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DEPARTMENT OF  
POLICE

CITY OF SACRAMENTO  
CALIFORNIA

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JOHN P. KEARNS  
CHIEF OF POLICE

September 8, 1989

Law and Legislation Committee  
Sacramento, California

Honorable members in Session:

SUBJECT: ASSEMBLY BILL 30 (Klehs)

SUMMARY

The Sacramento Police Department is requesting that the Law and Legislation Committee support Assembly Bill 30 (Klehs), pertaining to the establishment of a California Anti-Drug Superfund.

BACKGROUND

Two recent developments have drastically changed cocaine trafficking and increased the level of organized crime and violence in California.

- 1) Columbian cocaine cartels have shifted primary operations from Florida to California. Federal authorities now estimate that 40% to 50% of the nation's cocaine is now funneled through Los Angeles. This change has occurred due to increased pressure from state and federal law enforcement officials in the state of Florida, which was the previous cocaine capital for the nation.
- 2) California has experienced an increase in the popularity and supply of a highly addictive form of relatively pure and cheaply marketed "crack" or "rock" cocaine. This cocaine is widely distributed by currently established California street gang networks. These California street gangs offer Columbian and

Mexican drug cartels networks for the sale and distribution of cocaine. Columbian and Mexican drug cartels are utilizing long-established heroin routes to import large volumes of cocaine into California which were previously brought in through the State of Florida.

Federal authorities have admitted that they are understaffed in California and are unable to meet the rapid growth of cocaine importation and to interdict cocaine at the nation's borders. In view of this fact, the President has openly encouraged states to greatly increase their own efforts.

Partnerships have already been established between Columbian and Mexican drug cartels and California street gangs, and distribution of cocaine from California now extends as far away as Alaska, Oregon, Washington, and the mid-western states.

In order to combat Columbian and Mexican cartel activity in the state of California and to decrease the level of organized crime and violence which results from this type of drug trafficking, the state of California will have to use tactics similar to those used in the State of Florida. For example, we must vigorously enforce our state asset forfeiture program, utilize our wire-tap statutes, increase staffing levels for drug enforcement efforts, and expand our narcotic enforcement activities to include intelligence gathering, analysis, and dissemination, utilizing state-level task forces and increasing cooperation in intelligence and enforcement with federal authorities. Only with the use of these tactics was Florida able to experience a decline in cocaine trafficking and related violent crime. Effective utilization of new state laws such as money laundering, asset forfeiture, and wire-tap, will require resources beyond the scope of many California law enforcement agencies unless assisted by state and federal agencies which offer intelligence on drug trafficking cartels.

AB 30 provides for the formation of programs to support these tactics in California and allows local agencies to be assisted by state and federal agency intelligence. The proposed CrackDown Task Force Program will establish two major enforcement operations: one in Southern California and the other in Northern California. These operations will be staffed by more than 200 new state narcotics agents, auditors, intelligence analysts and support personnel. Their mission will be to target Columbian cartel street gang cocaine networks. Fourteen task forces will be formed under the program and will work primarily in the major urban areas. A mobile component for each of the two operations will also be utilized to assist local agencies throughout the state. Significant resources would be available to defray investigative expenses incurred by local officers during investigations. These task forces will increase the development,

exchange, and utilization of statewide, national and international intelligence on the importation and distribution of cocaine.

Aside from local law enforcement benefiting from the CrackDown Task Force Program, AB 30 also provides for Superfund money which will be spent by local police and sheriff's departments for drug and gang enforcement or prevention efforts. The proposed \$120 million per year will be distributed on a per-capita basis. The only requirement, other than it be used for gang and drug enforcement, is that the money only be used to provide new services. It cannot be used to subsidize current efforts.

Another \$80 million per year will be distributed to counties on a per-capita basis and is to be used for drug treatment, education, prosecution, or prevention, depending on each county's needs.

AB 30 has already been amended three times with the last amendment in Assembly September 5, 1989. We do not feel that further amendments would improve this bill's favorability.

AB 30 is supported by the Attorney General and by the League of California Cities.

FINANCIAL DATA

The California Anti-Drug Superfund Program will be funded by the elimination of loopholes which exist in current state bank and corporation tax law. These loopholes were removed from federal tax law by Congress and by President Reagan in 1987.

The State Controller shall distribute to the Attorney General's Office \$22 million a year to fund state and local "Crackdown" Task Forces in Northern and Southern California. The remaining \$200 million per year will be split into two parts with 60% (\$120 million) going directly to police and sheriff's departments on a per capita basis, based on the population of each department's service area, and 40% (\$80 million) going to County Boards of Supervisors.

POLICY CONSIDERATIONS

None.

MBE/WBE EFFORTS

None.

RECOMMENDATION

It is recommended that the Law and Legislation Committee support Assembly Bill 30 (Klehs), pertaining to the establishment of a California Anti-Drug Superfund.

Respectfully submitted,

RECOMMENDATION APPROVED:

*Solon Wisham Jr.*  
**SOLON WISHAM JR.**  
 Assistant City Manager

*John P. Kearns*  
**JOHN P. KEARNS**  
 CHIEF OF POLICE

CONTACT PERSON:

CAPT. JERRY LEDBETTER, NARCOTICS/GANGS DIVISION, 449-5796

jpk:dln

REF:9-27

September 21, 1989  
 ALL DISTRICTS

Attachment

**JOHN  
VAN DE KAMP**  
ATTORNEY GENERAL

August 29, 1989

Chief John P. Kearns  
Sacramento Police Department  
813 Sixth Street  
Sacramento, CA 95814

Dear Chief Kearns:

I am proud of the mutual respect and support I have developed with local law enforcement during seven years as State Attorney General. I'm especially proud of my efforts to provide police agencies with the resources required to do their jobs.

From time to time we may disagree. You may not choose to lend me your political support. But I know there are important things we can still do together.

Today I'm writing to you about one of them: showing the drug lords, street gangs, and narcotics pushers we're serious about winning the war on drugs.

So with Assemblyman Johan Klehs, I am sponsoring a massive eight-year all-out crackdown on drug dealing financed with \$1.7 billion obtained by closing business and corporate tax loopholes.

Our legislation combines tax equity with crime fighting. It closes the same corporate income tax loopholes for California that President Reagan signed into law for the nation in 1987. Revenue from closing tax loopholes for banks and corporations will go directly into the California Anti-drug Superfund.

Every year for the next eight years, the Anti-drug Superfund will distribute \$222 million for drug enforcement, treatment, prevention, and prosecution in every corner of California.

Here's how the money will be spent each year.



o \$120 million, or 60%, will go directly to police and sheriffs departments on a per-capita formula, depending on each department's service area population. It will fund desperately needed reinforcements for drug and gang enforcement and prevention targeted to neighborhoods being overrun by drug dealers.

If these funds are used solely to hire new officers, they could put 2,400 more cops on the streets almost overnight.

o \$80 million, or 40%, would be dispersed to counties on a per-capita basis for drug treatment, education, prosecution, or prevention -- depending on each county's needs.

If this share of Superfund money is used for drug treatment, it could boost treatment slots for recovering addicts by roughly 40%. Every addict kept off of drugs means fewer emergency room cases, less crime in our streets, and fewer babies born addicted to "crack."

These funds come with only one restriction: they must provide new services -- more cops, new treatment beds and drug education efforts; they cannot be used to subsidize current programs.

The Superfund's purpose is to redouble existing efforts. What's already being done isn't nearly good enough.

We can't count on the federal government for much help. Past federal promises have come up short on money for fighting drugs. New programs -- including President Bush's long-awaited anti-drug strategy -- won't make much of a dent in the enormous drug problem facing California.

