$30,593,877	\$254,600	1,642	-\$65,545,901	-\$56,892,048	\$337,800
NET INCOME								
\$1 UNDER \$5,000	839	6,072,535	1,143,780	186,593	801	3,886,604	1,257,992	185,616
5,000 UNDER 10,000	141	1,110,401	1,022,080	91,796	217	3,193,199	1,594,817	143,739
10,000 UNDER 15,000	74	916,711	915,205	82,369	119	2,602,918	1,461,948	131,573
15,000 UNDER 20,000	44	1,427,837	764,770	68,628	90	3,136,178	1,549,094	139,418
20,000 UNDER 25,000	40	923,740	901,866	81,170	58	3,529,130	1,314,493	118,306
25,000 UNDER 30,000	30	1,213,294	820,972	73,887	52	1,293,171	1,422,637	128,039
30,000 UNDER 40,000	32	1,443,415	1,112,790	100,149	81	6,682,518	2,756,628	248,095
40,000 UNDER 50,000	30	1,410,938	1,344,492	120,404	53	4,318,539	2,403,313	216,299
50,000 UNDER 100,000	59	6,277,786	4,177,800	375,602	112	10,183,112	7,723,285	694,699
100,000 UNDER 200,000	28	8,628,959	4,042,272	361,604	50	10,881,095	7,036,116	632,450
200,000 UNDER 500,000	22	73,946,775	7,099,866	634,788	22	11,255,942	6,331,545	567,640
500,000 UNDER 1,000,000	3	5,909,542	2,314,557	205,110	5	2,970,475	3,140,057	282,606
1,000,000 UNDER 2,000,000	4	10,677,211	5,784,718	520,426	10	38,694,287	15,119,595	1,358,963
2,000,000 UNDER 5,000,000	—	—	—	—	3	14,913,266	8,727,252	784,252
5,000,000 AND OVER.....	3	177,994,395	69,189,777	6,222,880	2	87,911,329	35,253,806	3,170,243
SUBTOTALS.....	1,349	\$297,953,539	\$100,634,945	\$9,125,406	1,675	\$205,451,763	\$97,092,578	\$8,801,938
GRAND TOTALS.....	2,597	\$260,297,276	\$70,041,068	\$9,380,006	3,317	\$139,905,862	\$40,200,530	\$9,139,738

FOOTNOTES FOLLOW THIS SECTION.

Table 3 (continued) †
 Bank and Corporation Franchise Tax Statistics
 STATE NET INCOME BY INDUSTRY
 1976 Income Year

NET INCOME TAXABLE IN CALIFORNIA	PERSONAL SERVICES				BUSINESS SERVICES			
	NUMBER OF RETURNS	INCOME REPORTED FOR TAXATION		TAX ASSESSED	NUMBER OF RETURNS	INCOME REPORTED FOR TAXATION		TAX ASSESSED
		FEDERAL	STATE			FEDERAL	STATE	
NET LOSS.....	716	-\$16,966,084	-\$10,730,567	\$143,200	5,536	-\$383,351,220	-\$135,067,256	\$1,138,000
NO INCOME OR LOSS.....	87	—	—	17,400	1,232	—	—	246,400
SUBTOTALS.....	803	-\$16,966,084	-\$10,730,567	\$160,600	6,768	-\$383,351,220	-\$135,067,256	\$1,384,400
NET INCOME								
\$1 UNDER \$5,000	530	1,235,350	1,057,083	130,378	4,389	39,733,118	7,293,819	1,022,991
5,000 UNDER 10,000	231	2,030,685	1,699,207	152,932	1,237	23,443,212	8,870,560	798,174
10,000 UNDER 15,000	123	1,480,004	1,521,377	136,924	808	39,621,393	10,004,999	899,663
15,000 UNDER 20,000	82	2,870,470	1,411,546	127,043	522	19,936,990	8,973,773	807,245
20,000 UNDER 25,000	62	3,087,661	1,397,843	125,009	404	28,055,054	9,033,338	812,200
25,000 UNDER 30,000	49	1,238,191	1,336,610	120,298	329	16,008,893	9,031,526	812,234
30,000 UNDER 40,000	69	5,121,233	2,372,303	213,507	380	40,045,808	13,145,601	1,181,700
40,000 UNDER 50,000	56	2,520,767	2,487,063	223,836	311	21,280,748	13,921,273	1,251,116
50,000 UNDER 100,000	87	11,425,144	5,904,521	531,213	568	137,213,227	37,851,782	3,400,068
100,000 UNDER 200,000	23	7,900,239	3,095,633	278,007	238	148,035,774	32,919,698	2,953,977
200,000 UNDER 500,000	20	14,355,201	5,497,423	493,567	156	213,927,301	47,437,423	4,255,574
500,000 UNDER 1,000,000	10	29,649,148	7,204,403	646,596	51	293,584,864	36,414,147	3,266,673
1,000,000 UNDER 2,000,000	7	43,496,230	9,174,893	824,140	23	128,668,229	30,059,891	2,696,289
2,000,000 UNDER 5,000,000	—	—	—	—	15	127,346,094	46,708,805	4,185,791
5,000,000 AND OVER.....	—	—	—	—	5	280,268,273	52,845,011	4,746,451
SUBTOTALS.....	1,349	\$126,410,323	\$44,159,905	\$4,003,450	9,436	\$1,557,168,978	\$364,511,646	\$33,090,246
GRAND TOTALS.....	2,152	\$109,444,239	\$33,429,338	\$4,164,050	16,204	\$1,173,817,758	\$229,444,390	\$34,474,646
NET INCOME TAXABLE IN CALIFORNIA	PROFESSIONAL SERVICES A				OTHER SERVICES C			
	NUMBER OF RETURNS	INCOME REPORTED FOR TAXATION		TAX ASSESSED	NUMBER OF RETURNS	INCOME REPORTED FOR TAXATION		TAX ASSESSED
		FEDERAL	STATE			FEDERAL	STATE	
NET LOSS.....	2,252	-\$14,356,758	-\$13,999,831	\$450,400	3,747	-\$163,563,496	-\$156,904,041	\$782,000
NO INCOME OR LOSS.....	372	—	—	74,400	4,793	—	—	958,600
SUBTOTALS.....	2,624	-\$14,356,758	-\$13,999,831	\$524,800	8,540	-\$163,563,496	-\$156,904,041	\$1,740,600
NET INCOME								
\$1 UNDER \$5,000	5,614	11,506,802	9,786,986	1,319,886	2,993	5,540,984	5,692,380	712,897
5,000 UNDER 10,000	1,462	10,714,770	10,514,765	946,356	1,066	15,611,933	7,774,039	699,289
10,000 UNDER 15,000	729	9,188,312	8,947,229	805,269	627	35,760,403	7,738,855	695,906
15,000 UNDER 20,000	419	7,398,474	7,266,383	653,974	486	10,033,253	8,441,150	758,709
20,000 UNDER 25,000	277	6,467,043	6,198,333	557,844	366	9,734,277	8,153,383	733,809
25,000 UNDER 30,000	205	5,274,707	5,598,707	503,887	290	9,238,196	7,968,885	716,209
30,000 UNDER 40,000	252	8,899,527	8,698,331	782,854	385	22,291,642	13,363,276	1,202,299
40,000 UNDER 50,000	155	6,523,382	6,994,981	629,547	282	15,158,819	12,743,052	1,145,069
50,000 UNDER 100,000	153	8,987,397	9,567,369	861,062	511	46,252,403	35,959,391	3,054,946
100,000 UNDER 200,000	20	7,136,922	2,665,129	239,863	204	63,295,114	28,246,185	2,534,752
200,000 UNDER 500,000	3	4,456,780	865,152	77,864	102	64,026,245	31,446,912	2,824,818
500,000 UNDER 1,000,000	2	11,778,275	1,319,851	118,787	36	35,221,604	25,207,133	2,258,040
1,000,000 UNDER 2,000,000	—	—	—	—	17	105,727,539	21,837,746	1,856,796
2,000,000 UNDER 5,000,000	1	40,804,352	3,328,683	299,581	7	72,884,437	20,347,304	1,818,258
5,000,000 AND OVER.....	—	—	—	—	4	148,025,962	31,655,150	2,842,163
SUBTOTALS.....	9,292	\$139,136,743	\$81,751,899	\$7,796,774	7,376	\$658,802,811	\$264,574,841	\$23,953,960
GRAND TOTALS.....	11,916	\$124,779,985	\$67,752,068	\$8,321,574	15,916	\$495,239,315	\$107,670,800	\$25,694,560

Table 3 (continued) †
 Bank and Corporation Franchise Tax Statistics
 STATE NET INCOME BY INDUSTRY
 1976 Income Year

NET INCOME TAXABLE IN CALIFORNIA	RETAIL TRADE				WHOLESALE TRADE			
	NUMBER OF RETURNS	INCOME REPORTED FOR TAXATION		TAX ASSESSED	NUMBER OF RETURNS	INCOME REPORTED FOR TAXATION		TAX ASSESSED
		FEDERAL	STATE			FEDERAL	STATE	
NET LOSS.....	8,578	-\$824,038,431	-\$317,209,360	\$1,734,400	5,730	-\$1,001,037,121	-\$310,600,743	\$1,181,200
NO INCOME OR LOSS.....	978			195,600	1,262			252,400
SUBTOTALS.....	9,556	-\$824,038,431	-\$317,209,360	\$1,930,000	6,992	-\$1,001,037,121	-\$310,600,743	\$1,433,600
NET INCOME								
\$1 UNDER \$5,000	5,403	23,914,699	11,316,524	1,348,982	3,439	106,632,370	6,738,978	839,593
5,000 UNDER 10,000	2,492	18,602,090	18,194,528	1,637,548	1,505	134,833,260	11,018,993	989,960
10,000 UNDER 15,000	1,807	26,840,406	22,324,163	2,008,777	1,114	98,457,400	13,744,059	1,236,384
15,000 UNDER 20,000	1,392	29,752,191	24,169,372	2,175,250	916	92,290,937	15,923,286	1,432,698
20,000 UNDER 25,000	1,100	28,143,938	24,681,110	2,221,314	765	109,237,746	17,201,695	1,547,957
25,000 UNDER 30,000	939	41,494,845	25,717,872	2,314,612	603	149,858,104	16,478,723	1,482,494
30,000 UNDER 40,000	1,454	167,922,501	50,321,693	4,528,170	985	197,386,752	34,297,669	3,081,788
40,000 UNDER 50,000	1,155	51,824,304	52,343,599	4,710,324	923	248,095,687	41,607,934	3,740,111
50,000 UNDER 100,000	1,989	148,334,767	133,287,234	11,991,280	2,055	966,392,904	139,543,271	12,548,511
100,000 UNDER 200,000	939	211,504,296	131,080,357	11,793,455	1,115	1,334,077,000	156,694,621	14,075,131
200,000 UNDER 500,000	467	415,679,969	141,545,270	12,730,074	790	3,101,888,103	247,654,052	22,275,260
500,000 UNDER 1,000,000	138	291,751,875	94,698,378	8,511,659	279	1,919,951,004	195,882,371	17,604,012
1,000,000 UNDER 2,000,000	48	222,638,642	68,933,987	6,158,456	160	2,763,434,031	213,152,385	19,168,914
2,000,000 UNDER 5,000,000	41	865,382,680	121,796,449	10,934,477	69	2,794,863,148	216,523,377	19,447,304
5,000,000 AND OVER.....	33	2,839,066,845	660,968,685	59,433,582	28	3,093,004,892	308,930,101	27,786,110
SUBTOTALS.....	19,397	\$5,382,854,048	\$1,581,379,221	\$142,497,960	14,746	\$17,110,403,338	\$1,635,391,515	\$147,256,227
GRAND TOTALS.....	28,953	\$4,558,815,617	\$1,264,169,861	\$144,427,960	21,738	\$16,109,366,217	\$1,324,790,772	\$148,689,827

NET INCOME TAXABLE IN CALIFORNIA	BANKS ††				SAVINGS AND LOAN ASSOCIATIONS ††			
	NUMBER OF RETURNS	INCOME REPORTED FOR TAXATION		TAX ASSESSED	NUMBER OF RETURNS	INCOME REPORTED FOR TAXATION		TAX ASSESSED
		FEDERAL	STATE			FEDERAL	STATE	
NET LOSS.....	55	-\$28,373,726	-\$27,377,102	\$600	17	-\$1,081,818	-\$902,169	\$3,400
NO INCOME OR LOSS.....	55			\$600	6			1,200
SUBTOTALS.....	110	-\$28,373,726	-\$27,377,102	\$600	23	-\$1,081,818	-\$902,169	\$4,600
NET INCOME								
\$1 UNDER \$5,000	2	17,547,745	1,353	232	2	109,273	4,033	400
5,000 UNDER 10,000	—	—	—	—	2	12,839	13,239	1,721
10,000 UNDER 15,000	2	233,598	23,582	3,060	—	—	—	—
15,000 UNDER 20,000	3	79,847	52,331	6,791	1	15,933	18,333	1,649
20,000 UNDER 25,000	—	—	—	—	1	12,554	20,025	2,599
25,000 UNDER 30,000	2	176,723	56,707	7,359	2	40,816	54,433	4,899
30,000 UNDER 40,000	2	72,742,715	71,128	9,231	4	273,319	144,935	13,046
40,000 UNDER 50,000	4	247,355,479	180,669	23,447	3	48,591	139,152	14,333
50,000 UNDER 100,000	12	55,977,806	933,898	121,067	5	1,191,904	383,786	45,133
100,000 UNDER 200,000	28	49,612,398	4,080,385	528,772	9	1,859,762	1,089,185	109,882
200,000 UNDER 500,000	55	115,426,981	18,007,763	2,333,706	23	3,947,800	7,892,538	838,692
500,000 UNDER 1,000,000	30	712,600,159	20,907,334	2,698,503	24	12,148,768	18,532,157	2,068,012
1,000,000 UNDER 2,000,000	26	801,975,546	34,562,914	4,455,036	20	16,360,941	30,883,341	3,444,753
2,000,000 UNDER 5,000,000	15	1,717,268,045	46,040,915	5,950,558	30	45,014,330	81,652,963	8,936,567
5,000,000 AND OVER.....	9	660,251,737	442,641,556	57,446,018	18	122,884,634	389,045,980	47,344,245
SUBTOTALS.....	190	\$4,451,248,779	\$567,560,535	\$73,583,780	144	\$203,921,464	\$529,874,100	\$62,825,933
GRAND TOTALS.....	300	\$4,422,875,053	\$540,183,433	\$73,584,380	167	\$202,839,646	\$528,971,931	\$62,830,533

FOOTNOTES FOLLOW THIS SECTION.

