

## STATE AND LOCAL ALERT

### **California budget signed by Governor has significant immediate and long-term impact on individuals and corporations**

#### **Summary**

The California Legislature sent to the Governor of California a budget that was signed into law on September 23<sup>rd</sup>. The budget enacts changes to the use of net operating losses (“NOLs”) and limits the use of tax credits for 2008 and 2009. The legislation would also (a) revise the manner in which estimated tax payments are made; (b) accelerate the payment of the annual LLC fee; (c) permit an NOL carryback; (d) lengthen the time limit for using NOLs from 10 to 20 years; (e) permit the assignment of tax credits among members of a combined group; and (f) impose a 20-percent penalty against corporations for underpayments of tax in excess of \$1,000,000 for

taxable years beginning on or after January 1, 2003. Additionally, the budget tightens sales and use tax rules relating to the purchase of an aircraft, vehicle, or vessel.

#### **Description of Certain Important Changes**

##### ***NOLs***

The deduction for NOLs carried forward from prior taxable years would be suspended for the 2008 and 2009 taxable years. This suspension would not apply to taxpayers with income of less than \$500,000 or to corporations whose income subject to tax is less than \$500,000. For NOLs incurred in taxable years beginning on or after January 1, 2010, the carryover period to use the NOL deduction would be

extended from 10 years to 20 years. For taxable years beginning on or after January 1, 2011, California would permit a two-year NOL carryback, phased in over a three-year period. Thus, the 2011 carryback could not exceed 50 percent of the 2011 NOL, and the 2012 carryback could not exceed 75 percent of the 2012 NOL. Beginning with the taxable year 2013, the NOL could be carried back in full. No carrybacks from any year would be permitted to offset any 2008 liability.

##### ***Credits***

For taxable years beginning on or after July 1, 2008, California would permit the assignment of tax credits among members of a unitary group. In August 2006, the CA Supreme Court’s decision in *General Motors Corp. v. Franchise*

Tax Board held that only the taxpayer that incurred the research and development expenses may use the research and development credit so generated. However, the new law would allow taxpayers to assign and utilize R&D and other tax credits generated by one member of its unitary group against the tax liability of another member (The limitation on offsetting 50 percent of the tax would still apply for 2008 and 2009.)

### ***Estimated Tax Payments***

For taxable years beginning on or after January 1, 2009, the quarterly payments of estimated tax would be required at the rate of 30 percent of the required annual amount for each of the first and second quarters and 20 percent of the required annual amount for each of the third and fourth quarters. Estimated tax payments for short taxable years would also be accelerated.

### ***Underpayment of Tax Penalty***

Corporations having an underpayment of tax in excess of \$1,000,000 would be subject to a penalty of 20 percent of the amount of the underpayment. For purposes of determining whether this threshold is exceeded, the underpayments of all corporations that have filed, or are authorized to file, a combined report would be aggregated. In the case of a return for a taxable year beginning before January 1, 2008, the penalty can be reduced or eliminated by filing an amended return before May 31, 2009. In such a case, the amount shown on the amended return is treated as the amount of tax shown on an original return for purposes of this penalty.

### ***LLC Fee***

Effective immediately, the annual LLC fee payment would be due by the 15<sup>th</sup> day of the sixth month of the current taxable year instead of the 15<sup>th</sup> day of the fourth month of the year following the close of the taxable year.

### ***Sales and Use Tax Presumption***

The period of out-of-state use required to qualify for the presumption of the non-applicability of use tax on the purchase of an aircraft, vehicle, or vessel would be expanded from 90 days to 12 months.

### ***Action Steps***

The suspension of NOLs and 50-percent limitation on credit use increase the importance of nexus and income apportionment considerations. In addition, it calls into focus the need for taxpayers to properly identify and document its available tax credits, such as the R&D and Enterprise Zone credits.

---

*The new budget should therefore alert taxpayers to do comprehensive nexus, unitary, and apportionment analyses for 2008 and later tax years. Taxpayers should also consider reviewing the timing of deductions and recognition of income, especially with respect to accounting methods that may be changed without the prior consent of the Internal Revenue Service. The California tax changes should also be taken into account for purposes of financial statement disclosures and reporting.*