Remember, California has replaced South Florida as the number one entry point for cocaine in America. The President has warned us that the states must dramatically increase their own efforts. I agree.

California's Anti-drug Superfund is the best way for California to do what Mr. Bush has asked us to do -- and what we know we must do.

Please help me pass this urgently needed legislation. Take a moment to sign and return the enclosed self-addressed post card indicating your support.

We can't win a war with stirring phrases and good intentions. It's time we put our money where our mouth is.

Thank you for your consideration.

Sincerely,



John Van de Kamp  
Attorney General  
of California.

Enclosures

P.S. Please help me create the California Anti-drug Superfund by returning the enclosed postcard today.

STATEMENT BY JOHN VAN DE KAMP  
ATTORNEY GENERAL OF CALIFORNIA  
ANNOUNCING SUPPORT FOR A.B. 30  
SACRAMENTO, CALIFORNIA  
THURSDAY, AUGUST 24, 1989

Those of us in law enforcement are often criticized for comparing the struggle against drug traffickers to a war. The brutal violence in Colombia this week, which mirrors the growing danger in our own streets, demonstrates that this is a war. And we can't win a war with stirring phrases and good intentions.

In this war no one is a safe distance from the battlefield, especially no one in California. Our state is the number one target for the Colombian drug cartels. That puts us all on the frontlines, and the people know it. From San Diego to Mt. Shasta, we are all saying the same thing: drugs are the number one danger facing California.

This morning, Assemblyman Klehs and I are proposing legislation that will prove to the drug lords, and the gangs, and the pushers, that Californians mean what we say: This state is deadly serious about winning the war on drugs.

We are proposing that California finally close the same corporate tax loopholes that Ronald Reagan closed two years ago, and that we use the money -- about \$1.7 billion over the next eight years -- to fund an all-out fight against drugs and gangs in our streets, our schools and our neighborhoods.

Assemblyman Klehs is already carrying legislation, Assembly Bill 30, which would close the corporate loopholes. In a few minutes he will explain the purpose and the history of his bill. But first, I would like to go over the new provisions being amended into AB 30 as of today -- provisions that will dedicate the revenue to drug enforcement, treatment, prevention and prosecution in every corner of California.

When Ronald Reagan closed these corporate loopholes two years ago, he used the revenue to help trim the Federal deficit. When California closes those same loopholes we propose that the money be deposited directly into the "California Anti-drug Superfund."

Every year for the next eight years, the Anti-drug Superfund will distribute \$222 million to fund the war on drugs in California. At the end of the eight years, the Legislature will evaluate the success of the program and the voters will decide whether to continue it.

Here's how the money will be spent each year:  
 \$22,000,000 will be used to fund state/local law enforcement "CrackDown" Task Forces in Northern and Southern California. As I announced last week, more than 200 new state narcotics agents, auditors and intelligence analysts will be hired as part of "CrackDown." They will work closely with local law enforcement to provide the same kind of all-out effort that the federal government has funded in South Florida -- but has refused to fund in California.

The remaining \$200 million will be split two ways:

Sixty percent, or \$120 million, will go directly to police and sheriffs departments on a per-capita formula, depending on the population of each department's service area. It will be used for drug and gang enforcement and prevention. That will mean desperately needed reinforcements for cleaning up neighborhoods being overrun by drug dealers. If this share of the money were used to hire new policemen, for example, it could put 2,400 more cops on the streets almost overnight.

The other 40% of the money, some \$80 million a year, will be distributed to counties on a per-capita basis. It will be used for drug treatment, education, prosecution, or prevention, depending on each county's needs.

If this share of the money were used for drug treatment, we could expand the number of treatment slots available to recovering addicts by roughly 40%. And every addict we can keep off of drugs means less crime in our streets, fewer emergency cases filling our hospitals, and fewer babies born addicted to "crack."

Apart from the requirement that it be used for fighting drugs and gangs, the only restriction on the new money will be that it must provide new services: new cops, new treatment beds, new drug education efforts. It cannot be used to subsidize current efforts. The whole purpose of the superfund is to redouble our efforts. What's already being done isn't nearly good enough.

Two weeks from now, the President will formally unveil his long-awaited anti-drug strategy, but the broad outlines are already fairly clear. Frankly, by itself, the new program probably will not make much of a dent in the enormous drug problem we're facing in California. Remember that this state has now replaced South Florida as the number one entry point for cocaine in America.

We can't count on the federal government to save us. After all, past federal promises have come up short on money for fighting drugs. And the President has already warned us that the states must greatly increase their own efforts. I agree. We are all in this together.

AB 30 is the best way for California to do what the President has asked us to do, and what we know we must do. Only by combining new state resources with whatever help the Federal government finally provides, can we begin to cleanse California of the poisons that are destroying our children and corrupting the very soul of our society.

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## Attorney General's CrackDown Task Force Proposal

### Executive Summary

The emergence of powerful Colombian cocaine smuggling cartels utilizing domestic street gangs as the distribution network for "crack" is the most devastating drug problem in California today. Two recent developments have dramatically changed cocaine trafficking in California. First, Colombian cocaine cartels have shifted much of their operations from Florida to California. Federal authorities now estimate that 40 to 50 percent of the nation's cocaine is funneled through Los Angeles, the nation's new cocaine capital. Second, within California this increased supply of cocaine has led to a tremendous market in the inexpensive but highly addictive form of "crack" or "rock" cocaine. "Crack" cocaine is being widely distributed by street gang networks, creating an epidemic of "crack" addiction. This cocaine epidemic costs the people of California hundreds of millions of dollars each year.

Federal authorities admit that they are understaffed in California and, thus, unable to meet the rapid growth of cocaine importation. Lacking the authority to interdict cocaine at the nation's borders, state and local agencies find themselves frustrated in their efforts to identify and remove drug traffickers after they have lodged themselves in communities throughout the state. Effective utilization of new state laws such as money laundering, asset forfeiture, and wire-tap, tools which have proven very effective against Florida's cocaine traffickers, requires resources beyond the capability of many local law enforcement agencies. Additionally, state and local officials have a very limited ability to gather, exchange, and utilize intelligence on drug trafficking cartels, including the street gang distribution networks which have recently developed into major trafficking organizations.

The proposed CrackDown Task Force Program will establish two major enforcement operations: one in Southern California and the other in Northern California. Their mission will be to target on the Colombian cartel street gang cocaine network. The program would allow formation of 14 task forces to work primarily in the major urban areas, but they would also have mobile components which could target anywhere in the state. The task force approach has proven highly effective in reducing both domestic cultivation of marijuana and clandestine drug laboratories--two drug problems where California can directly attack the source. These task forces will be staffed with DOJ Special Agents, local and federal officers and support personnel to bring a coordinated, statewide effort to bear against major cocaine trafficking organizations. Significant resources would be available to defray investigative expenses incurred by local officers during these investigations. Of particular importance, these task forces will increase the development, exchange and utilization of statewide, national and international intelligence on the importation and distribution of cocaine.

CRACKDOWN TASK FORCE PROGRAM

TOTALS  
BY  
NUMBER OF POSITIONS  
AND  
FISCAL IMPACT

114 peace officer positions and 110 nonpeace officer positions  
224 total positions

<u>Budget Category</u>	<u>January 1, 1990 (6 months)</u>	<u>July 1, 1990 (1st year)</u>	<u>July 1, 1991 (2nd year)</u>
Personal Services:			
Peace Officers	\$ 1,685,000	\$ 5,169,000	\$ 6,174,000
Nonpeace Officers	1,399,000	3,776,000	3,973,000
Subtotal	<u>\$ 3,084,000</u>	<u>\$ 8,945,000</u>	<u>\$10,147,000</u>
Operating Expense & Equipment	<u>10,295,000</u>	<u>13,031,000</u>	<u>11,508,000</u>
Total	\$13,379,000	\$21,976,000	\$21,655,000*

\*In this amount is \$2,500,000 for local overtime (\$1,500,000) and local per diem (\$1,000,000).