Table 3 (continued) †
 Bank and Corporation Franchise Tax Statistics
 STATE NET INCOME BY INDUSTRY
 1976 Income Year

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NET INCOME TAXABLE IN CALIFORNIA	COMMUNICATIONS				RADIO AND TELEVISION INDUSTRIES			
	NUMBER OF RETURNS	INCOME REPORTED FOR TAXATION		TAX ASSESSED	NUMBER OF RETURNS	INCOME REPORTED FOR TAXATION		TAX ASSESSED
		FEDERAL	STATE			FEDERAL	STATE	
NET LOSS.....	30	\$254,093,172	-\$4,574,679	\$6,000	137	-\$10,004,516	-\$9,974,601	\$27,400
NO INCOME OR LOSS.....	13	—	—	2,600	37	—	—	7,400
SUBTOTALS.....	43	\$254,093,172	-\$4,574,679	\$8,600	174	-\$10,004,516	-\$9,974,601	\$34,800
NET INCOME								
\$1 UNDER \$5,000	9	6,539,400	15,121	2,223	36	118,316	71,721	8,899
5,000 UNDER 10,000	3	21,615	22,763	2,049	21	205,451	151,570	13,641
10,000 UNDER 15,000	2	23,525	25,851	2,327	16	208,026	205,757	18,518
15,000 UNDER 20,000	4	49,326	65,485	5,894	14	1,138,755	246,014	22,143
20,000 UNDER 25,000	3	52,709	63,340	5,701	9	193,653	204,285	18,385
25,000 UNDER 30,000	2	55,075	56,587	5,093	7	182,745	189,242	17,032
30,000 UNDER 40,000	7	7,957,575	247,359	22,263	13	451,576	453,127	40,781
40,000 UNDER 50,000	5	211,811	228,916	20,602	8	353,814	363,624	32,727
50,000 UNDER 100,000	13	862,860	921,974	82,977	20	1,254,889	1,333,412	120,006
100,000 UNDER 200,000	4	403,108	523,937	47,154	13	10,623,346	1,920,106	172,610
200,000 UNDER 500,000	8	14,922,873	2,401,987	216,179	13	8,010,205	3,986,174	358,357
500,000 UNDER 1,000,000	4	11,019,352	2,699,958	242,995	6	5,960,217	4,057,125	365,141
1,000,000 UNDER 2,000,000	3	43,104,978	4,720,320	424,629	1	1,375,950	1,495,914	134,632
2,000,000 UNDER 5,000,000	3	46,507,594	7,305,823	657,524	7	178,848,870	24,232,701	2,178,542
5,000,000 AND OVER.....	3	3,224,190,653	537,872,528	48,408,527	4	463,719,079	89,286,775	8,030,810
SUBTOTALS.....	73	\$3,355,922,454	\$557,171,949	\$50,146,137	188	\$672,644,894	\$128,197,547	\$11,532,224
GRAND TOTALS.....	116	\$3,610,015,626	\$552,597,270	\$50,154,737	362	\$662,640,378	\$118,222,946	\$11,567,024

NET INCOME TAXABLE IN CALIFORNIA	ELECTRIC AND GAS INDUSTRIES				OTHER PUBLIC UTILITIES‡			
	NUMBER OF RETURNS	INCOME REPORTED FOR TAXATION		TAX ASSESSED	NUMBER OF RETURNS	INCOME REPORTED FOR TAXATION		TAX ASSESSED
		FEDERAL	STATE			FEDERAL	STATE	
NET LOSS.....	6	-\$198,382,766	-\$142,847,314	\$1,200	388	-\$13,485,078	-\$8,693,267	\$79,800
NO INCOME OR LOSS.....	4	—	—	800	929	—	—	185,800
SUBTOTALS.....	10	-\$198,382,766	-\$142,847,314	\$2,000	1,317	-\$13,485,078	-\$8,693,267	\$265,600
NET INCOME								
\$1 UNDER \$5,000	2	6,067	7,080	641	287	865,643	537,438	70,290
5,000 UNDER 10,000	1	4,945	5,145	463	87	1,381,284	632,458	56,923
10,000 UNDER 15,000	—	—	—	—	56	3,278,531	688,669	61,980
15,000 UNDER 20,000	1	16,960	17,751	1,598	43	3,532,049	752,767	67,750
20,000 UNDER 25,000	—	—	—	—	28	797,989	630,352	56,732
25,000 UNDER 30,000	1	27,529	27,529	2,478	33	1,505,888	901,534	81,137
30,000 UNDER 40,000	1	33,805	35,175	3,166	34	1,406,416	1,157,602	104,184
40,000 UNDER 50,000	1	43,465	44,457	4,001	28	1,135,156	1,226,182	110,356
50,000 UNDER 100,000	—	—	—	—	56	11,304,747	3,900,916	351,080
100,000 UNDER 200,000	—	—	—	—	31	7,130,242	4,689,805	422,087
200,000 UNDER 500,000	1	2,931,244	403,424	36,308	28	19,014,255	9,046,353	808,573
500,000 UNDER 1,000,000	1	17,460,742	829,313	77,463	10	7,783,691	6,613,416	595,207
1,000,000 UNDER 2,000,000	1	8,785,036	1,164,638	104,818	6	10,227,448	8,333,084	748,778
2,000,000 UNDER 5,000,000	—	—	—	—	5	14,778,742	13,311,357	1,198,022
5,000,000 AND OVER.....	2	103,512,529	123,680,328	11,131,229	1	5,430,189	5,742,848	516,856
SUBTOTALS.....	12	\$132,822,322	\$126,214,840	\$11,362,165	733	\$89,572,270	\$58,164,781	\$5,249,955
GRAND TOTALS.....	22	-\$65,560,444	-\$16,632,474	\$11,364,165	2,050	\$76,087,192	\$49,471,514	\$5,515,555

FOOTNOTES FOLLOW THIS SECTION.

APPENDIX III

AMENDED IN ASSEMBLY MAY 7, 1979

CALIFORNIA LEGISLATURE—1979-80 REGULAR SESSION

ASSEMBLY BILL

No. 815

Introduced by Assemblyman Papan

March 12, 1979

REFERRED TO COMMITTEE ON REVENUE AND TAXATION

An act to add Section 24382 to the Revenue and Taxation Code, relating to taxation, to take effect immediately, tax levy.

LEGISLATIVE COUNSEL'S DIGEST

AB 815, as amended, Papan (Rev. & Tax.). Bank and corporation taxes: net operating losses.

Existing Bank and Corporation Tax Law provides for various deductions in the computation of taxable income.

This bill would provide for a carryover and carryback of net operating losses as a deduction in the computation of taxable income *under specified circumstances*.

The bill would take effect immediately as a tax levy; however, its provisions would apply to income years ending after December 31, 1979.

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

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

- 1 SECTION 1. Section 24382 is added to the Revenue
- 2 and Taxation Code, to read:
- 3 24382. (a) Commencing with income years ending

1 after December 31, 1979, there shall be allowed as a
2 deduction for the income year an amount equal to the
3 aggregate of (1) the net operating loss carryovers to such
4 year, plus (2) the net operating loss carrybacks to such
5 year, except that a net operating loss shall not be carried
6 back to income years ending on or before December 31,
7 1979. For purposes of this subtitle, the term "net
8 operating loss deduction" means the deduction allowed
9 by this subdivision.

10 (b) (1) Except as provided in subdivision (a), the
11 years to which a net operating loss may be carried are as
12 follows:

13 (A) Except as provided in subparagraphs (D), (E),
14 (F), (G), (H), and (I), a net operating loss for any
15 income year shall be a net operating loss carryback to
16 each of the three income years preceding the income
17 year of such loss.

18 (B) Except as provided in subparagraphs (C), (D),
19 (E), and (F), a net operating loss for any income year
20 ending after December 31, 1979, shall be a net operating
21 loss carryover to each of the seven income years following
22 the income year of such loss.

23 (C) In the case of a taxpayer which is a regulated
24 transportation corporation (as defined in paragraph (1)
25 of subdivision (g)), a net operating loss for any income
26 year ending after December 31, 1979, shall (except as
27 provided in subdivision (g)) be a net operating loss
28 carryover to each of the nine income years following the
29 income year of such loss.

30 (D) In the case of a taxpayer which has a foreign
31 expropriation loss (as defined in subdivision (h)) for any
32 income year ending after December 31, 1979, the portion
33 of the net operating loss for such year attributable to such
34 foreign expropriation loss shall not be a net operating loss
35 carryback to any income year preceding the income year
36 of such loss and shall be a net operating loss carryover to
37 each of the 10 income years following the income year of
38 such loss.

39 (E) In the case of a taxpayer which has a net operating
40 loss for any income year for which the provisions of part

1 II of subchapter M of the Internal Revenue Code of 1954
2 (relating to real estate investment trusts) apply to such
3 taxpayer, such loss shall not be a net operating loss
4 carryback to any income year preceding the income year
5 of such loss and shall be a net operating loss carryover to
6 each of the eight income years following the income year
7 of such loss. A net operating loss shall not be carried back
8 to an income year for which part II of subchapter M of the
9 Internal Revenue Code of 1954 applied to the taxpayer.

10 (F) In the case of a financial institution to which
11 Section 585, 586, or 593 of the Internal Revenue Code of
12 1954 applies, a net operating loss for any income year
13 beginning after December 31, 1979, shall be a net
14 operating loss carryback to each of the 10 income years
15 preceding the income year of such loss and shall be a net
16 operating loss carryover to each of the five income years
17 following the income year of such loss.

18 (G) In the case of a Bank for Cooperatives (organized
19 and chartered pursuant to Section 2 of the Farm Credit
20 Act of 1933 (12 U.S.C. 1134)), a net operating loss for any
21 income year beginning after December 31, 1979, shall be
22 a net operating loss carryback to each of the 10 income
23 years preceding the income year of such loss and shall be
24 a net operating loss carryover to each of the five income
25 years following the income year of such loss.

26 (H) In the case of a taxpayer which has a product
27 liability loss (as defined in subdivision (i)) for an income
28 year beginning after December 21, 1979 (referred to in
29 this subparagraph as the "loss year"), the product liability
30 loss shall be a net operating loss carryback to each of the
31 10 income years preceding the loss year.

32 (I) In the case of an electing GSOC under the Internal
33 Revenue Code of 1954 which has a net operating loss for
34 any income year such loss shall not be a net operating loss
35 carryback to any income year preceding the year of such
36 loss, but shall be a net operating loss carryover to each of
37 the 10 income years following the year of such loss.

38 (2) Except as provided in subparagraph (g), the entire
39 amount of the net operating loss for any income year
40 (hereinafter in this section referred to as the "loss year")

1 shall be carried to the earliest of the income years to
2 which (by reason of paragraph (1)) such loss may be
3 carried. The portion of such loss which shall be carried to
4 each of the other income years shall be the excess, if any,
5 of the amount of such loss over the sum of the taxable
6 income for each of the prior income years to which such
7 loss may be carried. For purposes of the preceding
8 sentence, the taxable income for any such prior income
9 year shall be computed—

10 (A) with the modifications specified in subdivision
11 (d) other than paragraphs (1), (4), and (6) thereof;
12 and

13 (B) by determining the amount of the net operating
14 loss deduction—

15 (i) without regard to the net operating loss for the
16 loss year or for any income year thereafter, and

17 (ii) without regard to that portion, if any, of a net
18 operating loss for an income year attributable to a
19 foreign expropriation loss, if such portion may not,
20 under subparagraph (D) of (1), be carried back to such
21 prior income year,

22 and the taxable income so computed shall not be
23 considered to be less than zero. For purposes of this
24 paragraph, if a portion of the net operating loss for the
25 loss year is attributable to a foreign expropriation to
26 which paragraph (1)(D) applies, such portion shall be
27 considered to be a separate net operating loss for such
28 year to be applied after the other portion of such net
29 operating loss.

30 (3) (A) Paragraph (1)(D) shall apply only if

31 (i) The foreign expropriation loss (as defined in
32 subdivision (h)) for the income year equals or exceeds 50
33 percent of the net operating loss for the income year,

34 (ii) In the case of a foreign expropriation loss for an
35 income year ending after December 31, 1979, the
36 taxpayer elects (at such time and in such manner as the
37 Franchise Tax Board by regulations prescribes) to have
38 subparagraph (D) of paragraph (1) apply, and

39 (B) Any taxpayer entitled to a carryback period under
40 paragraph (1) may elect to relinquish the entire

1 carryback period with respect to a net operating loss for
2 any income year ending after December 31, 1979. Such
3 election shall be made in such manner as may be
4 prescribed by the Franchise Tax Board, and shall be
5 made by the due date (including extensions of time) for
6 filing the taxpayer's return for the income year of the net
7 operating loss for which the election is to be in effect.
8 Such election, once made for any income year, shall be
9 irrevocable for that income year.

10 (c) For purposes of this section, the term "net
11 operating loss" means the excess of the deductions
12 allowed by this part over the gross income. Such excess
13 shall be computed with the modifications specified in
14 subdivision (d).

15 (d) The modifications referred to in this section are as
16 follows:

17 (1) No net operating loss deduction shall be allowed.

18 (2) In the case of a taxpayer other than a
19 corporation—

20 (A) The amount deductible on account of losses from
21 sales or exchanges of capital assets shall not exceed the
22 amount includible on account of gains from sales or
23 exchanges of capital assets; and

24 (B) 100 percent of the capital gains provided by
25 Section 18162.5 shall be taken into account.

26 (3) In the case of a taxpayer other than a corporation,
27 the deductions allowable by this part which are not
28 attributable to a taxpayer's trade or business shall be
29 allowed only to the extent of the amount of the gross
30 income not derived from such trade or business. For
31 purposes of the preceding sentence—

32 (A) Any gain or loss from the sale or other disposition
33 of—

34 (i) property, used in the trade or business, of a
35 character which is subject to the allowance for
36 depreciation provided in Section 167 of the Internal
37 Revenue Code of 1954, or

38 (ii) real property used in the trade or business,
39 shall be treated as attributable to the trade or business;

40 (B) The modifications specified in paragraph (1) and

1 subparagraph (B) of paragraph (2) shall be taken into
2 account;

3 (C) Any deduction allowable under Section 165(c) (3)
4 of the Internal Revenue Code of 1954 (relating to
5 casualty losses) shall not be taken into account; and

6 (D) Any deduction allowed under Section 404 or
7 subdivision (c) of Section 405 of the Internal Revenue
8 Code of 1954 to the extent attributable to contributions
9 which are made on behalf of an individual who is an
10 employee within the meaning of subparagraph (1) of
11 subdivision (c) of Section 401 of the Internal Revenue
12 Code of 1954 shall not be treated as attributable to the
13 trade or business of such individual.

14 (5) In computing the deduction for dividends
15 received, the deductions allowed by Sections 243
16 (relating to dividends received by corporations), 244
17 (relating to dividends received on certain preferred
18 stock of public utilities), and 245 (relating to dividends
19 received from certain foreign corporations) shall be
20 computed without regard to subdivision (b) of Section
21 246 of the Internal Revenue Code of 1954 (relating to
22 limitation on aggregate amount of deductions); and the
23 deduction allowed by Section 247 of the Internal
24 Revenue Code of 1954 (relating to dividends paid on
25 certain preferred stock of public utilities) shall be
26 computed without regard to subparagraph (B) of
27 paragraph (1) of subdivision (a) of such section.

28 (6) In the case of any income year for which part II of
29 subchapter M of the Internal Revenue Code of 1954
30 (relating to real estate investment trusts) applies to the
31 taxpayer—

32 (A) The net operating loss for such income year shall
33 be computed by taking into account the adjustments
34 described in paragraph (2) of subdivision (b) of Section
35 857 (other than the deduction for dividends paid
36 described in subparagraph (B) of paragraph (2) of
37 subdivision (b) of Section 857); and

38 (B) Where such income year is a "prior income year"
39 referred to in paragraph (2) of subdivision (b), the term
40 "taxable income" in such paragraph shall mean "real

1 estate investment trust taxable income" (as defined in
2 paragraph (2) of subdivision (b) of Section 857).

