

Client Alert

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California Enacts Federal Conformity Bill

By Eric J. Coffill

The governor of California has signed AB 154, which selectively conforms the California Revenue and Taxation Code to specified provisions of the Internal Revenue Code enacted as of January 1, 2015. This is a significant change from current California law, which conforms to the Internal Revenue Code enacted as of January 1, 2009. AB 154 also provides for additional relief from the LCUP. The bill is an urgency statute that is generally operative for taxable years beginning on or after January 1, 2015.

On September 30, 2015, Governor Brown signed Assembly Bill (AB) 154 (Ting), Stats. 2015, c. 359, which enacted two conformity provisions, as well as a provision to provide additional penalty relief regarding the large corporate understatement penalty (LCUP) set forth in Revenue and Taxation Code section 19138. The first conformity provision changes California's general "specified date" of conformity to federal income tax law in the California Revenue and Taxation Code from January 1, 2009, to January 1, 2015, for taxable years beginning on or after January 1, 2015. The second conformity provision generally conforms California law to the federal net operating loss (NOL) rules, which allow corporations expecting an NOL carryback to extend the time for payment of taxes for the preceding taxable year.

The third provision in AB 154 creates three additional exceptions to the LCUP, which generally imposes a twenty-percent penalty on any understatement of tax for any taxable year in excess of \$1 million. The penalty will not be imposed on an increase in tax from a proper election under IRC Section 338 as reported on the first amended return. In addition, the penalty will not be imposed on an understatement resulting from a change to the taxpayer's federal method of accounting, but only to the extent of understatements for taxable years where the due date of the return, without regard to any extensions of time for filing the return, is before the date the secretary of the treasury consents to that change of method. Finally, the penalty will not be imposed on an understatement resulting from the FTB's imposition of an alternative apportionment or allocation method under authority of Revenue and Taxation Code section 25137. This specific provision of AB 154 adding the LCUP relief relating to FTB's imposition of alternative apportionment under section 25137 applies to understatements for any taxable year for which the statute of limitations on assessment has not expired as of the effective date of the bill.

AB 154 was an urgency bill and required a two-thirds vote, and is to take effect immediately. The bill was supported by a broad base of organizations including the California Taxpayers Association, the California Chamber of Commerce, and the California Bankers Association. No formal opposition was received.

California's last conformity bill was SB 401, which was enacted in 2010. Proposition 26, which was approved by the voters on November 2, 2010, provided that any change in state statute that results in any taxpayer paying a higher tax must be passed by a two-thirds vote of the Legislature. There is "significant ambiguity" regarding the meaning of a provision in Proposition 26 stating that any state law adopted between January 1, 2010, and November 2, 2010, that conflicted with Proposition 26 would be repealed one year after the proposition's approval

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(unless the Legislature passed the law again in compliance with Proposition 26).¹ To address the concern that SB 401 is not a valid law under this provision of Proposition 26, AB 154 includes a legislative intent provision to provide reassurance to taxpayers by confirming the validity and ongoing effect of SB 401. Changing the specified date means the Revenue and Taxation Code conforms to Internal Revenue Code changes made from January 1, 2009, through December 31, 2014, thus conforming to the changes made to federal law during the six-year period to the extent California conforms to those laws by reference.

For more information on the specific conformity provisions, please see a copy of the FTB's September 8, 2015 final Bill Analysis of AB154, [located here](#).

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¹ California Assembly Floor Analysis, Concurrence in Senate Amendments, Aug. 31, 2015, p. 6.