Investigation/Money Laundering Component

Team Structure

- 1 - Special Agent Supervisor
- 5 - Special Agents
- 10+ - Local officers/federal officers

Assignments

Southern California:

- 6 teams - task force target investigations
- 2 teams - money laundering investigations
- 1 team - mobile

Northern California:

- 3 teams - task force target investigations
- 1 team - money laundering investigations
- 1 team - mobile

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CRACKDOWN TASK FORCE PROGRAM

I. PROBLEM STATEMENT

A. BACKGROUND INFORMATION

Two recent developments have dramatically changed cocaine trafficking in California, with a resulting increased level of organized crime and violence.

The two recent developments are summarized as follows:

1. Colombian cocaine cartels are shifting their operations from Florida to California.

This change is occurring for two reasons. First, state and federal law enforcement officials in Florida have exerted enough pressure to force drug traffickers to shift their operations to a safer environment. For example, law enforcement authorities in Florida have more than twice as many narcotic agents per capita than California; Florida has vigorously enforced a state asset forfeiture program since 1980; and Florida has had its own wire-tap statute since 1971. In addition, state law enforcement authorities in Florida, after watching a similar epidemic of increased cocaine smuggling and abuse, concluded that traditional methods of drug enforcement were not sufficient to keep up with a rapidly expanding drug trafficking trend or the technology utilized by the smugglers and distributors. They report that increased staffing levels for drug enforcement efforts as a "stand alone method" also did not work. Only after they included in their repertoire of strategies the increased emphasis on intelligence gathering, analysis, and dissemination, utilization of state level task force efforts and increased cooperation in intelligence and enforcement with federal authorities did the rate of the cocaine problem severity begin to subside. As a result, while the cocaine problem in Florida is far from being solved, the dramatic yearly increases in seizures, arrests and drug overdoses has, to some degree, abated. Further enhancing this approach is what Florida authorities refer to as a "package law enforcement approach" wherein major smuggling groups or, at the very least, their principal operators are investigated and prosecuted utilizing the full force of all applicable statutes rather than the traditional methodologies of charging only the most predominant offense documented during an investigation.

Second, Colombian and Mexican drug cartels have forged a partnership and are now using long-established heroin routes to import large volumes of cocaine into California to replace the abandoned Florida routes. Federal authorities are doing very little to prevent the drugs from crossing the border into California by land, sea and air. This leaves state and local officials with the more difficult task of attempting to "catch up" with the drug traffickers after they have made it to our streets.

- 2. Within California the increased supply of cocaine, marketed cheaply in the highly addictive form of "crack" or "rock" cocaine by already established street gang networks, has exploded in popularity.

As a result of the Colombians shifting their operations to California, we are drenched in cheap and relatively pure cocaine. Where in 1978 the Los Angeles Police Department seized just over 100 pounds, now more than 10 drug dealers in south central Los Angeles each deal from 400 to 600 pounds of cocaine per month. State and federal seizures have increased from approximately 5,000 pounds in 1986 to approximately 13,000 pounds in 1988.

The shift in operations is also evident in the movement of federal cash reserves as the currency essential for drug transactions follows the drugs to California. Last year the Federal Reserve Board reported that Los Angeles-area banks amassed a \$3.8 billion cash surplus, up over 2,000 percent from only \$165 million three years ago. Correspondingly, Miami's cash reserves dropped 24 percent over the same period as, again, the nation's cash followed cocaine west. (Refer to Charts 1 and 2 for further information.)

As further evidence of the shift from Florida to California, cash seizures under the federal asset forfeiture law, as reported by the U.S. Attorney's Office for fiscal year 1989 (through April), indicate that Florida seizures account for 10 percent of the nationwide total while California now represents 25 percent. According to the Drug Enforcement Administration, approximately 25 percent of all cocaine seized in the United States comes from California.

Federal authorities now estimate that over half of all cocaine brought into the nation is funneled through Los Angeles, America's new cocaine capital.

California street gangs, many of which were already operating their own "rock houses" before the shift in importation, have formed a natural partnership with the Colombian cartels. The gangs provide established networks for sales, distribution, and enforcement which span not only California, but have been documented as far away as Alaska, Oregon, Washington and the mid-western states. As a result, since the mid-1980s the funneling of Colombian cocaine through California street gangs has dramatically increased the number, size, sophistication, profits and violence of these street gangs. In gang-rich south central Los Angeles, crack dealing is estimated to be a \$5 million-a-week business.

The Colombian street gang crack network is a relatively new phenomenon. Most communities lack specific information as to drug trends, the new magnitude and nature of the problem, and effective strategies. This information is critically needed to

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enable local officials to plan and deliver not only a law enforcement response, but also health and social support services.

#### B. IMPACT TO SOCIETY

California's "crack" cocaine problem is rapidly becoming an emergency situation. The statewide costs of cocaine abuse related to lost productivity, crime and medical care are estimated at over \$820 million annually. All indications are that the problem is growing dramatically. California experienced over 500 gang-related homicides last year, many in wars fought over the right to sell "crack" cocaine. Los Angeles County spent over \$35 million and Alameda County \$11 million last year to treat injuries resulting from gang violence. Attachment A summarizes the types of problems and the costs to society which are currently growing to uncontrollable proportions.

#### C. LAW ENFORCEMENT IMPACT

The staggering profits and massive cash flow generated by the increased cocaine trafficking create a tremendous potential for corruption of law enforcement and other governmental authorities. Recently, several DEA agents in the Los Angeles area were indicted for laundering cocaine profits. A local mayor was recently arrested, and in June of this year was indicted for cocaine trafficking and laundering money related to cocaine trafficking.

California has recently enacted progressive drug enforcement laws to give state and local agencies the authority to more aggressively pursue organized cocaine traffickers. These include legislation which strengthens the state asset forfeiture law, a wire-tap law which gives law enforcement the authority to conduct court-authorized wire-taps against major traffickers and a money laundering law which gives law enforcement a legal basis to pursue suspects who are involved in the financial management of the cocaine trafficking business. These laws are highly technical and will require trained specialists to effectively use them against cocaine traffickers. In addition, experience has clearly shown that financial investigations and wire-tap investigations are both extremely labor intensive. Many agencies in California lack the expertise and the manpower to effectively utilize these laws without the support of state and other local agencies.

Local authorities have further identified a fundamental lack of coordination on a regional and statewide basis on those high-level cases involving major cocaine trafficking organizations. Local authorities also cite a lack of analytical capabilities with regard to intelligence gathering and dissemination and effective

coordination with other police agencies on a statewide basis. In addition, rural California agencies often lack the appropriate staffing levels to keep pace with the rapidly expanding cocaine problem or to efficiently report and analyze what was characterized by one official as a "glut" of intelligence which, at this point, must go unused due to a lack of resources.

Three principal organizations are now involved with intelligence collection: The Western States Information Network (WSIN), the Attorney General's Bureau of Organized Crime and Criminal Intelligence (BOCCI) and the Los Angeles-area Narcotic Enforcement Network (NIN).

WSIN is an index system which collects drug intelligence information, on a voluntary basis, from agencies which participate throughout California and four other western states. While WSIN has established an outstanding capability as an index system, it does not operate target identification or "on-site" pro-active collection and analysis programs. The limited tactical case analysis resources within WSIN must be shared with four other states.

NIN acts as a regional intelligence coordination program, with a target selection capability.

BOCCI collects limited intelligence on cocaine trafficking organizations for input into existing organized crime intelligence systems.