3 (e) In determining the amount of any net operating
4 loss carryback or carryover to any income year, the
5 necessary computations involving any other income year
6 shall be made under the law applicable to such other
7 income year.

8 (f) In determining the amount of the net operating loss
9 deduction under subsection (a) of any corporation, there
10 shall be disregarded the net operating loss of such
11 corporation for any income year for which such
12 corporation is an electing small business corporation
13 under subchapter S of the Internal Revenue Code of 1954.

14 (g) (1) For purposes of subparagraph (C) of
15 paragraph (1) of subdivision (b), the term "regulated
16 transportation corporation" means a corporation as
17 defined by Section 172 of the Internal Revenue Code of
18 1954.

19 (2) For purposes of subparagraph (C) of paragraph
20 (1) of subdivision (b):

21 (A) A net operating loss may not be a net operating
22 loss carryover to the eighth income year following the
23 loss year unless the taxpayer is a regulated transportation
24 corporation for such eighth income year;

25 (B) A net operating loss may not be a net operating
26 loss carryover to the ninth income year following the loss
27 year unless the taxpayer is a regulated transportation
28 corporation for the sixth income year following the loss
29 year and for such ninth income year; and

30 (h) For purposes of subdivision (b)—

31 (1) The term "foreign expropriation loss" means, for
32 any income year, the sum of the losses sustained by reason
33 of the expropriation, intervention, seizure, or similar
34 taking of property by the government of any foreign
35 country, any political subdivision thereof, or any agency
36 or instrumentality of the foregoing. For purposes of the
37 preceding sentence, a debt which becomes worthless
38 shall, to the extent of any deduction allowed under
39 subdivision (a) of Section 17207, be treated as a loss.

40 (2) The portion of the net operating loss for any

1 income year attributable to a foreign expropriation loss is
 2 the amount of the foreign expropriation loss for such year
 3 (but not in excess of the net operating loss for such year).

4 (i) For purposes of subdivision (b) —

5 (1) The term “product liability loss” means, for any
 6 income year, the lesser of—

7 (A) The net operating loss for such year reduced by
 8 any portion thereof which is attributable to a foreign
 9 expropriation loss, or

10 (B) The sum of the amounts allowable as deductions
 11 under Sections 17202, 17202.3, 17206, and 17206.5 which
 12 are attributable to—

13 (i) Product liability, or

14 (ii) Expenses incurred in the investigation or
 15 settlement of, or opposition to, claims against the
 16 taxpayer on account of product liability.

17 (2) The term “product liability” means—

18 (A) Liability of the taxpayer for damages on account
 19 of physical injury or emotional harm to individuals, or
 20 damage to or loss of the use of property, on account of any
 21 defect in any product which is manufactured, leased, or
 22 sold by the taxpayer, but only if

23 (B) Such injury, harm, or damage arises after the
 24 taxpayer has completed or terminated operations with
 25 respect to, and has relinquished possession of, such
 26 product.

27 (3) Any taxpayer entitled to a 10-year carryback under
 28 subparagraph (H) of paragraph (1) of subdivision (b)
 29 from any loss year may elect to have the carryback period
 30 with respect to such loss year determined without regard
 31 to such subparagraph. Such election shall be made in such
 32 manner as may be prescribed by the Franchise Tax Board
 33 and shall be made by the due date (including extensions
 34 of time) for filing the taxpayer’s return for the income
 35 year of the net operating loss. Such election, once made
 36 for any income year, shall be irrevocable for that income
 37 year.

38 (j) *This section shall not apply to:*

39 (1) *Corporations which have gross sales in excess of*
 40 *one million five hundred thousand dollars (\$1,500,000) in*

1 *the income year in which there is a net operating loss, or*
 2 *(2) Corporations which were not doing business in this*
 3 *state prior to January 1, 1977.*

4 SEC. 2. This act provides for a tax levy within the
 5 meaning of Article IV of the Constitution and shall go into
 6 immediate effect. However, its provisions shall apply to
 7 income years ending after December 31, 1979.

APPENDIX IV

CALIFORNIA LEGISLATURE—1979-80 REGULAR SESSION

ASSEMBLY BILL

No. 874

Introduced by Assemblymen McVittie, Leonard, Imbrecht, Thurman, Bannai, Bergeson, Dennis Brown, Chappie, Cline, Costa, Elder, Ellis, Filante, Greene, Hallett, Lancaster, McAlister, Moorhead, Naylor, Nolan, Papan, Rosenthal, Statham, Stirling, Tanner, Torres, Maxine Waters, Norman Waters, Wray, and Wyman
(Coauthor: Senator Robbins)

March 14, 1979

REFERRED TO COMMITTEE ON REVENUE AND TAXATION

An act to amend Sections 23151, 23153, 23184, 23186, and 23501 of, to add Chapter 3 (commencing with Section 23800) to Part 11 of Division 2 of, and to add and to repeal Chapter 7 (commencing with Section 24341) of Part 11 of Division 2 of, the Revenue and Taxation Code, relating to taxation, to take effect immediately, tax levy.

LEGISLATIVE COUNSEL'S DIGEST

AB 874, as introduced, McVittie (Rev. & Tax.). Bank and corporation tax rates.

Under existing Bank and Corporation Tax Law taxes are imposed according to, or measured by, net income, at the general rate of 9%, and at a rate not to exceed 13% with regard to banks, which is in lieu of other specified taxes.

This bill would revise the general tax rate for corporations, other than banks and financial corporations, to 3% of the first \$25,000 of net income, 4% for net income exceeding \$25,000 but not exceeding \$50,000, 5% for net income in excess of \$50,000 but not in excess of \$75,000, 7% for net income in

excess of \$75,000 but not in excess of \$100,000 and 9% for net income in excess of \$100,000, and makes certain conforming changes in the computation of taxes on banks and financial corporations.

This bill would also provide that certain small business corporations may elect not to be subject to the bank and corporation tax but may elect to have the shareholders pay taxes on the income of the corporation as if the income had been received by the shareholders.

Under existing Bank and Corporation Tax Law, net income upon which the taxes are imposed or measured, is computed by deducting specified authorized expenses from gross income, as defined.

This bill would eliminate such authorized deductions and would specify that net income shall be net taxable income, as determined under the Federal Internal Revenue Code, with specified adjustments.

Existing Bank and Corporation Tax Law does not authorize a taxpayer to carry a loss incurred in an income year to preceding or following income years.

This bill would authorize a taxpayer to carry net operating losses to preceding or following income years, as specified.

This bill would take effect immediately as a tax levy.

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

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

SECTION 1. Section 23151 of the Revenue and Taxation Code is amended to read:

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

state, for the said privilege, a minimum tax of one hundred dollars (\$100).

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

(c) For income years beginning after December 31, 1971, the one hundred dollars (\$100) specified in subdivision (a) shall be two hundred dollars (\$200) instead of one hundred dollars (\$100), and for income years beginning after December 31, 1979, the one hundred dollars (\$100) specified in subdivision (a) shall be thirty-five dollars (\$35).

(d) For income years beginning after December 31, 1979, the rate of tax shall be:

(1) Three percent on the first twenty-five thousand dollars (\$25,000) of income.

(2) Four percent on income in excess of twenty-five thousand dollars (\$25,000) and not in excess of fifty thousand dollars (\$50,000).

(3) Five percent on income in excess of fifty thousand dollars (\$50,000) and not in excess of seventy-five thousand dollars (\$75,000).

(4) Seven percent on income in excess of seventy-five thousand dollars (\$75,000) and not in excess of one hundred thousand dollars (\$100,000).

(5) Nine percent on income in excess of one hundred thousand dollars (\$100,000).

(e) When the income 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 rate of tax as provided in subdivision (d), shall be based on the combined net income from all sources prior to the exclusion of net income which is not subject to the tax imposed under this part.

SEC. 2. Section 23153 of the Revenue and Taxation Code is amended to read:

23153. (a) Every corporation not otherwise taxed under this chapter and not expressly exempted by the provisions of this part or the Constitution of this state shall pay annually to the state a tax of one hundred dollars

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1 ~~(\$100)~~, except that the following corporations shall pay
2 annually to the state a tax of twenty-five dollars ~~(\$25)~~:
3 *thirty-five dollars (\$35)*.

4 (1) A credit union not otherwise taxed under this
5 chapter whose gross income is twenty thousand dollars
6 ~~(\$20,000)~~ or less.

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

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

16 Every such domestic corporation taxable under this
17 section shall be subject to the said tax from the date of
18 incorporation until the effective date of dissolution as
19 provided in Section 23331.

20 For the purpose of paragraphs (2) and (3) a
21 corporation shall not be considered to have done business
22 if it engages in other than mining.

23 (b) For income years beginning after December 31,
24 1971, the one hundred dollars ~~(\$100)~~ specified in
25 subdivision (a) shall be two hundred dollars ~~(\$200)~~
26 instead of one hundred dollars ~~(\$100)~~.

27 SEC. 3. Section 23184 of the Revenue and Taxation
28 Code is amended to read:

29 23184. (a) Financial corporations may offset against
30 the franchise tax the amounts paid during the income
31 year to this state or to any county, city, town, or other
32 political subdivisions of the state as personal property
33 taxes, or as license fees or excise taxes for the following
34 privileges:

35 (1) Operating as personal property brokers or brokers
36 as defined in the Personal Property Brokers Law
37 provided for in Division 9 (commencing with Section
38 22000) of the Financial Code.

39 (2) Engaging in the business of loaning money,
40 advancing credit, or loaning credit or arranging for the

1 loan of money or advancing of credit or loaning of credit.
2 (3) Storing, using or otherwise consuming in this state
3 of tangible personal property by savings and loan
4 associations.

5 (b) The offset allowed to any financial corporation for
6 any income year as provided in this section may, at the
7 election of that financial corporation, be offset, in whole
8 or in part, against its franchise tax for that income year or
9 offset in whole or in part against its franchise tax in one
10 or more of the next four succeeding years of its selection,
11 until such time as the total amount of such offset is so
12 utilized; provided, however, that for such purposes,
13 offsets elected to be utilized against the franchise tax of
14 a succeeding year shall be applied in the order of their
15 respective years of origin and prior to the application of
16 the offset which might otherwise be allowable for
17 amounts paid during that income year.

18 (c) Notwithstanding anything to the contrary
19 contained in this section, the tax on financial corporations
20 after the allowance of all offsets provided for herein shall
21 not be less than 7.6 percent of its net income for the
22 preceding income year nor less than the following
23 minimum tax: *thirty-five dollars (\$35)*.

24 (1) In the case of financial corporations, other than
25 credit unions whose gross income is twenty thousand
26 dollars ~~(\$20,000)~~ or less, one hundred dollars ~~(\$100)~~.

27 (2) In the case of credit unions whose gross income is
28 twenty thousand dollars ~~(\$20,000)~~ or less, twenty-five
29 dollars ~~(\$25)~~.

30 (d) For purposes of this section, with respect to
31 calendar or fiscal years ending after June 30, 1972, the tax
32 on financial corporations after the allowance of all offsets
33 shall not be less than 9 percent of its net income nor less
34 than the minimum tax as provided by subdivision (c).

35 (e) For income years beginning after December 31,
36 1971, the one hundred dollars ~~(\$100)~~ specified in
37 paragraph (1) of subdivision (c) shall be two hundred
38 dollars ~~(\$200)~~ instead of one hundred dollars ~~(\$100)~~.

39 SEC. 4. Section 23186 of the Revenue and Taxation
40 Code is amended to read:

1 23186. The rate of tax on banks and financial
 2 corporations shall be a percentage equal to the
 3 percentage of ~~the total amount of~~ net income *in excess of*
 4 *one hundred thousand dollars (\$100,000)*, allocable to this
 5 state; of every corporation taxable under Section 23151 or
 6 subdivision (c) of Section 23151.1 or paragraph (1) of
 7 subdivision (d) of Section 23151.1, as the case may be,
 8 other than public utilities as defined in the Public Utilities
 9 Act, for the next preceding calendar year or fiscal years
 10 ended during such calendar year, required to be paid to
 11 this state as franchise taxes according to or measured by
 12 such net income, and required to be paid to this state or
 13 its political subdivisions by such corporations as personal
 14 property taxes during the preceding calendar year or
 15 fiscal years ended in such calendar year; provided,
 16 however, that said rate of tax shall not exceed 13 percent.
 17 The percentage of the net income of every corporation
 18 taxable under Section 23151, or subdivision (c) of Section
 19 23151.1, or paragraph (1) of subdivision (d) of Section
 20 23151.1, as the case may be, other than public utilities as
 21 defined in the Public Utilities Act, required to be paid to
 22 this state or its political subdivisions in personal property
 23 taxes shall be determined by ascertaining the ratio which
 24 the total amount of such personal property taxes, less 9 8
 25 percent thereof, bears to the total amount of net income
 26 of such corporations allocable to California, increased by
 27 the amount of such personal property taxes; provided,
 28 however, that if any such corporation sustains a net loss
 29 allocable to California the personal property taxes
 30 required to be paid by such corporation to this state or its
 31 political subdivisions during the preceding calendar year
 32 or fiscal years ended during such calendar year shall be
 33 considered for the purpose of determining such ratio only
 34 to the extent which such personal property taxes exceed
 35 such net loss allocable to California.

36 SEC. 5. Section 23501 of the Revenue and Taxation
 37 Code is amended to read:

38 23501. (a) There shall be imposed upon every
 39 corporation for each taxable year, a tax at the rate of 7.6
 40 percent upon its net income derived from sources within

1 this state on or after January 1, 1937, other than income
 2 for any period for which the corporation is subject to
 3 taxation under Chapter 2 of this part, according to or
 4 measured by its net income.

5 (b) For calendar or fiscal years ending after June 30,
 6 1973, the rate of tax shall be 9 percent instead of 7.6
 7 percent as provided by subdivision (a).

8 (c) *For calendar or fiscal years ending after June 30,*
 9 *1979, the rate of tax on net income derived from sources*
 10 *within this state, other than income for any period for*
 11 *which the corporation is subject to taxation under*
 12 *Chapter 2 of this part, according to or measured by its net*
 13 *income, shall be:*

14 (1) *Three percent on the first twenty-five thousand*
 15 *dollars (\$25,000) of income.*

16 (2) *Four percent on income in excess of twenty-five*
 17 *thousand dollars (\$25,000) and not in excess of fifty*
 18 *thousand dollars (\$50,000).*

19 (3) *Five percent on income in excess of fifty thousand*
 20 *dollars (\$50,000) and not in excess of seventy-five*
 21 *thousand dollars (\$75,000).*

22 (4) *Seven percent on income in excess of seventy-five*
 23 *thousand dollars (\$75,000) and not in excess of one*
 24 *hundred thousand dollars (\$100,000).*

25 (5) *Nine percent on income in excess of one hundred*
 26 *thousand dollars (\$100,000).*

27 (d) *When the income of a taxpayer subject to the tax*
 28 *imposed under this part is derived from or attributable to*
 29 *sources both within and without this state, the rate of tax*
 30 *as provided in subdivision (d), shall be based on the*
 31 *combined net income from all sources, prior to the*
 32 *exclusion of net income which is not subject to the tax*
 33 *imposed under this part.*

34 SEC. 6. Chapter 3.5 (commencing with Section
 35 23800) is added to Part 11 of Division 2 of the Revenue
 36 and Taxation Code, to read:

37
 38 CHAPTER 3.5. TAX ELECTION OF SMALL BUSINESS
 39 CORPORATIONS.
 40

1 23800. (a) For purposes of this chapter, the term
2 "small business corporation" means a corporation which
3 is not a member of an affiliated group as defined in
4 Section 1504 of Title 26 of the United States Code
5 Annotated, and which does not:

6 (1) Have more than 15 shareholders;

7 (2) Have as a shareholder a person (other than an
8 estate and other than a trust described in subdivision (e))
9 who is not an individual;

10 (3) Have a nonresident alien of the United States as a
11 shareholder; and

12 (4) Have more than one class of stock.

