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California Tax Law Changes 2008-2011

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Improve Compliance with Taxes by Establishing a Penalty for Understatement of Tax

Corporate taxpayers who understate their tax liability by $1 million or more willbe subject to a new penalty. This penalty, equal to 20 percent of tax understatement, would apply to tax years beginning on and after 2003 and will be assessed in addition to the current 10 percent annual interest applied to these late payments. Taxpayers could file amended returns and report and pay tax understatements by May 31, 2009 to avoid paying the penalty. This tax law change is expected to increase 2007-08 revenues by $1.435 billion, 2008-09 revenues by $75 million and 2009-10 revenues by $45 million.

Vehicle and Aircraft Use Tax

Under prior law, vehicles, vessels, and aircraft shippedor brought into California within 90 days of the date of purchase were generally subject to the use tax. This period has been extended from 90 days to 12 months,and made permanent. This tax law change is expected to increase revenues by $16 million in 2008-09 and $21 million in 2009-10.

Modified Group Income Tax Returns

This provision will permit certain non-resident partners and directors to fulfill their California income tax obligation through group tax returns filed by their partnerships or corporations. The partner's or director's income would be taxed at the highest income tax rate for that income.

Net Operating Loss (NOL) Suspension and Carryback

Except for taxpayers with income that is less than or equal to $500,000, NOL deductions are suspended for tax years 2008 and 2009. Also, beginning in 2008, the time limit on carrying forward NOLs is increased from 10 to 20 years. Beginning in 2011, taxpayers will be permitted to carryback losses for two years, bringing California into conformity with federal law.

Carrybacks will be limited to 50 percent of losses for tax year 2011, and 75 percent for tax year 2012. The full NOL could be carried back starting in 2013. This tax law change is expected to increase revenues by $1.265 billion in 2008-09 and $695 million in 2009-10.

In part because of carrybacks, this tax law change is expected to reduce revenues in subsequent years. The revenue loss is projected to be $265 million in 2010-11 and $485 million in 2011-12.

Tax Credit Limitation and Usage Modification

Under prior law, business incentive credits could reduce corporate tax liability to the $800 minimum tax, and eliminate entirely personal income tax (PIT) liability. This provision will limit tax reductions from tax credits to 50 percent of tax liability. This limitation is effective for tax years 2008 and 2009 for corporate and individual taxpayers. For tax years 2010 and later, the 50-percentlimitation would no longer apply. In addition, corporations will now be allowed to share credits within a unitary group, but only if the receiving member of the group was in the group when the credit was earned. If a corporation is sold or transferred to another unitary group, credit sharing would generally not be allowed.

Limited Liability Companies (LLC) Payment Date Change

Under prior law, LLC's were not required to pay the LLC fee until after the end of the year. This law change will require an estimated payment of the fee amount on the 15th day of the sixth month of the LLC year, generally June 15.

Accelerate Estimated Payments

Generally estimated payments for PIT and corporations are required to be paid in equal amounts evenly divided among the four estimated payments. Going forward, taxpayers will be required to pay 30 percent each with the first two estimated payments, and 20 percent each for the last two estimated payments. Taxpayers with large unexpected mid-year changes in income will still be able to use the annualization method to avoid penalties.

Remove Estimated Payment Option for High Income Taxpayers

Currently PIT taxpayers with large increases in income and taxes from the prior tax year can avoid penalties if their prepayment amounts are equal to or greater than their prior year tax liability. This law change will instead require that taxpayers make prepayments based on their current income eliminating the "safe harbor" for PIT taxpayers with adjusted gross income (AGI) equal to or greater than $1 million ($500,000 if filing single). Taxpayers with large unexpected mid-year changes in income will still be able to use the annualization method to avoid penalties.

Accrual Change

To more properly measure tax receipts from income earned in the prior year and to implement appropriate accounting principles, the Budget includes an accrual accounting adjustment.

RECENT FEDERAL CHANGES

On 9/23/08, US Senate passed legislation for reconciliation with House to extend for one or two years all expiring tax credits including solar, alternative energy, R&D, and other incentive based tax credits. Also it extended the AMT exemption increase that expired last year. Lastly, non-itemizers can now deduct property taxes and not lose them with just a standard deduction. With the financial bailout pending, there may be other provisions lurking to boost the housing market and help lenders.

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