Although NIN forwards cocaine intelligence to WSIN, the NIN system is not a statewide, pro-active intelligence system. While it is an extremely effective regional system, NIN does not have the analytical capability to deal with the volume of cocaine trafficking intelligence available just at the regional level, much less on a statewide level.

While these systems work well for what they are designed to do, in-field strategic and tactical intelligence relative to cocaine cartels and cocaine distribution networks is not collected.

The FBI, DEA, U.S. Customs Service, Immigration and Naturalization Service, and the U.S. Attorney's Office agree that the West Coast is short-changed in the allocation of federal drug enforcement resources. Federal resources are simply inadequate to deal with the fundamental change in the volume and trafficking of cocaine coming into Southern California. For example, the FBI has identified 96 separate Mexican cartels importing cocaine that federal officials are unable to investigate with current staffing.

The federal government has simply not responded in a significant way to the cocaine problem in California. The federal government has instead placed a far greater proportion of their resources in Florida and New York.

II. LAW ENFORCEMENT RESOURCES ARE INADEQUATE

A. ATTORNEY GENERAL'S OFFICE

In 1984, the Attorney General's Commission on Narcotics recommended that state-level drug enforcement efforts should be enhanced and expanded to address those drug supplies for which California is the source (domestically grown cannabis, diversion of prescription drugs, and substances manufactured by clandestine laboratories). The Commission further recommended that the state should encourage the continued formation of regional task forces to best deal with the multijurisdictional nature of criminal drug activities. The Commission also recommended that additional training should be provided to local law enforcement to assist them in improving their efforts to combat the growing problem of illicit drugs. To this end, the Attorney General's Bureau of Narcotic Enforcement (BNE) has focused their resources on source drug problems, the development of over 22 regional task forces, and a significantly increased training program presented through the Attorney General's Advanced Training Center.

Since 1984, BNE has augmented its resources in these areas; however, these priority areas have taken the great bulk of BNE resources to develop and implement effective programs. Thus, BNE is left with approximately one team (seven Special Agents) per field office to conduct general investigations against major traffickers, including major cocaine cartels.

Given BNE's limited resources, it has been unable to direct significant resources towards the formation of task forces to target major violators except in a few extraordinary cases. BNE, in cooperation with other agencies, has had outstanding success where it has directed resources toward the establishment of major target cases.

"Operation Cacus" was a major investigation against the Hell's Angels conducted in 1987. This case lasted approximately six months and required the total commitment of all available agent resources in the San Francisco office, although it was conducted jointly with the Federal Bureau of Investigation, San Francisco and Oakland Police Departments. "Operation Cacus" resulted in the arrest of 12 suspects, the seizure of 3 clandestine labs, and the initiation of asset forfeiture against over \$3 million worth of assets (including well over \$2 million in cash seized). During the final week of the investigation, BNE had to commit its total statewide Special Agent force to the San Francisco area in order to conduct the service of the arrest and search warrants that resulted from this investigation.

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"Operation Polar Cap" was a money laundering investigation conducted by Los Angeles BNE in conjunction with the federal Drug Enforcement Administration and the Los Angeles Police Department. This investigation disclosed that two interrelated organizations were moving as much as \$1 billion per year throughout the world for international cocaine trafficking organizations, including the Medellin Colombia drug cartel. The investigation ultimately led to the installation of federal telephone intercepts along with video surveillance intercepts. During February and March of 1989, the investigation resulted in the arrest of 33 high-level cocaine traffickers and money launderers and the seizure of over \$112 million in forfeitable assets. During the investigation, as much 40 percent of the total agent resources of the Los Angeles field office were committed to this single investigation.

Luis Borda Investigation - In this case, the Orange and Riverside field offices teamed up with the Long Beach Police Department, the California Highway Patrol, and the FBI in a year-long investigation of a major cocaine trafficking organization. The investigation involved extensive surveillance and undercover operations, and revealed a major network which was part of a larger Colombian cocaine distribution organization believed to be smuggling cocaine into Miami, Florida, and distributing it throughout California, to other parts of the U.S. and into Canada. During the one-year investigation, in 1988 agents made a 100 kilo seizure of cocaine in Riverside County, seized \$100,000 in cash in Los Angeles, and provided information to the Royal Canadian Mounted Police, resulting in the seizure of 26 kilos of cocaine. On July 3, 1989, the investigation culminated in the arrest of subject Borda and three associates and the service of five search warrants, all of which resulted in the seizure of 431 kilos of cocaine, six vehicles, and jewelry. A total of 557 kilos of cocaine were seized along with over one million dollars in assets. A significant proportion of the Orange and Riverside BNE special agent force was committed to this case.

In summary, the task force approach continues to prove itself an efficient response to the problem, but currently does not have adequate resources within the Bureau of Narcotic Enforcement or the Bureau of Organized Crime and Criminal Intelligence.

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These examples show that when a "drug specific" or "case specific" task force is formed by all agencies with a proprietary interest in a case, the results are dramatic.

The Attorney General's Bureau of Organized Crime and Criminal Intelligence (BOCCI) currently has various systems in place which are utilized to collect and analyze a limited amount of cocaine-related intelligence. These systems, including the Automated Criminal Information Index, Interpol, the computer-generated graphics system, and other files and systems, simply do not have the resources to support a total statewide cocaine intelligence collection, analysis, and dissemination effort. The increasing size of the cocaine problem, and the need for a statewide collection and coordination effort, exceeds the current BOCCI resources assigned to intelligence collection.

The Western States Information Network (WSIN) currently operates a narcotic information index and pointer system for five western states (California, Oregon, Washington, Alaska and Hawaii). WSIN does not have a field unit to collect cocaine-specific intelligence, conduct analysis, and identify targets for directed investigations which is adequate for California law enforcement's needs. WSIN continues to function effectively as an index and general reference system. WSIN also does not have the resources to redirect to a cocaine specific program without negatively impacting the ongoing programs operating in other drug areas.

**B. LOCAL AGENCIES** - Most local agencies lack the resources to conduct and coordinate statewide or regional cocaine specific intelligence coordination programs. Local authorities have cited a lack of analytical expertise and equipment and have further cited that one of the greatest needs that law enforcement has today is an overall coordination of the cocaine investigation effort. Traditionally, these agencies have relied on state and federal agencies to coordinate intelligence and major target investigations. The larger local departments, such as the Los Angeles Police Department and the Los Angeles Sheriff's Department, have identified a need for state- and federal-level agencies to provide specialized resources and overall coordination and perspective for major target investigations. Traditionally, the state has played a limited role in the major urban areas, while the federal agencies have done significantly more in these areas.

**C. FEDERAL AGENCIES** - The federal government has publicly recognized that the border interdiction effort has been largely unsuccessful. Further, the federal government has decided not to direct substantial resources to California and has instead directed these resources to the state of Florida where they are having a significant impact on the cocaine trafficking problem. Effectively, there are over twice as many federal agents per capita in Florida as there are in California. In addition, Florida state-level resources are staffed at twice the per capita ratio as California. For details, refer to attached Chart 3.

III. CRACKDOWN PROGRAM

A. INTRODUCTION

Law Enforcement has determined that one of the most successful modes of operating against major drug traffickers is the formation of a task force wherein state, federal and local agencies can pool their resources to provide the higher level of personnel, equipment, funding and expertise necessary in complex, long-term investigations. Recent experience in the "Operation Polar Cap," "Operation Cacus" and Borda cases has confirmed the success which can be obtained through the task force approach. Drug-specific task forces operate best when they are focused on a specific major drug trafficking organization.