13 (b) For purposes of this chapter, the term "electing
14 small business corporation" means, with respect to any
15 taxable year, a small business corporation which has made
16 an election under subdivision (a) of Section 23801 which,
17 under Section 23801, is in effect for such taxable year.

18 (c) For purposes of paragraph (1) of subdivision (a),
19 a husband and wife, and their estates, shall be treated as
20 one shareholder.

21 (d) For purposes of subdivision (a), a corporation shall
22 not be considered a member of an affiliated group at any
23 time during any taxable year by reason of the ownership
24 of stock in another corporation if such other corporation

25 (1) has not begun business at any time on or after the
26 date of its incorporation and before the close of such
27 taxable year, and (2) does not have taxable income for
28 the period included within such taxable year.

29 (e) For purposes of subdivision (a), the following
30 trusts may be shareholders:

31 (1) A trust all of which is treated as owned by the
32 grantor under Article 5 (commencing with Section
33 17781) of Chapter 9 of Part 10 of this division.

34 (2) A trust created primarily to exercise the voting
35 power of stock transferred to it.

36 (3) Any trust with respect to trust transferred to it
37 pursuant to the terms of a will, but only for the 60-day
38 period beginning on the day on which such stock is
39 transferred to it.

40 In the case of a trust described in paragraph (2) of

1 subdivision (e), each beneficiary shall, for purposes of
2 paragraph (1) of subdivision (a), be treated as a
3 shareholder. In the case of a trust described in paragraph
4 (1) of subdivision (e), the grantor shall be treated as a
5 shareholder.

6 23801. (a) Except as provided in subdivision (f), any
7 small business corporation may elect, in accordance with
8 the provisions of this section, not to be subject to the taxes
9 imposed by this part. Such election shall be valid only if
10 all persons who are shareholders in such corporation on
11 the day on which such election is made consent to such
12 election.

13 (b) If a small business corporation makes an election
14 under subdivision (a):

15 (1) With respect to the taxable years of the
16 corporation for which such election is in effect, such
17 corporation shall not be subject to the taxes imposed by
18 this part and, with respect to such taxable years and all
19 succeeding taxable years, the provisions of Section 23806
20 shall apply to such corporation;

21 (2) With respect to the taxable years of a shareholder
22 of such corporation in which or with which the taxable
23 years of the corporation for which such election is in
24 effect, the provisions of Sections 23802, 23803, and 23804
25 shall apply to such shareholder, and with respect to such
26 taxable years and all succeeding taxable years, the
27 provisions of Section 23805 shall apply to such
28 shareholder.

29 (c) (1) An election under subdivision (a) may be
30 made by a small business corporation for any taxable year
31 (A) at any time during the preceding taxable year, or (B)
32 at any time during the first 75 days of the taxable year.

33 (2) If (A) a small business corporation makes an
34 election under subdivision (a) for any taxable year, and
35 (B) such election is made after the first 75 days of the
36 taxable year and on or before the last day of such taxable
37 year, then such election shall be treated as made for the
38 following taxable year.

39 (3) An election under subdivision (a) shall be made in
40 such manner as the Franchise Tax Board shall prescribe

1 by regulations.

2 (d) An election under subdivision (a) shall be
3 effective for the taxable year of the corporation for which
4 it is made and for all succeeding taxable years of the
5 corporation, unless it is terminated, with respect to any
6 such taxable year, under subdivision (e).

7 (e) (1) (A) An election under subdivision (a) made
8 by a small business corporation shall terminate if any
9 person who was not a shareholder in such corporation on
10 the day on which the election is made becomes a
11 shareholder in such corporation and affirmatively refuses
12 to consent to such election on or before the 60th day after
13 the day on which he acquires the stock.

14 (B) If the person acquiring the stock is the estate of a
15 decedent, the period under subparagraph (A) for
16 affirmatively refusing to consent to the election shall
17 expire on the 60th day after the day on which the
18 executor or administrator of the estate qualifies, or the
19 last day of the taxable year of the corporation in which
20 the decedent died, whichever is earlier.

21 (C) Any termination of an election under
22 subparagraph (A) by reason of the affirmative refusal of
23 any person to consent to such election shall be effective
24 for the taxable year of the corporation in which such
25 person becomes a shareholder in the corporation (or, if
26 later, the first taxable year for which such election would
27 otherwise have been effective) and for all succeeding
28 taxable years of the corporation.

29 (2) An election under subdivision (a) made by a small
30 business corporation may be revoked by it for any taxable
31 year of the corporation after the first taxable year for
32 which the election is effective. An election may be
33 revoked only if all persons who are shareholders in the
34 corporation on the day on which the revocation is made
35 consent to the revocation. A revocation under this
36 paragraph shall be effective:

37 (A) for the taxable year in which made, if made
38 before the close of the first month of such taxable year,

39 (B) for the taxable year following the taxable year in
40 which made, if made after the close of such first month,

1 and for all succeeding taxable years of the corporation.
2 Such revocation shall be made in such manner as the
3 secretary or his delegate shall prescribe by regulations.

4 (3) An election under subdivision (a) made by a small
5 business corporation shall terminate if at any time:

6 (A) after the first day of the first taxable year of the
7 corporation for which the election is effective, if such
8 election is made on or before such first day, or

9 (B) after the day on which the election is made, if
10 such election is made after such first day,

11 the corporation ceases to be a small business corporation.
12 Such termination shall be effective for the taxable year of
13 the corporation in which the corporation ceases to be a
14 small business corporation and for all succeeding taxable
15 years of the corporation.

16 (4) An election under subdivision (a) made by a small
17 business corporation shall terminate if for any taxable
18 year of the corporation for which the election is in effect,
19 such corporation derives more than 80 percent of its gross
20 receipts from sources outside the United States. Such
21 termination shall be effective for the taxable year of the
22 corporation in which it derives more than 80 percent of
23 its gross receipts from sources outside the United States,
24 and for all succeeding taxable years of the corporation.

25 (5) (A) Except as provided in subparagraph (B), an
26 election under subdivision (a) made by a small business
27 corporation shall terminate if, for any taxable year of the
28 corporation for which the election is in effect, such
29 corporation has gross receipts more than 20 percent of
30 which is passive investment income. Such termination
31 shall be effective for the taxable year of the corporation
32 in which it has gross receipts of such amount, and for all
33 succeeding taxable years of the corporation.

34 (B) Subparagraph (A) shall not apply with respect to
35 a taxable year in which a small business corporation has
36 gross receipts more than 20 percent of which is passive
37 investment income, if—

38 (i) Such taxable year is the first taxable year in which
39 the corporation commenced the active conduct of any
40 trade or business or the next succeeding taxable year; and

1 (ii) The amount of passive investment income for such
2 taxable year is less than three thousand dollars (\$3,000).

3 (C) For purposes of this paragraph, the term “passive
4 investment income” means gross receipts derived from
5 royalties, rents, dividends, interest, annuities, and sales or
6 exchanges of stock or securities (gross receipts from such
7 sales or exchanges being taken into account for purposes
8 of this paragraph only to the extent of gains therefrom).
9 Gross receipts derived from sales or exchanges of stock or
10 securities for purposes of this paragraph shall not include
11 amounts received by an electing small business
12 corporation which are treated under Section 24501
13 (relating to corporate liquidations) as payments in
14 exchange for stock where the electing small business
15 corporation owned more than 50 percent of each class of
16 the stock of the liquidating corporation.

17 (f) If a small business corporation has made an election
18 under subdivision (a) and if such election has been
19 terminated or revoked under subdivision (e), such
20 corporation (and any successor corporation) shall not be
21 eligible to make an election under subdivision (a) for any
22 taxable year prior to its fifth taxable year which begins
23 after the first taxable year for which such termination or
24 revocation is effective, unless the Franchise Tax Board
25 consents to such election.

26 23802. (a) The undistributed taxable income of an
27 electing small business corporation for any taxable year
28 shall be included in the gross income of the shareholders
29 of such corporation in the manner and to the extent set
30 forth in this section.

31 (b) Each person who is a shareholder of an electing
32 small business corporation on the last day of a taxable
33 year of such corporation shall include in his gross income,
34 for his taxable year in which or with which the taxable
35 year of the corporation ends, the amount he would have
36 received as a dividend, if on such last day there had been
37 distributed pro rata to its shareholders by such
38 corporation an amount equal to the corporation's
39 undistributed taxable income for the corporation's
40 taxable year. For purposes of this part, the amount so

1 included shall be treated as an amount distributed as a
2 dividend on the last day of the taxable year of the
3 corporation.

4 (c) For purposes of this section, the term
5 “undistributed taxable income” means taxable income
6 (computed as provided in subdivision (d)) minus the
7 sum of (1) the taxes imposed by Section 23400 and (2) the
8 amount of money distributed as dividends during the
9 taxable year, to the extent that any such amount is a
10 distribution out of earnings and profits of the taxable year
11 as specified in subdivision (b) of Section 24495.

12 (d) For purposes of this chapter, the taxable income of
13 an electing small business corporation shall be
14 determined without regard to the deductions allowed by
15 Article 2 (commencing with Section 24401) of Chapter 7
16 of this part (other than the deduction allowed by Section
17 24408, relating to organization expenditures).

18 23803. (a) A net operating loss of an electing small
19 business corporation for any taxable year shall be allowed
20 as a deduction from gross income of the shareholders of
21 such corporation in the manner and to the extent set forth
22 in this section.

23 (b) Each person who is a shareholder of an electing
24 small business corporation at any time during a taxable
25 year of the corporation in which it has a net operating loss
26 shall be allowed as a deduction from gross income, for his
27 taxable year in which or with which the taxable year of
28 the corporation ends (or for the final taxable year of a
29 shareholder who dies before the end of the corporation's
30 taxable year), an amount equal to his portion of the
31 corporation's net operating loss (as determined under
32 subdivision (c)). The deduction allowed by this
33 subdivision shall, for purposes of this chapter, be
34 considered as a deduction attributable to a trade or
35 business carried on by the shareholder.

36 (c) (1) For purposes of this section, a shareholder's
37 portion of the net operating loss of an electing small
38 business corporation is his pro rata share of the
39 corporation's net operating loss (except that the
40 deductions provided in Article 2 (commencing with

1 Section 24401) of Chapter 7 of this part shall not be
 2 allowed) for his taxable year in which or with which the
 3 taxable year of the corporation ends. For purposes of this
 4 paragraph, a shareholder's pro rata share of the
 5 corporation's net operating loss is the sum of the portions
 6 of the corporation's daily net operating loss attributable
 7 on a pro rata basis to the shares held by him on each day
 8 of the taxable year. For purposes of the preceding
 9 sentence, the corporation's daily net operating loss is the
 10 corporation's net operating loss divided by the number of
 11 days in the taxable year.

12 (2) A shareholder's portion of the net operating loss of
 13 an electing small business corporation for any taxable
 14 year shall not exceed the sum of—

15 (A) The adjusted basis (determined without regard to
 16 any adjustment under Section 23805 for the taxable year)
 17 of the shareholder's stock in the electing small business
 18 corporation, determined as of the close of the taxable
 19 year of the corporation (or, in respect of stock sold or
 20 otherwise disposed of during such taxable year, as of the
 21 day before the day of such sale or other disposition), and

22 (B) The adjusted basis (determined without regard to
 23 any adjustment under Section 23805 for the taxable year)
 24 of any indebtedness of the corporation to the
 25 shareholder, determined as of the close of the taxable
 26 year of the corporation (or, if the shareholder is not a
 27 shareholder as of the close of such taxable year, as of the
 28 close of the last day in such taxable year on which the
 29 shareholder was a shareholder in the corporation).

30 23804. (a) (1) The amount includible in the gross
 31 income of a shareholder as dividends (including amounts
 32 treated as dividends under subdivision (b) of Section
 33 23802) from an electing small business corporation
 34 during any taxable year of the corporation, to the extent
 35 that such amount is a distribution of property out of
 36 earnings and profits of the taxable year as specified in
 37 subdivision (b) of Section 24495, shall be treated as a
 38 long-term capital gain to the extent of the shareholder's
 39 pro rata share of the corporation's net capital gain for
 40 such taxable year. For purposes of this paragraph, such

1 net capital gain shall be deemed not to exceed the
 2 corporation's taxable income (computed as provided in
 3 subdivision (d) of Section 23802) for the taxable year.

4 (2) A shareholder's pro rata share of such excess for
 5 any taxable year shall be an amount which bears the same
 6 ratio to such excess as the amount of dividends described
 7 in paragraph (1) includible in the shareholder's gross
 8 income bears to the entire amount of dividends described
 9 in paragraph (1) includible in the gross income of all
 10 shareholders.

11 (3) For purposes of paragraphs (1) and (2), an
 12 electing small business corporation's net capital gain for
 13 a taxable year shall be reduced by an amount equal to the
 14 amount of the taxes imposed by Section 23400 on such
 15 corporation for such year.

16 (b) Any dividend received by a shareholder from an
 17 electing small business corporation (including any
 18 amount treated as a dividend under subdivision (b) of
 19 Section 23802) may be apportioned or allocated by the
 20 board between or among shareholders of such
 21 corporation who are members of such shareholder's
 22 family, if he determines that such apportionment or
 23 allocation is necessary in order to reflect the value of
 24 services rendered to the corporation by such
 25 shareholders.

26 (c) (1) An electing small business corporation may
 27 distribute, in accordance with regulations prescribed by
 28 the board, to any shareholder all or any portion of the
 29 shareholder's net share of the corporation's undistributed
 30 taxable income for taxable years prior to the taxable year
 31 in which such distribution is made. Any such distribution
 32 shall, for purposes of this chapter, be considered a
 33 distribution which is not a dividend, but the earnings and
 34 profits of the corporation shall not be reduced by reason
 35 of any such distribution.

36 (2) For purposes of this subdivision, a shareholder's
 37 net share of the undistributed taxable income of an
 38 electing small business corporation is an amount equal
 39 to—

40 (A) The sum of the amounts included in the gross

1 income of the shareholder under subdivision (b) of
2 Section 23802 for all prior taxable years (excluding any
3 taxable year to which the provisions of this section do not
4 apply and all taxable years preceding such year), reduced
5 by

6 (B) The sum of—

7 (i) The amounts allowable under subdivision (b) of
8 Section 23803 as a deduction from gross income of the
9 shareholder for all prior taxable years (excluding any
10 taxable year to which the provisions of this section do not
11 apply and all taxable years preceding such year), and

12 (ii) All amounts previously distributed during the
13 taxable year and all prior taxable years (excluding any
14 taxable year to which the provisions of this section do not
15 apply and all taxable years preceding such year) to the
16 shareholder which under subdivision (d) or paragraph
17 (1) of this subdivision were considered distributions
18 which were not dividends.