Based on the success of task force operations in conducting successful investigations against major drug trafficking organizations, the Department of Justice should move to expand its role in the major metropolitan areas. As described in this proposal, the Department of Justice will provide the resources to form a nucleus around which "target-specific" task forces will be formed to initiate investigations against Colombian cocaine organizations and the accumulation of assets and money laundering which are commonly associated with cocaine trafficking. This program has four major components.

B. PROGRAM COMPONENTS

**INVESTIGATION/MONEY LAUNDERING** - This component is the nucleus of the task force operational approach. Two major units will be established: one north and one south, located in two major metropolitan areas. These units will be composed of a total of 14 teams of Special Agents, local and federal officers and support staff, nine teams in Southern California and five teams in Northern California. Two additional teams will be assigned to mobile operations directed at supporting law enforcement in the rural areas, where the "crack" cocaine problem is in the developmental stages. Each team will have the mission to form task forces to target investigations against cocaine trafficking organizations and to conduct parallel money laundering investigations. Each team will be the core group of permanently assigned state agents around which local officers (10-15) will form for a case-specific task force. Targeted cases will also involve local officers brought in to the task force group for the length of the case. A typical investigation might involve 2-6 local, state and federal agencies. They will be trained and equipped to ensure that the state money laundering, wire-tap and asset forfeiture laws are used to the fullest extent.

**INTELLIGENCE** - The Bureau of Organized Crime and Criminal Intelligence (BOCCI) will establish a program to network existing intelligence systems, coordinate and disseminate intelligence to support federal, state and local efforts as well as the task force investigative teams. This effort will act as a central intelligence system focusing on the escalating cocaine cartel/criminal gang problem. Information derived will be disseminated to allied agencies.

The program will establish a narcotics intelligence network (NIN) in the San Francisco Bay Area which will be linked to other intelligence systems including Los Angeles NIN, WSIN, El Paso Intelligence Center (EPIC), and the BOCCI intelligence center. These criminal intelligence systems will be automated and regionally accessible. As an example of the critical need for this information, Northern California law enforcement officials recently reported several organizations that distributed 100 kilos of cocaine per week that were flourishing in Los Angeles without Los Angeles law enforcement's knowledge; likewise, Los Angeles law enforcement officials have knowledge of similar operations in Northern California.

This program will assign analytical support personnel to the Los Angeles and Bay Area NIN programs, and to the investigation teams to provide on-site support to task force investigations. Additional analysts will be assigned to BOCCI's analytical center.

This program will also assign 22 Special Agents to the investigation teams to act as on-site, pro-active intelligence collection agents and as intelligence coordinators with and for local agencies.

**SUPPORT** - The support component comprises all the resources and personnel elements which are essential to support successful task force target investigations. These elements are briefly described in the following paragraphs. For fiscal impact, refer to Attachment C.

1. Operating Expense and Equipment for Task Forces - The state (DOJ) will underwrite the travel and overtime expense for local agencies participating in a task force investigation. DOJ will also provide surveillance equipment, communications, and office space for participating local agencies.
2. Technical Support Personnel - The CrackDown Program will require the expertise of a number of different types of specialized non-sworn support personnel. Some personnel, such as auditors and criminal intelligence specialists, will be assigned to work with the investigation teams to provide on-site support of task force investigations. Other personnel, such as program analysts, will be assigned to work at headquarters, while criminalists will be assigned to an appropriate DOJ forensic lab. Other support personnel will be assigned as appropriate.

- 3. Clerical Support Personnel - Appropriate clerical support personnel will be assigned to all the other components as required.
- 4. Air Support - Experience has shown that target investigations against major cocaine traffickers are surveillance-intense and require a tremendous level of air support.

Local agencies which operate air support programs have significant non-drug enforcement commitments for their programs within their own local jurisdictions. No local agency can provide the statewide air support resources which this program will require. This element will provide four trained Special Agent-pilots and appropriately equipped aircraft to conduct statewide surveillance on major cocaine traffickers.

- 5. Training - This element will add one Special Agent and two non-sworn positions (with operating expense and equipment) to the DOJ Advanced Training Center to establish a program for expanded training for local officers specifically related to cocaine and money laundering investigations.
- 6. Evidence Purchase and Witness Protection Funds - The higher level of violence and close-knit nature of the cocaine trafficking organizations increase the need to provide adequate witness protection, to conduct major sophisticated reverse stings, and to make larger and more expensive undercover drug purchases. This element will provide an augmented fund for use by the task forces in conducting major investigations.

**MANAGEMENT** - The Attorney General will form program advisory committees north and south. These committees shall be composed of DOJ and local narcotic commanders who shall oversee the implementation of this program, including the development of operational plans and policy (such as press policy and asset forfeiture proceeds distribution) and the selection of targets. The state will underwrite all travel, per diem, and support costs for the local agencies sitting on the committee.

An Assistant Bureau Chief and two Special Agents in Charge will manage the program.

**C. FEDERAL AGENCY COORDINATION**

Where appropriate, intelligence and investigations will be coordinated with federal authorities. The federal Organized Crime Drug Enforcement Task Force (OCDETF) program will be utilized in conducting federal level investigations.

REPLY TO:

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COMMITTEES:

CHAIR: REVENUE & TAXATION 3  
ELECTIONS, REAPPORTIONMENT  
& CONSTITUTIONAL AMENDMENTS  
GOVERNMENTAL ORGANIZAT  
HEALTH:  
LABOR & EMPLOYMENT

# Assembly California Legislature

JOHAN KLEHS

ASSEMBLYMAN, FOURTEENTH DISTRICT

## Statement By Assemblyman Johan Klehs For the California Anti-Drug Superfund Bill August 24, 1989

I am introducing this milestone drug crackdown legislation with the Attorney General because drug abuse and drug crime are a plague in the county I represent.

Last year, drug-related murders increased 20% in Alameda County.

Arrests for possession and sale of heroin and cocaine in Alameda County have skyrocketed by 72% in the last two years, according to the county district attorney's office.

The district attorney also estimates that 75% of all adult court cases, and over 80% of all juvenile cases, are drug-related.

And over 40% of admissions to the county's emergency mental health wards are due to cocaine abuse.

In my county, and throughout California, drugs are out of control.

Of the \$200 million a year program this proposal will establish, \$8.7 million a year will go to help Alameda County -- with \$5.2 million for local law enforcement to combat drug- and gang-related crime. The rest will be used for local drug abuse prevention, treatment, and prosecution, including programs to deal with drug problems in schools.

Our legislation finances a massive -- and desperately needed -- anti-drug effort with a creative new mechanism.

It combines tax equity with crime fighting.

It produces urgently needed revenue for a vital cause by closing tax loopholes that create unintended windfalls for big corporations.

We propose to enact the same legislation for California that President Reagan signed into law at the federal level in 1987. Ronald Reagan closed a number of business and corporate tax loopholes. They allowed businesses to avoid income taxes by using certain preferential accounting rules.

Forty-one states followed the federal example. California permitted these tax loopholes to remain.

Now it's time to correct the inequity.

This state taxes individuals much more than it taxes corporations. Banks and corporations are contributing a much smaller part of overall revenues today than they were 20 years ago.

For example, in 1968, banks and corporations paid 16.2% of general fund tax revenues; individual taxpayers paid 26.8%.

In 1988, banks and corporations paid 13.8% of general fund tax revenues; individual taxpayers paid 37.4%.

In addition, a preliminary study by the accounting firm of Price Waterhouse shows that California's tax conformity legislation of 1987 inadvertently provided banks and corporations a windfall this year of approximately \$224 million.

We propose modifying accounting rules in three major areas: installment sales, accrual of vacation pay, and long-term contracts.

In summary, we propose to simplify tax calculations for businesses by adopting the same rules that were approved by Congress and President Reagan for federal tax purposes.

Passing this legislation is an important step the Legislature and Governor can take to stem the tide of drugs in Alameda County and throughout California.

#####

ASSEMBLY BILL 30 (KLEHS):

CALIFORNIA ANTI-DRUG SUPERFUND

I. Expenditures:

**Anti-Drug Superfund Account:** All revenues collected pursuant to AB 30 shall be deposited into a Superfund account. Those revenues are estimated at \$355 million for fiscal year 1989-90, \$391 million in 1990-91, and \$262 million in 1991-92, declining to approximately \$137 million per year thereafter. (see Attachment)

**Disbursement of Funds:** For each of the next eight fiscal years, the Controller shall disburse \$222 million out of the Superfund account according to the distribution formula below. Since the law will be in effect only for the second half of fiscal year 1989-90, the Controller will disburse only \$111 million for the first fiscal year.

**Distribution Formula:** The Controller shall distribute to the Attorney General's Office \$22 million a year to fund state and local "CrackDown" Task Forces in Northern and Southern California. The remaining \$200 million will be split into two parts. Sixty percent, or \$120 million, will go directly to police and sheriff's departments on a per capita basis, based on the population of each department's service area. The remaining 40 percent, or \$80 million, will go to county Boards of Supervisors.

**Purposes for Which Superfund Money May Be Spent:** Police and sheriff's departments may spend Superfund money for drug and gang enforcement or prevention efforts. County Boards of Supervisors may spend Superfund money for drug treatment, prevention or prosecution. The Superfund monies shall not be used to supplant existing revenues. These monies will supplement local efforts. Except for these restrictions, the best use of the funds will be left to the discretion of local law enforcement and Boards of Supervisors.

**Sunset Clause:** At the end of eight years, the Superfund will sunset unless it is reapproved by the Legislature and the voters. The revenues flowing into the fund will revert to the General Fund at that point. The Legislature is required to study and evaluate the effectiveness of the program before it can be submitted to the people for extension beyond the sunset date.

II. Funding Source

**Adoption of Federal Tax Rules:** The California Anti-Drug Superfund program is funded by the elimination of a number of loopholes which exist in current state bank and corporation tax law. These loopholes were removed from federal tax law by Congress and by the President in 1987. By adopting these rules, state tax policy becomes consistent with existing federal tax law.

**Provisions:** Certain provisions in current state law allow businesses to defer taxes by recognizing expenses early and income late. The tax portion of this bill modifies accounting rules for three major items -- installment sales, accrual of vacation pay, long-term contracts -- so that income and expenses will be recognized more evenly over time. All of these changes will make state law the same as federal law, while removing a tax shelter from business taxpayers. Specifically, the provisions of this bill are as follows:

- a) Reserve For Vacation Pay Accrual. (\$142 mil., 1989-90) Restricts the deduction allowed for additions to a reserve for vacation pay. Under this restriction, the vacation pay deduction cannot exceed the amount of vacation pay that is: (1) paid to employees during the current tax year; or (2) vested by the end of the year and paid within 2-1/2 months after the end of the accounting year.
- b) Installment Sales. (\$105 mil., 1989-90) Repeals the installment method for dealers in real property and generally repeals the proportionate disallowance rule. Dealer sales of nonfarm real property used in a taxpayer's trade or business, or property held for rental income with a selling price above \$150,000 are: (1) charged interest on the tax deferred to the extent that deferred payments from the dispositions of this property exceed \$5 million in that year; (2) subject to income tax on loans used as collateral for installment payments due to the dealer; and (3) allowed to use the installment method to compute the alternative minimum taxable income. Allows use of installment sales method of accounting only for dealers in farm property, residential lots and time-share rights or interests.
- c) Long-Term Contracts. (\$68 mil., 1989-90) Requires that income from long-term contracts be reported 90% by the percentage of completion method and 10% by another accounting method, usually the completed contract method. Current law only requires 40% use of the percentage of completion method of reporting income.
- d) Dividend Exclusion. (\$12 mil., 1989-90) Restricts the "dividends-received" deduction based on the percent of the paying corporation that is owned by the receiving corporation. Current state law allows a 100% deduction for all dividends paid out of California taxable income from one corporation to another, regardless of the affiliation between the corporations.

- e) Corporate Capital Losses Deduction. (\$9 mil., 1989-90) Restricts the deduction of corporate capital losses. Corporate capital losses may only offset capital gains income; excess losses may be carried forward for five years. Under current state law, losses on the sale of capital assets may offset ordinary income, as well as capital gains income.
- f) Past Service Pension Costs. (\$7 mil., 1989-90) Adds past service pension costs to the list of costs which must be capitalized. Current pension costs must be capitalized under existing law.
- g) Mirror Subsidiaries. (\$5 mil., 1989-90) Redefines corporate reorganization provisions to prevent tax avoidance through use of "mirror subsidiaries."
- h) Conversion From C to S Corporation -- Recapture of LIFO Inventory Benefits. (\$5 mil., 1989-90) Expands the amount of gain on sale of inventories which must be taxed when a C corporation elects Subchapter S status. LIFO (last-in, first-out inventory) benefits become subject to taxation if inventories are sold within 10 years of the conversion from C corporation to S corporation status.
- i) Publicly Traded Partnerships. (\$1 mil., 1989-90) Treats publicly traded partnerships (generally mutual funds) as corporations for tax purposes. This treatment is designed to prevent PTPs from being treated as tax shelters. Also, taxes an exempt organization's income from a noncorporate PTP as unrelated business income.
- j) Limit On Cash Method For Large Family Farms. (\$1 mil., 1989-90) Requires family farm corporations with gross income greater than \$25 million to use the accrual method of accounting.

**Rationale for Adopting Federal Rules:** First, corporations should not be given special tax treatment. Businesses should be required to pay the taxes they lawfully owe, on time. The state should not allow the use of accounting methods whose only purpose is to defer or avoid payment of taxes.

Second, keeping a separate set of rules from the federal government makes California's tax system needlessly complex. Because California did not adopt the 1987 federal rule changes, businesses must keep two sets of books, one for state taxes and one for federal taxes. Individuals spend hours of time keeping separate records because California law is different. These differences should be removed so that tax preparation can be kept as simple as possible.

AB 30 (Klehs):

California Anti-Drug Superfund

ATTACHMENT

**Expenditures:**  
(per year)

CrackDown Program:	\$ 22 million
Police and Sheriffs: drug and gang law enforcement, drug prevention:	120 million
Boards of Supervisors: drug treatment, prevention, prosecution:	<u>80 million</u>
<b>Total Annual Superfund Expenditures:</b>	<b>\$222 million</b>

**Funding Sources:**  
(\$ Millions)

	<u>1989-90</u>	<u>1990-91</u>	<u>1991-92</u>	<u>Ongoing</u>
o. Vacation Pay	\$142	\$171	\$ 78	\$ 34
o. Installment Sales	105	95	63	10
o. Long-term Contracts	68	74	62	29
o. Dividends Received Deduction	12	14	15	17
o. Corporate Capital Losses	9	10	11	13
o. Past Service Pensions	7	8	8	3
o. Mirror Subsidiaries	5	11	17	18
o. LIFO Inventory Recapture	5	5	5	8
o. Publicly Traded Partnerships	1	2	2	3
o. Large Family Farms	1	1	1	2
<b>Total Revenue Gains:</b>	<b>\$355</b>	<b>\$391</b>	<b>\$262</b>	<b>\$137</b>

# Van de Kamp Proposes Raising Business Taxes to Battle Drugs

By Robert B. Gunnison  
Chronicle Sacramento Bureau

## Sacramento

Attorney General John Van de Kamp proposed yesterday that business taxes be raised by \$1.7 billion during the next eight years to combat an invasion of drug dealers in California.