19 (d) (1) Any distribution of money made by a
20 corporation after the close of a taxable year with respect
21 to which it was an electing small business corporation and
22 on or before the 15th day of the third month following the
23 close of such taxable year to a person who was a
24 shareholder of such corporation at the close of such
25 taxable year shall be treated as a distribution of the
26 corporation's undistributed taxable income for such year,
27 to the extent such distribution (when added to the sum
28 of all prior distributions of money made to such person by
29 such corporation following the close of such year) does
30 not exceed such person's share of the corporation's
31 undistributed taxable income for such year. Any
32 distribution so treated shall, for purposes of this chapter,
33 be considered a distribution which is not a dividend, and
34 the earnings and profits of the corporation shall not be
35 reduced by reason of such distribution.

36 (2) For purposes of paragraph (1), a person's share of
37 a corporation's undistributed taxable income for a taxable
38 year is the amount required to be included in his gross
39 income under subdivision (b) of Section 23802 as a
40 shareholder of such corporation for his taxable year in

1 which or with which the taxable year of the corporation
2 ends.

3 23805. (a) The basis of a shareholder's stock in an
4 electing small business corporation shall be increased by
5 the amount required to be included in the gross income
6 of such shareholder under subdivision (b) of Section
7 23802, but only to the extent to which such amount is
8 included in his gross income in his return, increased or
9 decreased by any adjustment of such amount in any
10 redetermination of the shareholder's tax liability.

11 (b) (1) The basis of a shareholder's stock in an
12 electing small business corporation shall be reduced (but
13 not below zero) by an amount equal to the amount of his
14 portion of the corporation's net operating loss for any
15 taxable year attributable to such stock (as determined
16 under subdivision (c) of Section 23803).

17 (2) The basis of any indebtedness of an electing small
18 business corporation to a shareholder of such corporation
19 shall be reduced (but not below zero) by an amount
20 equal to the amount of the shareholder's portion of the
21 corporation's net operating loss for any taxable year (as
22 determined under subdivision (c) of Section 23803), but
23 only to the extent that such amount exceeds the adjusted
24 basis of the stock of such corporation held by the
25 shareholder.

26 23806. (a) The accumulated earnings and profits of
27 an electing small business corporation as of the close of its
28 taxable year shall be reduced to the extent that its
29 undistributed taxable income for such year is required to
30 be included in the gross income of the shareholders of
31 such corporation under subdivision (b) of Section 23802.

32 (b) The earnings and profits of an electing small
33 business corporation for any taxable year (but not its
34 accumulated earnings and profits) shall not be reduced
35 by any amount which is not allowable as a deduction in
36 computing its taxable income (as provided in subdivision
37 (d) of Section 23802) for such taxable year.

38 (c) The earnings and profits and the accumulated
39 earnings and profits of an electing small business
40 corporation shall not be affected by any item of gross

1 income or any deduction taken into account in
2 determining the amount of any net operating loss
3 (computed as provided in subdivision (c) of Section
4 23803) of such corporation.

5 (d) For purposes of determining whether a
6 distribution by an electing small business corporation
7 constitutes a distribution of such corporation's
8 undistributed taxable income previously taxed to
9 shareholders (as provided for in subdivision (d) of
10 Section 23804), the earnings and profits of such
11 corporation for the taxable year in which the distribution
12 is made shall be computed without regard to Section
13 24491.1. Such computation shall be made without regard
14 to Section 24491.1 only for such purposes.

15 23807. (a) A trust forming part of a stock bonus or
16 profit-sharing plan which provides contributions or
17 benefits for employees some or all of whom are
18 shareholder-employees shall not constitute a qualified
19 trust (relating to qualified pension, profit-sharing, and
20 stock bonus plans) unless the plan of which such trust is
21 a part provides that forfeitures attributable to
22 contributions deductible under Section 17516 for any
23 taxable year (beginning after December 31, 1970) of the
24 employer with respect to which it is an electing small
25 business corporation may not inure to the benefit of any
26 individual who is a shareholder-employee for such
27 taxable year. A plan shall be considered as satisfying the
28 requirement of this subdivision for the period beginning
29 with the first day of a taxable year and ending with the
30 15th day of the third month following the close of such
31 taxable year, if all the provisions of the plan which are
32 necessary to satisfy this requirement are in effect by the
33 end of such period and have been made effective for all
34 purposes with respect to the whole of such period.

35 (b) (1) An individual who is a shareholder-employee
36 of an electing small business corporation shall include in
37 gross income, for his taxable year in which or with which
38 the taxable year of the corporation ends, the excess of the
39 amount of contributions paid on his behalf which is
40 deductible under Sections 17514, 17515, and 17516 by the

1 corporation for its taxable year over the lesser of—

2 (A) 15 percent of the compensation received or
3 accrued by him from such corporation during its taxable
4 year, or

5 (B) \$7,500.

6 (2) Any amount included in the gross income of a
7 shareholder-employee under paragraph (1) shall be
8 treated as consideration for the contract contributed by
9 the shareholder-employee for purposes of Section 17102.

10 (3) If—

11 (A) amounts are included in the gross income of an
12 individual under paragraph (1), and

13 (B) the rights of such individual (or his
14 beneficiaries) under the plan terminate before
15 payments under the plan which are excluded from
16 gross income equal the amounts included in gross
17 income under paragraph (1),

18 then there shall be allowed as a deduction, for the taxable
19 year in which such rights terminate, an amount equal to
20 the excess of the amounts included in gross income under
21 paragraph (1) over such payments.

22 (c) No amount deductible shall be carried forward
23 under Section 17516 to a taxable year of a corporation
24 with respect to which it is not an electing small business
25 corporation from a taxable year with respect to which it
26 is an electing small business corporation.

27 (d) For purposes of this section, the term
28 "shareholder-employee" means an employee or officer of
29 an electing small business corporation who owns (or is
30 considered as owning within the meaning of subdivision

31 (a) of Section 17384), on any day during the taxable year
32 of such corporation, more than 5 percent of the
33 outstanding stock of the corporation.

34 SEC. 7. Chapter 7 (commencing with Section 24341)
35 of Part 11 of Division 2 of the Revenue and Taxation Code
36 is repealed.

37 SEC. 8. Chapter 7 (commencing with Section 24341)
38 is added to Part 11 of Division 2 of the Revenue and
39 Taxation Code, to read:

CHAPTER 7. NET INCOME

Article 1. Net Income Defined

24341. "Net income" means the net taxable income, as determined under the United States Internal Revenue Code of 1954, for the income year, as adjusted under this article, less the deductions allowed under Article 2 (commencing with Section 24401) of this chapter.

24342. For purposes of this article, a taxpayer shall exclude any loss carried forward or carried back to the taxable year under the Internal Revenue Code of 1954, in determining net income.

24343. Interest on bonds issued by the United States, the State of California or a local government shall be deducted from net income, and any deductions incurred with respect to such income which were taken by the taxpayer in computing net taxable income for federal income tax purposes, shall be added to net income.

Article 2. Deductions

24345. (a) There shall be allowed as a deduction for the income year an amount equal to the aggregate of (1) the net operating loss carryovers to such year, plus (2) the net operating loss carrybacks to such year.

(b) A net operating loss for any income year shall be:

(1) A net operating loss carried forward from any of the seven income years following the income year of such loss.

(2) A net operating loss carryback to each of the five income years preceding the taxable year of such loss.

(c) The entire amount of the net operating loss for any income year shall be carried to the earliest of the income years to which such loss may be carried. The portion of such loss which shall be carried to each of the other income years shall be the excess, if any, of the amount of such loss over the sum of the income for each of the prior income years to which such loss may be carried. For purposes of the preceding sentence, the income for any

such prior income year shall be computed by determining the amount of the net operating loss deduction without regard to the net operating loss for the year in which the loss is incurred or for any income year thereafter, and the income computed under this subdivision shall not be less than zero.

(d) For purposes of this section, "net operating loss" means the excess of the deductions allowed by this part, for any income year, excluding deductions authorized by this section, over the gross income for such income year.

SEC. 9. This act provides for a tax levy within the meaning of Article IV of the Constitution and shall go into immediate effect.

APPENDIX V

CALIFORNIA LEGISLATURE—1979—80 REGULAR SESSION

ASSEMBLY BILL

No. 1470

Introduced by Assemblymen Kelley, McVittie, Felando, Cline, Bannai, Dennis Brown, Chappie, Ellis, Filante, Frazee, Hallett, Hayden, Hayes, Imbrecht, Ivers, Johnson, Lancaster, Lehman, Leonard, Mountjoy, Naylor, Nestande, Nolan, Rogers, Stirling, Thurman, Norman Waters, and Wyman

March 29, 1979

REFERRED TO COMMITTEE ON REVENUE AND TAXATION

An act to add Chapter 3.5 (commencing with Section 23800) to Part 11 of Division 2 of the Revenue and Taxation Code, relating to taxation, to take effect immediately, tax levy.

LEGISLATIVE COUNSEL'S DIGEST

AB 1470, as introduced, Kelley (Rev. & Tax.). Bank and corporation taxes: small business corporations.

Under existing Bank and Corporation Tax Law taxes are imposed according to, or measured by, net income, at the general rate of 9%, and at a rate not to exceed 13% with regard to banks, which is in lieu of other specified taxes.

This bill would provide that certain small business corporations may elect not to be subject to the bank and corporation tax but may elect to have the shareholders pay taxes on the income of the corporation as if the income had been received by the shareholders.

This bill would take effect immediately as a tax levy.

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

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

1 SECTION 1. Chapter 3.5 (commencing with Section
2 23800) is added to Part 11 of Division 2 of the Revenue
3 and Taxation Code, to read:

4
5 CHAPTER 3.5. TAX ELECTION OF SMALL BUSINESS
6 CORPORATIONS
7

8 23800. (a) For purposes of this chapter, the term
9 "small business corporation" means a corporation which
10 is not a member of an affiliated group as defined in
11 Section 1504 of Title 26 of the United States Code
12 Annotated, and which does not:

- 13 (1) Have more than 15 shareholders;
14 (2) Have as a shareholder a person (other than an
15 estate and other than a trust described in subdivision (e))
16 who is not an individual;
17 (3) Have a nonresident alien of the United States as a
18 shareholder; and
19 (4) Have more than one class of stock.
20 (b) For purposes of this chapter, the term "electing
21 small business corporation" means, with respect to any
22 taxable year, a small business corporation which has made
23 an election under subdivision (a) of Section 23801 which,
24 under Section 23801, is in effect for such taxable year.
25 (c) For purposes of paragraph (1) of subdivision (a),
26 a husband and wife, and their estates, shall be treated as
27 one shareholder.

28 (d) For purposes of subdivision (a), a corporation shall
29 not be considered a member of an affiliated group at any
30 time during any taxable year by reason of the ownership
31 of stock in another corporation if such other corporation
32 (1) has not begun business at any time on or after the
33 date of its incorporation and before the close of such
34 taxable year, and (2) does not have taxable income for
35 the period included within such taxable year.

36 (e) For purposes of subdivision (a), the following
37 trusts may be shareholders:

- 38 (1) A trust all of which is treated as owned by the

1 grantor under Article 5 (commencing with Section
2 17781) of Chapter 9 of Part 10 of this division.

3 (2) A trust created primarily to exercise the voting
4 power of stock transferred to it.

5 (3) Any trust with respect to trust transferred to it
6 pursuant to the terms of a will, but only for the 60-day
7 period beginning on the day on which such stock is
8 transferred to it.

9 In the case of a trust described in paragraph (2) of
10 subdivision (e), each beneficiary shall, for purposes of
11 paragraph (1) of subdivision (a), be treated as a
12 shareholder. In the case of a trust described in paragraph
13 (1) of subdivision (e), the grantor shall be treated as a
14 shareholder.

15 23801. (a) Except as provided in subdivision (f), any
16 small business corporation may elect, in accordance with
17 the provisions of this section, not to be subject to the taxes
18 imposed by this part. Such election shall be valid only if
19 all persons who are shareholders in such corporation on
20 the day on which such election is made consent to such
21 election.

22 (b) If a small business corporation makes an election
23 under subdivision (a):

24 (1) With respect to the taxable years of the
25 corporation for which such election is in effect, such
26 corporation shall not be subject to the taxes imposed by
27 this part and, with respect to such taxable years and all
28 succeeding taxable years, the provisions of Section 23806
29 shall apply to such corporation;

30 (2) With respect to the taxable years of a shareholder
31 of such corporation in which or with which the taxable
32 years of the corporation for which such election is in
33 effect, the provisions of Sections 23802, 23803, and 23804
34 shall apply to such shareholder, and with respect to such
35 taxable years and all succeeding taxable years, the
36 provisions of Section 23805 shall apply to such
37 shareholder.

38 (c) (1) An election under subdivision (a) may be
39 made by a small business corporation for any taxable year
40 (A) at any time during the preceding taxable year, or (B)

1 at any time during the first 75 days of the taxable year.

2 (2) If (A) a small business corporation makes an
3 election under subdivision (a) for any taxable year, and
4 (B) such election is made after the first 75 days of the
5 taxable year and on or before the last day of such taxable
6 year, then such election shall be treated as made for the
7 following taxable year.

8 (3) An election under subdivision (a) shall be made in
9 such manner as the Franchise Tax Board shall prescribe
10 by regulations.

11 (d) An election under subdivision (a) shall be
12 effective for the taxable year of the corporation for which
13 it is made and for all succeeding taxable years of the
14 corporation, unless it is terminated, with respect to any
15 such taxable year, under subdivision (e).

16 (e) (1) (A) An election under subdivision (a) made
17 by a small business corporation shall terminate if any
18 person who was not a shareholder in such corporation on
19 the day on which the election is made becomes a
20 shareholder in such corporation and affirmatively refuses
21 to consent to such election on or before the 60th day after
22 the day on which he acquires the stock.

23 (B) If the person acquiring the stock is the estate of a
24 decedent, the period under subparagraph (A) for
25 affirmatively refusing to consent to the election shall
26 expire on the 60th day after the day on which the
27 executor or administrator of the estate qualifies, or the
28 last day of the taxable year of the corporation in which
29 the decedent died, whichever is earlier.

30 (C) Any termination of an election under
31 subparagraph (A) by reason of the affirmative refusal of
32 any person to consent to such election shall be effective
33 for the taxable year of the corporation in which such
34 person becomes a shareholder in the corporation (or, if
35 later, the first taxable year for which such election would
36 otherwise have been effective) and for all succeeding
37 taxable years of the corporation.

38 (2) An election under subdivision (a) made by a small
39 business corporation may be revoked by it for any taxable
40 year of the corporation after the first taxable year for

1 which the election is effective. An election may be
2 revoked only if all persons who are shareholders in the
3 corporation on the day on which the revocation is made
4 consent to the revocation. A revocation under this
5 paragraph shall be effective:

6 (A) for the taxable year in which made, if made
7 before the close of the first month of such taxable year,

8 (B) for the taxable year following the taxable year in
9 which made, if made after the close of such first month,
10 and for all succeeding taxable years of the corporation.

11 Such revocation shall be made in such manner as the
12 secretary or his delegate shall prescribe by regulations.

13 (3) An election under subdivision (a) made by a small
14 business corporation shall terminate if at any time:

15 (A) after the first day of the first taxable year of the
16 corporation for which the election is effective, if such
17 election is made on or before such first day, or

18 (B) after the day on which the election is made, if
19 such election is made after such first day,

20 the corporation ceases to be a small business corporation.
21 Such termination shall be effective for the taxable year of
22 the corporation in which the corporation ceases to be a
23 small business corporation and for all succeeding taxable
24 years of the corporation.

25 (4) An election under subdivision (a) made by a small
26 business corporation shall terminate if for any taxable
27 year of the corporation for which the election is in effect,
28 such corporation derives more than 80 percent of its gross
29 receipts from sources outside the United States. Such
30 termination shall be effective for the taxable year of the
31 corporation in which it derives more than 80 percent of
32 its gross receipts from sources outside the United States,
33 and for all succeeding taxable years of the corporation.

34 (5) (A) Except as provided in subparagraph (B), an
35 election under subdivision (a) made by a small business
36 corporation shall terminate if, for any taxable year of the
37 corporation for which the election is in effect, such
38 corporation has gross receipts more than 20 percent of
39 which is passive investment income. Such termination
40 shall be effective for the taxable year of the corporation

1 in which it has gross receipts of such amount, and for all
2 succeeding taxable years of the corporation.

3 (B) Subparagraph (A) shall not apply with respect to
4 a taxable year in which a small business corporation has
5 gross receipts more than 20 percent of which is passive
6 investment income, if—

7 (i) Such taxable year is the first taxable year in which
8 the corporation commenced the active conduct of any
9 trade or business or the next succeeding taxable year; and

10 (ii) The amount of passive investment income for such
11 taxable year is less than three thousand dollars (\$3,000).

12 (C) For purposes of this paragraph, the term “passive
13 investment income” means gross receipts derived from
14 royalties, rents, dividends, interest, annuities, and sales or
15 exchanges of stock or securities (gross receipts from such
16 sales or exchanges being taken into account for purposes
17 of this paragraph only to the extent of gains therefrom).

18 Gross receipts derived from sales or exchanges of stock or
19 securities for purposes of this paragraph shall not include
20 amounts received by an electing small business
21 corporation which are treated under Section 24501
22 (relating to corporate liquidations) as payments in
23 exchange for stock where the electing small business
24 corporation owned more than 50 percent of each class of
25 the stock of the liquidating corporation.

26 (f) If a small business corporation has made an election
27 under subdivision (a) and if such election has been
28 terminated or revoked under subdivision (e), such
29 corporation (and any successor corporation) shall not be
30 eligible to make an election under subdivision (a) for any
31 taxable year prior to its fifth taxable year which begins
32 after the first taxable year for which such termination or
33 revocation is effective, unless the Franchise Tax Board
34 consents to such election.

35 23802. (a) The undistributed taxable income of an
36 electing small business corporation for any taxable year
37 shall be included in the gross income of the shareholders
38 of such corporation in the manner and to the extent set
39 forth in this section.

40 (b) Each person who is a shareholder of an electing

1 small business corporation on the last day of a taxable
2 year of such corporation shall include in his gross income,
3 for his taxable year in which or with which the taxable
4 year of the corporation ends, the amount he would have
5 received as a dividend, if on such last day there had been
6 distributed pro rata to its shareholders by such
7 corporation an amount equal to the corporation's
8 undistributed taxable income for the corporation's
9 taxable year. For purposes of this part, the amount so
10 included shall be treated as an amount distributed as a
11 dividend on the last day of the taxable year of the
12 corporation.

13 (c) For purposes of this section, the term
14 “undistributed taxable income” means taxable income
15 (computed as provided in subdivision (d)) minus the
16 sum of (1) the taxes imposed by Section 23400 and (2) the
17 amount of money distributed as dividends during the
18 taxable year, to the extent that any such amount is a
19 distribution out of earnings and profits of the taxable year
20 as specified in subdivision (b) of Section 24495.

21 (d) For purposes of this chapter, the taxable income of
22 an electing small business corporation shall be
23 determined without regard to the deductions allowed by
24 Article 2 (commencing with Section 24401) of Chapter 7
25 of this part (other than the deduction allowed by Section
26 24408, relating to organization expenditures).

27 23803. (a) A net operating loss of an electing small
28 business corporation for any taxable year shall be allowed
29 as a deduction from gross income of the shareholders of
30 such corporation in the manner and to the extent set forth
31 in this section.

32 (b) Each person who is a shareholder of an electing
33 small business corporation at any time during a taxable
34 year of the corporation in which it has a net operating loss
35 shall be allowed as a deduction from gross income, for his
36 taxable year in which or with which the taxable year of
37 the corporation ends (or for the final taxable year of a
38 shareholder who dies before the end of the corporation's
39 taxable year), an amount equal to his portion of the
40 corporation's net operating loss (as determined under

1 subdivision (c)). The deduction allowed by this
2 subdivision shall, for purposes of this chapter, be
3 considered as a deduction attributable to a trade or
4 business carried on by the shareholder.

5 (c) (1) For purposes of this section, a shareholder's
6 portion of the net operating loss of an electing small
7 business corporation is his pro rata share of the
8 corporation's net operating loss (except that the
9 deductions provided in Article 2 (commencing with
10 Section 24401) of Chapter 7 of this part shall not be
11 allowed) for his taxable year in which or with which the
12 taxable year of the corporation ends. For purposes of this
13 paragraph, a shareholder's pro rata share of the
14 corporation's net operating loss is the sum of the portions
15 of the corporation's daily net operating loss attributable
16 on a pro rata basis to the shares held by him on each day
17 of the taxable year. For purposes of the preceding
18 sentence, the corporation's daily net operating loss is the
19 corporation's net operating loss divided by the number of
20 days in the taxable year.

21 (2) A shareholder's portion of the net operating loss of
22 an electing small business corporation for any taxable
23 year shall not exceed the sum of—

24 (A) The adjusted basis (determined without regard to
25 any adjustment under Section 23805 for the taxable year)
26 of the shareholder's stock in the electing small business
27 corporation, determined as of the close of the taxable
28 year of the corporation (or, in respect of stock sold or
29 otherwise disposed of during such taxable year, as of the
30 day before the day of such sale or other disposition), and

31 (B) The adjusted basis (determined without regard to
32 any adjustment under Section 23805 for the taxable year)
33 of any indebtedness of the corporation to the
34 shareholder, determined as of the close of the taxable
35 year of the corporation (or, if the shareholder is not a
36 shareholder as of the close of such taxable year, as of the
37 close of the last day in such taxable year on which the
38 shareholder was a shareholder in the corporation).

39 23804. (a) (1) The amount includible in the gross
40 income of a shareholder as dividends (including amounts

1 treated as dividends under subdivision (b) of Section
2 23802) from an electing small business corporation
3 during any taxable year of the corporation, to the extent
4 that such amount is a distribution of property out of
5 earnings and profits of the taxable year as specified in
6 subdivision (b) of Section 24495, shall be treated as a
7 long-term capital gain to the extent of the shareholder's
8 pro rata share of the corporation's net capital gain for
9 such taxable year. For purposes of this paragraph, such
10 net capital gain shall be deemed not to exceed the
11 corporation's taxable income (computed as provided in
12 subdivision (d) of Section 23802) for the taxable year.

13 (2) A shareholder's pro rata share of such excess for
14 any taxable year shall be an amount which bears the same
15 ratio to such excess as the amount of dividends described
16 in paragraph (1) includible in the shareholder's gross
17 income bears to the entire amount of dividends described
18 in paragraph (1) includible in the gross income of all
19 shareholders.

20 (3) For purposes of paragraphs (1) and (2), an
21 electing small business corporation's net capital gain for
22 a taxable year shall be reduced by an amount equal to the
23 amount of the taxes imposed by Section 23400 on such
24 corporation for such year.

25 (b) Any dividend received by a shareholder from an
26 electing small business corporation (including any
27 amount treated as a dividend under subdivision (b) of
28 Section 23802) may be apportioned or allocated by the
29 board between or among shareholders of such
30 corporation who are members of such shareholder's
31 family, if he determines that such apportionment or
32 allocation is necessary in order to reflect the value of
33 services rendered to the corporation by such
34 shareholders.

35 (c) (1) An electing small business corporation may
36 distribute, in accordance with regulations prescribed by
37 the board, to any shareholder all or any portion of the
38 shareholder's net share of the corporation's undistributed
39 taxable income for taxable years prior to the taxable year
40 in which such distribution is made. Any such distribution

1 shall, for purposes of this chapter, be considered a
 2 distribution which is not a dividend, but the earnings and
 3 profits of the corporation shall not be reduced by reason
 4 of any such distribution.

5 (2) For purposes of this subdivision, a shareholder's
 6 net share of the undistributed taxable income of an
 7 electing small business corporation is an amount equal
 8 to—

9 (A) The sum of the amounts included in the gross
 10 income of the shareholder under subdivision (b) of
 11 Section 23802 for all prior taxable years (excluding any
 12 taxable year to which the provisions of this section do not
 13 apply and all taxable years preceding such year), reduced
 14 by

15 (B) The sum of—

16 (i) The amounts allowable under subdivision (b) of
 17 Section 23803 as a deduction from gross income of the
 18 shareholder for all prior taxable years (excluding any
 19 taxable year to which the provisions of this section do not
 20 apply and all taxable years preceding such year), and

21 (ii) All amounts previously distributed during the
 22 taxable year and all prior taxable years (excluding any
 23 taxable year to which the provisions of this section do not
 24 apply and all taxable years preceding such year) to the
 25 shareholder which under subdivision (d) or paragraph
 26 (1) of this subdivision were considered distributions
 27 which were not dividends.

28 (d) (1) Any distribution of money made by a
 29 corporation after the close of a taxable year with respect
 30 to which it was an electing small business corporation and
 31 on or before the 15th day of the third month following the
 32 close of such taxable year to a person who was a
 33 shareholder of such corporation at the close of such
 34 taxable year shall be treated as a distribution of the
 35 corporation's undistributed taxable income for such year,
 36 to the extent such distribution (when added to the sum
 37 of all prior distributions of money made to such person by
 38 such corporation following the close of such year) does
 39 not exceed such person's share of the corporation's
 40 undistributed taxable income for such year. Any

1 distribution so treated shall, for purposes of this chapter,
 2 be considered a distribution which is not a dividend, and
 3 the earnings and profits of the corporation shall not be
 4 reduced by reason of such distribution.

5 (2) For purposes of paragraph (1), a person's share of
 6 a corporation's undistributed taxable income for a taxable
 7 year is the amount required to be included in his gross
 8 income under subdivision (b) of Section 23802 as a
 9 shareholder of such corporation for his taxable year in
 10 which or with which the taxable year of the corporation
 11 ends.

12 23805. (a) The basis of a shareholder's stock in an
 13 electing small business corporation shall be increased by
 14 the amount required to be included in the gross income
 15 of such shareholder under subdivision (b) of Section
 16 23802, but only to the extent to which such amount is
 17 included in his gross income in his return, increased or
 18 decreased by any adjustment of such amount in any
 19 redetermination of the shareholder's tax liability.

20 (b) (1) The basis of a shareholder's stock in an
 21 electing small business corporation shall be reduced (but
 22 not below zero) by an amount equal to the amount of his
 23 portion of the corporation's net operating loss for any
 24 taxable year attributable to such stock (as determined
 25 under subdivision (c) of Section 23803).

26 (2) The basis of any indebtedness of an electing small
 27 business corporation to a shareholder of such corporation
 28 shall be reduced (but not below zero) by an amount
 29 equal to the amount of the shareholder's portion of the
 30 corporation's net operating loss for any taxable year (as
 31 determined under subdivision (c) of Section 23803), but
 32 only to the extent that such amount exceeds the adjusted
 33 basis of the stock of such corporation held by the
 34 shareholder.

35 23806. (a) The accumulated earnings and profits of
 36 an electing small business corporation as of the close of its
 37 taxable year shall be reduced to the extent that its
 38 undistributed taxable income for such year is required to
 39 be included in the gross income of the shareholders of
 40 such corporation under subdivision (b) of Section 23802.

1 (b) The earnings and profits of an electing small
2 business corporation for any taxable year (but not its
3 accumulated earnings and profits) shall not be reduced
4 by any amount which is not allowable as a deduction in
5 computing its taxable income (as provided in subdivision
6 (d) of Section 23802) for such taxable year.

7 (c) The earnings and profits and the accumulated
8 earnings and profits of an electing small business
9 corporation shall not be affected by any item of gross
10 income or any deduction taken into account in
11 determining the amount of any net operating loss
12 (computed as provided in subdivision (c) of Section
13 23803) of such corporation.

14 (d) For purposes of determining whether a
15 distribution by an electing small business corporation
16 constitutes a distribution of such corporation's
17 undistributed taxable income previously taxed to
18 shareholders (as provided for in subdivision (d) of
19 Section 23804), the earnings and profits of such
20 corporation for the taxable year in which the distribution
21 is made shall be computed without regard to Section
22 24491.1. Such computation shall be made without regard
23 to Section 24491.1 only for such purposes.

24 23807. (a) A trust forming part of a stock bonus or
25 profit-sharing plan which provides contributions or
26 benefits for employees some or all of whom are
27 shareholder-employees shall not constitute a qualified
28 trust (relating to qualified pension, profit-sharing, and
29 stock bonus plans) unless the plan of which such trust is
30 a part provides that forfeitures attributable to
31 contributions deductible under Section 17516 for any
32 taxable year (beginning after December 31, 1970) of the
33 employer with respect to which it is an electing small
34 business corporation may not inure to the benefit of any
35 individual who is a shareholder-employee for such
36 taxable year. A plan shall be considered as satisfying the
37 requirement of this subdivision for the period beginning
38 with the first day of a taxable year and ending with the
39 15th day of the third month following the close of such
40 taxable year, if all the provisions of the plan which are

1 necessary to satisfy this requirement are in effect by the
2 end of such period and have been made effective for all
3 purposes with respect to the whole of such period.

4 (b) (1) An individual who is a shareholder-employee
5 of an electing small business corporation shall include in
6 gross income, for his taxable year in which or with which
7 the taxable year of the corporation ends, the excess of the
8 amount of contributions paid on his behalf which is
9 deductible under Sections 17514, 17515, and 17516 by the
10 corporation for its taxable year over the lesser of—

11 (A) 15 percent of the compensation received or
12 accrued by him from such corporation during its taxable
13 year, or

14 (B) \$7,500.

15 (2) Any amount included in the gross income of a
16 shareholder-employee under paragraph (1) shall be
17 treated as consideration for the contract contributed by
18 the shareholder-employee for purposes of Section 17102.

19 (3) If—

20 (A) amounts are included in the gross income of an
21 individual under paragraph (1), and

22 (B) the rights of such individual (or his
23 beneficiaries) under the plan terminate before
24 payments under the plan which are excluded from
25 gross income equal the amounts included in gross
26 income under paragraph (1),

27 then there shall be allowed as a deduction, for the taxable
28 year in which such rights terminate, an amount equal to
29 the excess of the amounts included in gross income under
30 paragraph (1) over such payments.

31 (c) No amount deductible shall be carried forward
32 under Section 17516 to a taxable year of a corporation
33 with respect to which it is not an electing small business
34 corporation from a taxable year with respect to which it
35 is an electing small business corporation.

36 (d) For purposes of this section, the term
37 "shareholder-employee" means an employee or officer of
38 an electing small business corporation who owns (or is
39 considered as owning within the meaning of subdivision
40 (a) of Section 17384), on any day during the taxable year

1 of such corporation, more than 5 percent of the
2 outstanding stock of the corporation.
3 SEC. 2. This act provides for a tax levy within the
4 meaning of Article IV of the Constitution and shall go into
5 immediate effect.