"Only by combining new state resources with whatever help the federal government finally provides, can we begin to cleanse California of the poisons that are destroying our children and corrupting the very soul of our society," declared Van de Kamp.

"Our state is the No. 1 target of Colombian drug cartels," he said as he unveiled plans for an "anti-drug superfund."

Van de Kamp, who is seeking the Democratic nomination for governor next year, said that state business tax laws should be changed to conform to federal laws signed by Republican President Ronald Reagan to raise the money needed to pay for more narcotics officers, drug education and treatment and prosecutions.

"This is a closure of tax loopholes, pure and simple," the attorney general said at a Capitol press con-



JOHN VAN DE KAMP  
His 'anti-drug superfund'

ference. When reporters pressed on whether that meant a tax increase, he said, "You can call it whatever you want."

Van de Kamp's plan will be contained in a bill by Assemblyman Johan Klehs, D-San Leandro, which is pending in the Assembly.

The major money-raising aspects of the bill would make state law conform to federal statutes af-

fecting deductions enjoyed by businesses for vacation pay reserves, installment sales of real estate, long-term contract income and dividend exclusions.

Some of those elements were supported by Governor Deukmejian last year when the state faced a \$1 billion revenue shortage because a new tax law provided far less money than Deukmejian expected.

But yesterday, the Deukmejian administration had no kind words for the Van de Kamp plan. "The governor doesn't support increasing revenue for new state programs," said the Deukmejian's press secretary, Kevin Brett.

The California Chamber of Commerce, the chief business lobby in Sacramento, objected to the plan, too. "We'll do everything we can to oppose it," said Fred Main, the chamber's tax specialist.

If enacted, the bill would raise \$355 million in the current fiscal year and a total of \$1.7 billion during the next eight years.

Of the new revenue, \$22 million a year would pay for special anti-drug task forces to work with local and federal law enforcement in a way similar to an effort in south Florida.

# 'Loopholes' Targeted in Drug War

## Van de Kamp Seeks \$1.7 Billion From Business Tax Breaks

By RICHARD C. PADDOCK,  
*Times Staff Writer*

SACRAMENTO—Atty. Gen. John K. Van de Kamp called Thursday for closing "corporate tax loopholes" to raise \$1.7 billion to pay for a crackdown on drug dealers and help addicts kick their habits.

The Democratic gubernatorial hopeful shied away from calling his proposal a tax increase, preferring instead to use the euphemism, "revenue enhancement."

"It's a revenue enhancement, there's no question about that," Van de Kamp said testily when asked if his proposal amounted to a tax increase. "It increases revenues for the state. You can call it whatever you want."

Describing California as "the No. 1 target for the Colombian drug cartels," the attorney general said his eight-year program could put more than 2,000 police officers on the street and expand drug treatment programs throughout the state.

The money would be raised by closing "loopholes" in the state's corporate tax laws that allow businesses to keep an average of \$222 million a year, Van de Kamp said.

At a Capitol press conference, Van de Kamp repeatedly invoked the name of former Republican

**■ The L.A. CONNECTION**  
Indictments in Upstate New York point to Los Angeles as the nation's leading cocaine distribution center. Metro, Page 3

President Ronald Reagan, who signed legislation eliminating similar tax exemptions as one small part of the massive federal tax overhaul of 1986.

"He was willing to do it. Why shouldn't I?" the Democrat asked.

Van de Kamp's idea drew a frosty response from the governor he hopes to succeed. A spokesman for Gov. George Deukmejian said the Republican chief executive would veto the measure if it reached his desk because it would raise taxes.

"It appears to be a tax increase on business without any offsetting tax reductions," said Kevin Brett, Deukmejian's press secretary. "The governor does not support real or perceived tax increases without a vote of the people."

But Brett acknowledged that Van de Kamp's tax proposal is identical to part of a "revenue enhancement" plan Deukmejian himself offered last year to make up for a drop in state tax receipts. The governor angrily withdrew his proposal after it was branded a tax

increase.

Altogether, Van de Kamp proposed eliminating 10 tax breaks for business, including the deferral of taxes on vacation pay, installment sales and income from long-term contracts.

The money raised would go into the "California Anti-Drug Superfund," which would be devoted to the expansion of anti-drug activities. Among the programs funded would be expansion of local law enforcement, prosecution of drug cases, drug education and addict-treatment programs.

Under the attorney general's plan, the drug provision will be amended into a bill carried by Johan Klehs (D-Castro Valley)—now stalled on the Assembly floor—that would eliminate the 10 tax breaks for business.

"Assemblyman Klehs and I are proposing legislation that will prove to the drug lords and the gangs and the pushers that Californians mean what they say: This state is deadly serious about winning the war on drugs," Van de Kamp said.

Klehs acknowledged that business leaders are opposed to the bill, which would result in a first-year tax increase of \$355 million. "The business community would prefer to have \$355 million in new loopholes created for them," Klehs said.

AMENDED IN ASSEMBLY SEPTEMBER 5, 1989

AMENDED IN ASSEMBLY MAY 16, 1989

AMENDED IN ASSEMBLY APRIL 11, 1989

CALIFORNIA LEGISLATURE—1989-90 REGULAR SESSION

**ASSEMBLY BILL**

**No. 30**

*Introduced by Assembly Member Klehs Members Klehs, Eastin, Hauser, Hayden, O'Connell, and Maxine Waters*

December 5, 1988

An act to amend Sections 17560, 17561, 23456, 23732, 23735, 23802, 24402, 24412, 24422.3, 24457, 24513, 24533, 24591, 24652, 24667, 24673.2, 24681, 24692, 24701, and 24990.5 of, to add Sections 17008.5, 17064, 17279, 17563, 17564, 17738, 23038.5, and 24604 to, to repeal and add Section 24685 of, and to repeal Sections 23733, 24274, 24702, 24703, 24704, 24705, 24706, and 24707 of, the Revenue and Taxation Code, relating to taxation, to take effect immediately, tax levy. An act to add and repeal Article 7.7 (commencing with Section 16419) of Chapter 2 of Part 2 of Division 2 of Title 2 of the Government Code, to amend Sections 17062, 17560, 17561, 17563, 17564, 23456, 23732, 23735, 23802, 24402, 24422.3, 24457, 24533, 24601, 24652, 24667, 24673.2, 24681, 24692, and 24990.5 of, to add Sections 17008.5 and 23038.5 to, to repeal and add Section 24685 of, and to repeal Sections 17094, 17279, and 24274 of, the Revenue and Taxation Code, relating to substance abuse, making an appropriation therefor, and declaring the urgency thereof, to take effect immediately.

LEGISLATIVE COUNSEL'S DIGEST

AB 30, as amended, Klehs. ~~Income~~ Substance abuse: income taxes: bank and corporation taxes.

The Revenue Act of 1987 (P.L. 100-203) and the Technical

and Miscellaneous Revenue Act of 1988 (P.L. 100-647) made numerous changes in the federal income tax laws, including, among other things, substantive, clarifying, or nonsubstantive technical changes relating to certain publicly traded partnerships treated as corporations, minimum tax, capitalization and inclusion in inventory costs of certain expenses, amortization of past service pension costs, *recapture of LIFO benefits*, change in method of accounting, *repeal of the proportionate disallowance rule, the percentage of items taken into account under the completed contract method*, installment method, repeal of the reserve for accrual of vacation pay, *qualified mortgage interest*, long-term contracts, treatment of publicly traded partnerships for unrelated business tax, treatment of certain partnership allocations, *unrelated business taxable income*, unrelated debt-financed income, "S" corporations, dividends received deduction, *treatment of mirror subsidiary transactions, effective dates for recognition of gain and loss on distributions of property in liquidation, redemption through use of related corporations*, installment sales, certain farm corporations required to use accrual method of accounting, *special rules for dealers, LIFO inventories*, and capital loss carrybacks.