APPENDIX VI

CALIFORNIA LEGISLATURE—1979-80 REGULAR SESSION

ASSEMBLY BILL

No. 1478

Introduced by Assemblyman Naylor

March 29, 1979

REFERRED TO COMMITTEE ON REVENUE AND TAXATION

An act to amend Sections 23151, 23186, and 23501 of the Revenue and Taxation Code, relating to taxation, to take effect immediately, tax levy.

LEGISLATIVE COUNSEL'S DIGEST

AB 1478, as introduced, Naylor (Rev. & Tax.). Bank and corporation tax rates.

Under existing Bank and Corporation Tax Law, taxes are imposed according to, or measured by, net income, at the general rate of 9%, and at a rate not to exceed 13% with regard to banks, which is in lieu of other specified taxes.

This bill would revise the general tax rate for corporations, other than banks and financial corporations, to 3% of the first \$25,000 of net income, 4% for net income exceeding \$25,000 but not exceeding \$50,000, 6% for net income in excess of \$50,000 but not in excess of \$75,000, 8% for net income in excess of \$75,000 but not in excess of \$100,000, and 9% for net income in excess of \$100,000, and makes certain conforming changes in the computation of taxes on banks and financial corporations.

This bill would take effect immediately as a tax levy but the operative date of this act would depend on its effective date.

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

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

1 SECTION 1. Section 23151 of the Revenue and
2 Taxation Code is amended to read:

3 23151. (a) With the exception of financial
4 corporations, every corporation doing business within the
5 limits of this state and not expressly exempted from
6 taxation by the provisions of the Constitution of this state
7 or by this part, shall annually pay to the state, for the
8 privilege of exercising its corporate franchises within this
9 state, a tax according to or measured by its net income,
10 to be computed at the rate of 7.6 percent upon the basis
11 of its net income for the next preceding income year. In
12 any event, each such corporation shall pay annually to the
13 state, for the said privilege, a minimum tax of one
14 hundred dollars (\$100).

15 (b) For calendar or fiscal years ending after June 30,
16 1973, the rate of tax shall be 9 percent instead of 7.6
17 percent as provided by subdivision (a).

18 (c) For income years beginning after December 31,
19 1971, the one hundred dollars (\$100) specified in
20 subdivision (a) shall be two hundred dollars (\$200)
21 instead of one hundred dollars (\$100).

22 (d) *For income years beginning after December 31,*
23 *1979, the rate of tax shall be:*

24 (1) *Three percent on the first twenty-five thousand*
25 *dollars (\$25,000) of income.*

26 (2) *Four percent on income in excess of twenty-five*
27 *thousand dollars (\$25,000) and not in excess of fifty*
28 *thousand dollars (\$50,000).*

29 (3) *Six percent on income in excess of fifty thousand*
30 *dollars (\$50,000) and not in excess of seventy-five*
31 *thousand dollars (\$75,000).*

32 (4) *Eight percent in excess of seventy-five thousand*
33 *dollars (\$75,000) and not in excess of one hundred*
34 *thousand dollars (\$100,000).*

35 (5) *Nine percent on income in excess of one hundred*
36 *thousand dollars (\$100,000).*

37 SEC. 2. Section 23186 of the Revenue and Taxation
38 Code is amended to read:

1 23186. (a) The rate of tax on banks and financial
2 corporations shall be a percentage equal to the
3 percentage of the total amount of net income, allocable
4 to this state, of every corporation taxable under Section
5 23151 or subdivision (c) of Section 23151.1 or paragraph
6 (1) of subdivision (d) of Section 23151.1, as the case may
7 be, other than public utilities as defined in the Public
8 Utilities Act, for the next preceding calendar year or fiscal
9 years ended during such calendar year, required to be
10 paid to this state as franchise taxes according to or
11 measured by such net income, and required to be paid to
12 this state or its political subdivisions by such corporations
13 as personal property taxes during the preceding calendar
14 year or fiscal years ended in such calendar year; provided,
15 however, that said rate of tax shall not exceed 13 percent.
16 The percentage of the net income of every corporation
17 taxable under Section 23151, or subdivision (c) of Section
18 23151.1, or paragraph (1) of subdivision (d) of Section
19 23151.1, as the case may be, other than public utilities as
20 defined in the Public Utilities Act, required to be paid to
21 this state or its political subdivisions in personal property
22 taxes shall be determined by ascertaining the ratio which
23 the total amount of such personal property taxes, less 9
24 percent thereof, bears to the total amount of net income
25 of such corporations allocable to California, increased by
26 the amount of such personal property taxes; provided,
27 however, that if any such corporation sustains a net loss
28 allocable to California the personal property taxes
29 required to be paid by such corporation to this state or its
30 political subdivisions during the preceding calendar year
31 or fiscal years ended during such calendar year shall be
32 considered for the purpose of determining such ratio only
33 to the extent which such personal property taxes exceed
34 such net loss allocable to California.

35 (b) *The 9 percent figure used in ascertaining the*
36 *personal property tax in subdivision (a) shall be adjusted*
37 *by the Franchise Tax Board to reflect the changes made*
38 *to the tax rate in Section 23151.*

39 SEC. 3. Section 23501 of the Revenue and Taxation
40 Code is amended to read:

1 23501. (a) There shall be imposed upon every
 2 corporation for each taxable year, a tax at the rate of 7.6
 3 percent upon its net income derived from sources within
 4 this state on or after January 1, 1937, other than income
 5 for any period for which the corporation is subject to
 6 taxation under Chapter 2 of this part, according to or
 7 measured by its net income.

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

11 (c) *For calendar or fiscal years ending after June 30,*
 12 *1979, the rate of tax net income derived from sources*
 13 *within the state, other than income for any period for*
 14 *which the corporation is subject to taxation under*
 15 *Chapter 2 of this part, according to or measured by its net*
 16 *income, shall be:*

17 (1) *Three percent on the first twenty-five thousand*
 18 *dollars (\$25,000) of income.*

19 (2) *Four percent on income in excess of twenty-five*
 20 *thousand dollars (\$25,000) and not in excess of fifty*
 21 *thousand dollars (\$50,000).*

22 (3) *Six percent on income in excess of fifty thousand*
 23 *dollars (\$50,000) and not in excess of seventy-five*
 24 *thousand dollars (\$75,000).*

25 (4) *Eight percent on income in excess of seventy-five*
 26 *thousand dollars (\$75,000) and not in excess of one*
 27 *hundred thousand dollars (\$100,000).*

28 (5) *Nine percent on income in excess of one hundred*
 29 *thousand dollars (\$100,000).*

30 SEC. 4. This act provides for a tax levy within the
 31 meaning of Article IV of the Constitution and shall go into
 32 immediate effect. However, the provisions of this act
 33 shall be applied in the computation of taxes for taxable
 34 years beginning on or after the first day of the calendar
 35 year in which this act becomes effective provided the
 36 effective date is more than 90 days prior to the last day
 37 of the calendar year. If the effective date is 90 days or less
 38 prior to the last day of the calendar year, the provisions
 39 of this act shall apply in the computation of taxes for
 40 taxable years beginning on or after the first day of the

1 calendar year following the effective date.

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APPENDIX VII

AMENDED IN ASSEMBLY JUNE 21, 1979

CALIFORNIA LEGISLATURE—1979-80 REGULAR SESSION

ASSEMBLY BILL

No. 1479

Introduced by Assemblyman Naylor

March 29, 1979

REFERRED TO COMMITTEE ON REVENUE AND TAXATION

An act to add Sections 17202.6 and 24440 to the Revenue and Taxation Code, relating to taxation, to take effect immediately, tax levy.

LEGISLATIVE COUNSEL'S DIGEST

AB 1479, as amended, Naylor (Rev. & Tax.). State taxes: carryover operating loss.

Existing Personal Income Tax Law and State Bank and Corporation Tax Law does not authorize taxpayers subject to the imposition of taxes under such law to carry the net operating loss, defined as the excess of allowable deductions over gross income, incurred in 1 income year to following years.

This bill would authorize such taxpayers to carry such net operating loss incurred in one income year to preceding and following income years, in the manner specified.

This bill would take effect immediately as a tax levy, but its operative effect will depend upon the time at which it becomes effective.

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

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

1 SECTION 1. Section 17202.6 is added to the Revenue
2 and Taxation Code, to read:

3 17202.6. (a) There shall be allowed as a deduction for
4 the taxable year an amount equal to the aggregate of (1)
5 the net operating loss carryovers to such year, plus (2)
6 the net operating loss carrybacks to such year. For
7 purposes of this subtitle, the term "net operating loss
8 deduction" means the deduction allowed by this
9 subsection.

10 (b) (1) For purposes of this section:

11 (A) A net operating loss for any taxable year shall be
12 a net operating loss carryback to each of the three taxable
13 years preceding the taxable year of such loss.

14 (B) A net operating loss for any taxable year ending
15 after December 31, 1978, shall be a net operating loss
16 carryover to each of the seven taxable years following the
17 taxable year of such loss.

18 (2) Except as provided in subdivision (g), the entire
19 amount of the net operating loss for any taxable year
20 (hereinafter in this section referred to as the "loss year")
21 shall be carried to the earliest of the taxable years to
22 which (by reason of paragraph (1)) such loss may be
23 carried. The portion of such loss which shall be carried to
24 each of the other taxable years shall be the excess, if any,
25 of the amount of such loss over the sum of the taxable
26 income for each of the prior taxable years to which such
27 loss may be carried.

28 (c) Any taxpayer entitled to a carryback period under
29 paragraph (1) may elect to relinquish the entire
30 carryback period with respect to a net operating loss for
31 any taxable year ending after December 31, 1978. Such
32 election shall be made in such manner as may be
33 prescribed by the Franchise Tax Board, and shall be
34 made by the due date (including extensions of time) for
35 filing the taxpayer's return for the taxable year of the net
36 operating loss for which the election is to be in effect.
37 Such election, once made for any taxable year, shall be
38 irrevocable for that taxable year.

1 (d) For purposes of this section, the term "net
2 operating loss" means the excess of the deductions
3 allowed by this chapter over the gross income. Such
4 excess shall be computed with the modifications specified
5 in subdivision (e).

6 (e) (1) No net operating loss deduction shall be
7 allowed *for any loss which occurred prior to the 1979*
8 *income year.*

9 (2) (A) The amount deductible on account of losses
10 from sales or exchanges of capital assets shall not exceed
11 the amount includible on account of gains from sales or
12 exchanges of capital assets; and

13 (B) The deduction for gains from capital assets held
14 five years or more shall not be allowed.

15 (3) The deductions allowable by this section which are
16 not attributable to a taxpayer's trade or business shall be
17 allowed only to the extent of the amount of the gross
18 income not derived from such trade or business. For
19 purposes of the preceding sentence—

20 (A) Any gain or loss from the sale or other disposition
21 of—

22 (i) property, used in the trade or business, of a
23 character which is subject to the allowance for
24 depreciation provided in Section 17208, or

25 (ii) real property used in the trade or business, shall be
26 treated as attributable to the trade or business;

27 (B) The modifications specified in paragraphs (1),
28 (2) (B), and (3) shall be taken into account;

29 (C) Any deduction allowable under Section 17206
30 (relating to casualty losses) shall not be taken into
31 account; and

32 (D) Any deduction allowed under Section 17512 or
33 Section 17526 to the extent attributable to contributions
34 which are made on behalf of an individual who is an
35 employee within the meaning of Section 17502.2 shall not
36 be treated as attributable to the trade or business of such
37 individual.

38 (4) *In no event shall the maximum net operating loss*
39 *subject to carryover or carryback exceed one million five*
40 *hundred thousand dollars (\$1,500,000).*

1 (f) In determining the amount of any net operating
2 loss carryback or carryover to any taxable year, the
3 necessary computations involving any other taxable year
4 shall be made under the law applicable to such other
5 taxable year.

6 SEC. 2. Section 24440 is added to the Revenue and
7 Taxation Code, to read:

8 24440. (a) There shall be allowed as a deduction for
9 the income year an amount equal to the aggregate of (1)
10 the net operating loss carryovers to such year, plus (2)
11 the net operating loss carrybacks to such year. For
12 purposes of this subtitle, the term "net operating loss
13 deduction" means the deduction allowed by this
14 subsection.

15 (b) (1) For purposes of this section:

16 (A) A net operating loss for any taxable year shall be
17 a net operating loss carryback to each of the three taxable
18 years preceding the taxable year of such loss.

19 (B) A net operating loss for any taxable year ending
20 after December 31, 1978, shall be a net operating loss
21 carryover to each of the seven taxable years following the
22 taxable year of such loss.

23 (2) The entire amount of the net operating loss for any
24 taxable year (hereinafter in this section referred to as the
25 "loss year") shall be carried to the earliest of the income
26 years to which (by reason of paragraph (1)) such loss may
27 be carried. The portion of such loss which shall be carried
28 to each of the other income years shall be the excess, if
29 any, of the amount of such loss over the sum of the taxable
30 income for each of the prior income years to which such
31 loss may be carried.

32 (c) For purposes of this section, the term "net
33 operating loss" means the excess of the deductions
34 allowed by this chapter over the gross income.

35 (d) *This section shall not apply to any loss which*
36 *occurred prior to the 1979 income year.*

37 (e) *In no event shall the maximum net operating loss*
38 *subject to carryover or carryback exceed one million five*
39 *hundred thousand dollars (\$1,500,000).*

40 SEC. 3. This act provides for a tax levy within the

1 meaning of Article IV of the Constitution and shall go into
2 immediate effect. However, the provisions of this act
3 shall be applied in the computation of taxes for taxable
4 years and income years beginning on or after the first day
5 of the calendar year in which this act becomes effective
6 provided the effective date is more than 90 days prior to
7 the last day of the calendar year. If the effective date is
8 90 days or less prior to the last day of the calendar year,
9 the provisions of this act shall apply in the computation
10 of taxes for taxable years and income years beginning on
11 or after the first day of the calendar year following the
12 effective date.

Introduced by Assemblyman Filante

March 29, 1979

REFERRED TO COMMITTEE ON REVENUE AND TAXATION

An act to add Sections 17052.3 and 23606 to the Revenue and Taxation Code, relating to taxation, to take effect immediately, tax levy.

LEGISLATIVE COUNSEL'S DIGEST

AB 1555, as introduced, Filante (Rev. & Tax.). State taxes: investment credit.

Existing provisions of the Personal Income Tax Law and Bank and Corporation Tax Law do not authorize a tax credit for amounts invested in the acquisition of property.

This bill would authorize a credit against such taxes in an amount equal to 5% of the qualified investment in certain property, as specified, and would authorize the carryback and carryover of excess credits, within specified limits.

This bill would take effect immediately as a tax levy, but its operative date would depend upon its effective date.

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

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

1 SECTION 1. Section 17052.3 is added to the Revenue
2 and Taxation Code, to read:
3 17052.3. (a) There shall be allowed as a credit against
4 the tax imposed by this part the amount determined

1 under subdivision (b).
2 (b) (1) The amount of the credit allowed by
3 subdivision (a) for the taxable year shall be an amount
4 equal to the sum of—

5 (A) the investment credit carryovers carried to such
6 taxable year,

7 (B) the amount of the credit determined under
8 paragraph (2) for such taxable year, plus

9 (C) the investment credit carrybacks carried to such
10 taxable year.

11 (2) (A) The amount of the credit determined under
12 this paragraph for the taxable year shall be an amount
13 equal to 5 percent of the qualified investment.

14 (B) For purposes of this paragraph, the regular
15 percentage is 5 percent.

16 (C) For purposes of this paragraph, the regular
17 percentage shall not apply to any energy property which,
18 but for subdivision (b) would not be subject to this
19 section.

20 (3) Notwithstanding paragraph (1), the credit allowed
21 by this section for the taxable year shall not exceed—

22 (A) so much of the liability for tax for the taxable year
23 as does not exceed twenty-five thousand dollars
24 (\$25,000), plus

25 (B) the following percentage of so much of the
26 liability for tax for the taxable year as exceeds twenty-five
27 thousand dollars (\$25,000):

28	29	30	31	32
	If the taxable year ends in:	The percentage is:		
30	1980	70		
31	1981	80		
32	1982 or thereafter	90		

33
34 (c) (1) If the sum of the amount of the investment
35 credit carryovers to the taxable year under subsection
36 (a) (1) (A) plus the amount determined under subsection
37 (a) (1) (B) for the taxable year exceeds the amount of the
38 limitation imposed by subsection (a) (3) for such taxable
39 year (hereinafter in this subsection referred to as the
40 "unused credit year"), such excess attributable to the

1 amount determined under subsection (a) (1) (B) shall
2 be—

3 (A) an investment credit carryback to each of the 3
4 taxable years preceding the unused credit year, and

5 (B) an investment credit carryover to each of the 7
6 taxable years following the unused credit year,

7 and, subject to the limitations imposed by paragraphs (2)
8 and (3), shall be taken into account under the provisions

9 of subsection (a) (1) in the manner provided in such
10 subsection. The entire amount of the unused credit for an

11 unused credit year shall be carried to the earliest of the
12 10 taxable years to which (by reason of subparagraphs

13 (A) and (B)) such credit may be carried and then to each
14 of the other 9 taxable years to the extent, because of the

15 limitations imposed by paragraphs (2) and (3), such
16 unused credit may not be taken into account under

17 subsection (a) (1) for a prior taxable year to which such
18 unused credit may be carried.

19 (2) The amount of the unused credit which may be
20 taken into account under subsection (a) (1) for any

21 preceding taxable year shall not exceed the amount by
22 which the limitation imposed by subsection (a) (3) for

23 such taxable year exceeds the sum of—
24 (A) the amounts determined under subparagraphs

25 (A) and (B) of subsection (a) (1) for such taxable year,
26 plus

27 (B) the amounts which (by reason of this subsection)
28 are carried back to such taxable year and are attributable

29 to taxable years preceding the unused credit year.

30 (3) The amount of the unused credit which may be
31 taken into account under subsection (a) (1) (A) for any

32 succeeding taxable year shall not exceed the amount by
33 which the limitation imposed by subsection (a) (3) for

34 such taxable year exceeds the sum of the amounts which,
35 by reason of this subsection, are carried to such taxable

36 year and are attributable to taxable years preceding the
37 unused credit year.

38 (d) (1) If during any taxable year any property is
39 disposed of, or otherwise ceases to be property subject to
40 this section with respect to the taxpayer, before the close

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1 of the useful life which was taken into account in
 2 computing the credit under this section, then the tax
 3 under this chapter for such taxable year shall be
 4 increased by an amount equal to the aggregate decrease
 5 in the credits allowed under this section for all prior
 6 taxable years which would have resulted solely from
 7 substituting, in determining qualified investment, for
 8 such useful life the period beginning with the time such
 9 property was placed in service by the taxpayer and
 10 ending with the time such property ceased to be
 11 property subject to this section.

12 (2) If during any taxable year any property taken into
 13 account in determining qualified investment becomes
 14 public utility property, then the tax under this chapter for
 15 such taxable year shall be increased by an amount equal
 16 to the aggregate decrease in the credits allowed under
 17 this section for all prior taxable years which would have
 18 resulted solely from treating the property, for purposes of
 19 determining qualified investment, as public utility
 20 property (after giving due regard to the period before
 21 such change in use). If the application of this paragraph
 22 to any property is followed by the application of
 23 paragraph (1) to such property, proper adjustment shall
 24 be made in applying paragraph (1).

25 (3) (A) If during any taxable year any property taken
 26 into account in determining qualified investment ceases
 27 (by reason of sale or other disposition, cancellation or
 28 abandonment of contract, or otherwise) to be, with
 29 respect to the taxpayer, property which, when placed in
 30 service, will be new property subject to this section, then
 31 the tax under this chapter for such taxable year shall be
 32 increased by an amount equal to the aggregate decrease
 33 in the credits allowed under this section for all prior
 34 taxable years which would have resulted solely from
 35 reducing to zero the qualified investment taken into
 36 account with respect to such property.

37 (B) Any amount which would have been applied as a
 38 reduction of the qualified investment in property to the
 39 extent excess credits were not required to be recaptured
 40 in the sale and leaseback of such property but for the fact

1 that a reduction under such paragraph cannot reduce
 2 qualified investment below zero shall be treated as an
 3 amount required to be recaptured under subparagraph
 4 (A) for the taxable year in which the property is placed
 5 in service.

6 (C) Under regulations prescribed by the Franchise
 7 Tax Board, a sale by, and leaseback to, a taxpayer who,
 8 when the property is placed in service, will be a lessee to
 9 whom this section applies shall not be treated as a
 10 cessation described in subparagraph (A) to the extent
 11 that the qualified investment which will be passed
 12 through to the lessee under this section with respect to
 13 such property is not less than the qualified progress
 14 expenditures properly taken into account by the lessee
 15 with respect to such property.

16 (D) If, after property is placed in service, there is a
 17 disposition or other cessation described in paragraph (1),
 18 paragraph (1) shall be applied as if any credit which was
 19 allowable and which has not been required to be
 20 recaptured before such cessation were allowable for the
 21 taxable year the property was placed in service.

22 (a) (1) Except as provided in this paragraph, the term
 23 "property subject to this section" means—

24 (A) tangible personal property (other than an air
 25 conditioning or heating unit), or

26 (B) other tangible property (not including a
 27 building and its structural components) but only if such
 28 property—

29 (i) is used as an integral part of manufacturing,
 30 production, or extraction or of furnishing
 31 transportation, communications, electrical energy, gas,
 32 water, or sewage disposal services, or

33 (ii) constitutes a research facility used in connection
 34 with any of the activities referred to in clause (i), or

35 (iii) constitutes a facility used in connection with
 36 any of the activities referred to in clause (i) for the bulk
 37 storage of fungible commodities (including
 38 commodities in a liquid or gaseous state), or

39 (C) elevators and escalators, but only if—

40 (i) the construction, reconstruction, or erection of

1 the elevator or escalator is completed by the taxpayer
2 after June 30, 1963, or

3 (ii) the elevator or escalator is acquired after June
4 30, 1963, and the original use of such elevator or
5 escalator commences with the taxpayer and
6 commences after such date, or

7 (D) single purpose agricultural or horticultural
8 structures; or

9 (E) in the case of a qualified rehabilitated building,
10 that portion of the basis which is attributable to
11 qualified rehabilitation expenditures (within the
12 meaning of subsection (g)).

13 Such term includes only property with respect to which
14 depreciation (or amortization in lieu of depreciation) is
15 allowable and having a useful life (determined as of the
16 time such property is placed in service) of 3 years or
17 more.

18 SEC. 2. Section 23605 is added to the Revenue and
19 Taxation Code, to read:

20 23605. (a) There shall be allowed as a credit against
21 the tax imposed by this part the amount determined
22 under subdivision (b).

23 (b) (1) The amount of the credit allowed by
24 subdivision (a) for the income year shall be an amount
25 equal to the sum of—

26 (A) the investment credit carryovers carried to such
27 income year,

28 (B) the amount of the credit determined under
29 paragraph (2) for such income year, plus

30 (C) the investment credit carrybacks carried to such
31 income year.

32 (2) (A) The amount of the credit determined under
33 this paragraph for the income year shall be an amount
34 equal to 5 percent of the qualified investment.

35 (B) For purposes of this paragraph, the regular
36 percentage is 5 percent.

37 (C) For purposes of this paragraph, the regular
38 percentage shall not apply to any energy property which,
39 but for subdivision (b) would not be subject to this
40 section.

1 (3) Notwithstanding paragraph (1), the credit allowed
2 by this section for the income year shall not exceed—

3 (A) so much of the liability for tax for the income year
4 as does not exceed twenty-five thousand dollars
5 (\$25,000), plus

6 (B) the following percentage of so much of the
7 liability for tax for the income year as exceeds twenty-five
8 thousand dollars (\$25,000):

9		
10	If the income year ends in:	The percentage is:
11	1980	70
12	1981	80
13	1982 or thereafter	90
14		

15 (c) (1) If the sum of the amount of the investment
16 credit carryovers to the income year under subsection
17 (a)(1)(A) plus the amount determined under subsection
18 (a)(1)(B) for the income year exceeds the amount of the
19 limitation imposed by subsection (a)(3) for such income
20 year (hereinafter in this subsection referred to as the
21 "unused credit year"), such excess attributable to the
22 amount determined under subsection (a)(1)(B) shall
23 be—

24 (A) an investment credit carryback to each of the 3
25 income years preceding the unused credit year, and

26 (B) an investment credit carryover to each of the 7
27 income years following the unused credit year,

28 and, subject to the limitations imposed by paragraphs (2)
29 and (3), shall be taken into account under the provisions
30 of subsection (a)(1) in the manner provided in such
31 subsection. The entire amount of the unused credit for an
32 unused credit year shall be carried to the earliest of the
33 10 income years to which (by reason of subparagraphs
34 (A) and (B)) such credit may be carried and then to each
35 of the other 9 income years to the extent, because of the
36 limitations imposed by paragraphs (2) and (3), such
37 unused credit may not be taken into account under
38 subsection (a)(1) for a prior income year to which such
39 unused credit may be carried.

40 (2) The amount of the unused credit which may be

1 taken into account under subsection (a)(1) for any
2 preceding income year shall not exceed the amount by
3 which the limitation imposed by subsection (a)(3) for
4 such income year exceeds the sum of—

5 (A) the amounts determined under subparagraphs
6 (A) and (B) of subsection (a)(1) for such income year,
7 plus

8 (B) the amounts which (by reason of this subsection)
9 are carried back to such income year and are attributable
10 to income years preceding the unused credit year.

11 (3) The amount of the unused credit which may be
12 taken into account under subsection (a)(1)(A) for any
13 succeeding income year shall not exceed the amount by
14 which the limitation imposed by subsection (a)(3) for
15 such income year exceeds the sum of the amounts which,
16 by reason of this subsection, are carried to such income
17 year and are attributable to income years preceding the
18 unused credit year.

19 (d) (1) If during any income year any property is
20 disposed of, or otherwise ceases to be property subject to
21 this section with respect to the taxpayer, before the close
22 of the useful life which was taken into account in
23 computing the credit under this section, then the tax
24 under this chapter for such income year shall be
25 increased by an amount equal to the aggregate decrease
26 in the credits allowed under this section for all prior
27 income years which would have resulted solely from
28 substituting, in determining qualified investment, for
29 such useful life the period beginning with the time such
30 property was placed in service by the taxpayer and
31 ending with the time such property ceased to be
32 property subject to this section.

33 (2) If during any income year any property taken into
34 account in determining qualified investment becomes
35 public utility property, then the tax under this chapter for
36 such income year shall be increased by an amount equal
37 to the aggregate decrease in the credits allowed under
38 this section for all prior income years which would have
39 resulted solely from treating the property, for purposes of
40 determining qualified investment, as public utility

1 property (after giving due regard to the period before
2 such change in use). If the application of this paragraph
3 to any property is followed by the application of
4 paragraph (1) to such property, proper adjustment shall
5 be made in applying paragraph (1).

6 (3)(A) If during any income year any property taken
7 into account in determining qualified investment ceases
8 (by reason of sale or other disposition, cancellation or
9 abandonment of contract, or otherwise) to be, with
10 respect to the taxpayer, property which, when placed in
11 service, will be new property subject to this section, then
12 the tax under this chapter for such income year shall be
13 increased by an amount equal to the aggregate decrease
14 in the credits allowed under this section for all prior
15 income years which would have resulted solely from
16 reducing to zero the qualified investment taken into
17 account with respect to such property.

18 (B) Any amount which would have been applied as a
19 reduction of the qualified investment in property to the
20 extent excess credits were not required to be recaptured
21 in the sale and leaseback of such property but for the fact
22 that a reduction under such paragraph cannot reduce
23 qualified investment below zero shall be treated as an
24 amount required to be recaptured under subparagraph
25 (A) for the income year in which the property is placed
26 in service.

27 (C) Under regulations prescribed by the Franchise
28 Tax Board, a sale by, and leaseback to, a taxpayer who,
29 when the property is placed in service, will be a lessee to
30 whom this section applies shall not be treated as a
31 cessation described in subparagraph (A) to the extent
32 that the qualified investment which will be passed
33 through to the lessee under this section with respect to
34 such property is not less than the qualified progress
35 expenditures properly taken into account by the lessee
36 with respect to such property.

37 (D) If, after property is placed in service, there is a
38 disposition or other cessation described in paragraph (1),
39 paragraph (1) shall be applied as if any credit which was
40 allowable and which has not been required to be

1 recaptured before such cessation were allowable for the
2 income year the property was placed in service.

3 (a) (1) Except as provided in this paragraph, the term
4 "property subject to this section" means—

5 (A) tangible personal property (other than an air
6 conditioning, or heating unit), or

7 (B) other tangible property (not including a
8 building and its structural components) but only if such
9 property—

10 (i) is used as an integral part of manufacturing,
11 production, or extraction or of furnishing
12 transportation, communications, electrical energy, gas,
13 water, or sewage disposal services, or

14 (ii) constitutes a research facility used in connection
15 with any of the activities referred to in clause (i), or

16 (iii) constitutes a facility used in connection with
17 any of the activities referred to in clause (i) for the bulk
18 storage of fungible commodities (including
19 commodities in a liquid or gaseous state), or

20 (C) elevators and escalators, but only if—

21 (i) the construction, reconstruction, or erection of
22 the elevator or escalator is completed by the taxpayer
23 after June 30, 1963, or

24 (ii) the elevator or escalator is acquired after June
25 30, 1963, and the original use of such elevator or
26 escalator commences with the taxpayer and
27 commences after such date, or

28 (D) single purpose agricultural or horticultural
29 structures; or

30 (E) in the case of a qualified rehabilitated building,
31 that portion of the basis which is attributable to
32 qualified rehabilitation expenditures (within the
33 meaning of subsection (g)).

34 Such term includes only property with respect to which
35 depreciation (or amortization in lieu of depreciation) is
36 allowable and having a useful life (determined as of the
37 time such property is placed in service) of 3 years or
38 more.

39 SEC. 3. This act provides for a tax levy within the
40 meaning of Article IV of the Constitution and shall go into

1 immediate effect. However, the provisions of this act
2 shall be applied in the computation of taxes for taxable
3 years beginning on or after the first day of the calendar
4 year in which this act becomes effective provided the
5 effective date is more than 90 days prior to the last day
6 of the calendar year. If the effective date is 90 days or less
7 prior to the last day of the calendar year, the provisions
8 of this act shall apply in the computation of taxes for
9 taxable years beginning on or after the first day of the
10 calendar year following the effective date.

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