This bill would provide specified conformity under the Personal Income Tax Law and the Bank and Corporation Tax Law to those federal changes.

This bill would also make technical and clarifying supplemental changes to the Personal Income Tax Law and the Bank and Corporation Tax Law.

*This bill would create the California Anti-drug Superfund in the State Treasury. All money raised by the bill would be transferred to that fund and would be appropriated to the Controller for allocation to the Department of Justice and cities and counties for anti-drug abuse programs, as provided.*

This bill would ~~take effect immediately~~ as a tax levy not become operative unless AB 802 of the 1989-90 Regular Session is chaptered before this bill.

*This bill would declare that it is to take effect immediately as an urgency statute.*

Vote:  $\frac{2}{3}$ . Appropriation: ~~no~~ yes. Fiscal committee: yes. State-mandated local program: no.

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

1 SECTION 1. Section 17098.5 is added to the Revenue

2 SECTION 1. The Legislature finds and declares the  
3 following:

4 (a) Increased state and federal law enforcement  
5 efforts within the State of Florida have resulted in a shift  
6 in the pattern of importing Columbian cocaine into the  
7 United States from the State of Florida to the State of  
8 California.

9 (b) Federal authorities estimate that over 50 percent  
10 of the nation's cocaine is funneled through Los Angeles,  
11 the nation's new cocaine capital.

12 (c) Cocaine-related deaths in California increased by  
13 270 percent between 1981 and 1986.

14 (d) Over 8 percent of unborn babies in California are  
15 exposed to "crack" cocaine.

16 (e) California taxpayers will spend \$500 million to \$1  
17 billion this year in hospital costs for treating drug-exposed  
18 infants.

19 (f) The federal government has been unable to stop  
20 the flow of cocaine into this country, thereby leaving  
21 California's state and local law enforcement authorities  
22 with the more difficult task of apprehending  
23 international drug traffickers after they have brought  
24 their cocaine into California and disbursed it throughout  
25 the communities and neighborhoods of this state.

26 (g) Over 40 percent of California students have  
27 experimented with drugs by the time they reach the 11th  
28 grade.

29 (h) In order to combat the menace of drug abuse and  
30 drug-related crime and its ravaging effects upon the  
31 citizens of California, the Legislature hereby enacts the  
32 California Anti-drug Superfund Act of 1989.

33 SEC. 1.2. Article 7.7 (commencing with Section  
34 16419) is added to Chapter 2 of Part 2 of Division 2 of Title  
35 2 of the Government Code, to read:

1 Article 7.7. California Anti-drug Superfund

2  
3 16419. The California Anti-drug Superfund is hereby  
4 created in the State Treasury.

5 16419.1. (a) (1) The Controller shall transfer from  
6 the Bank and Corporation Tax Fund to the California  
7 Anti-drug Superfund an amount equal to ninety-three  
8 million dollars (\$93,000,000) on January 1, 1990, four  
9 hundred sixteen million dollars (\$416,000,000) on July 1,  
10 1990, and three hundred seventy-five million dollars  
11 (\$375,000,000) on January 1, 1992.

12 (2) The Controller shall transfer from the Personal  
13 Income Tax Fund to the California Anti-drug Superfund  
14 an amount equal to three million dollars (\$3,000,000) on  
15 January 1, 1990, nineteen million dollars (\$19,000,000) on  
16 July 1, 1990, and sixteen million dollars (\$16,000,000) on  
17 January 1, 1992.

18 (b) (1) For each fiscal year commencing on or after  
19 July 1, 1992, the Franchise Tax Board shall make an  
20 estimate of the amount of additional revenues that will be  
21 generated in that fiscal year by the act adding this article.  
22 This estimate shall be transmitted to the Controller prior  
23 to the commencement of the fiscal year to which it  
24 relates.

25 (2) On July 1, 1992, and on July 1 of each subsequent  
26 fiscal year, the Controller shall transfer from the Bank  
27 and Corporation Tax Fund and the Personal Income Tax  
28 Fund to the California Anti-drug Superfund an amount  
29 equal to the amount determined under paragraph (1) as  
30 additional revenues for that fiscal year.

31 16419.2. Notwithstanding Section 13340, all money in  
32 the California Anti-drug Superfund is hereby  
33 continuously appropriated without regard to fiscal years  
34 to the Controller for allocation as follows:

35 (a) To the Department of Justice to implement the  
36 Crack Down Task Force Program specified in Chapter  
37 \_\_\_\_\_ of the Statutes of 1989 (SB 1661) as follows:

38 (1) Twenty-two million dollars (\$22,000,000) on July 1,  
39 1990, and twenty-two million dollars (\$22,000,000) on July  
40 1 of each subsequent year.

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1 (b) To all county sheriffs' departments and city police  
 2 departments in this state, to be used only for law  
 3 enforcement and prevention activities related to the  
 4 abuse of controlled substances, as determined to be  
 5 necessary by the sheriffs or chiefs of police of those  
 6 counties or cities, as follows:

7 (1) Fifty-seven million dollars (\$57,000,000) on  
 8 January 1, 1990.

9 (2) One hundred twenty million dollars (\$120,000,000)  
 10 on July 1, 1990, and one hundred twenty million dollars  
 11 (\$120,000,000) on July 1 of each year thereafter.

12 (3) All funds specified in this subdivision shall be  
 13 distributed equally to all county sheriffs' departments  
 14 and city police departments based upon the most recent  
 15 estimates of the population of those counties and cities as  
 16 determined by the Department of Finance. For this  
 17 purpose, the estimate of the population of counties shall  
 18 not include the population of cities therein that will  
 19 receive funds under this subdivision.

20 (c) To all county boards of supervisors in this state, to  
 21 be used only for controlled substance treatment and  
 22 prevention programs (including treatment and  
 23 prevention in schools), enhancement of probation  
 24 supervision of offenders with drug-related problems, and  
 25 prosecution of controlled substance offenses as  
 26 determined to be necessary by those county boards of  
 27 supervisors, as follows:

28 (1) Thirty-eight million dollars (\$38,000,000) on  
 29 January 1, 1990.

30 (2) Eighty million dollars (\$80,000,000) on July 1, 1990,  
 31 and eighty million dollars (\$80,000,000) on July 1 of each  
 32 year thereafter.

33 (3) All funds specified in this subdivision shall be  
 34 distributed equally to all county boards of supervisors  
 35 based upon the most recent estimates of the population  
 36 of the counties as determined by the Department of  
 37 Finance.

38 (d) To the Controller and the Franchise Tax Board in  
 39 an amount equal to their costs incurred in connection  
 40 with their duties under this article.

44

1 (e) The funds provided under this article shall not  
2 supplant existing funds for substance abuse programs.

3 16419.3. (a) On January 1, 1992, and on January 1 of  
4 each year thereafter, all county sheriff's departments,  
5 city police departments, and county boards of supervisors  
6 which received funds in the immediately preceding fiscal  
7 year under this article shall provide a report to the  
8 Auditor General disclosing how those funds were  
9 expended.

10 (b) Based on the reports provided under subdivision  
11 (a), and any other relevant information, the Auditor  
12 General shall make a determination as to whether the  
13 funds received under this article were expended for  
14 proper purposes or whether those funds supplanted  
15 other funds for substance abuse programs. On or before  
16 June 1, 1992, and on or before June 1 of each subsequent  
17 year, the Auditor General shall report its findings to the  
18 Legislature and the Controller.

19 (c) Based upon the report submitted under  
20 subdivision (b), for years beginning on or after July 1,  
21 1992, the Controller shall not provide any funds pursuant  
22 to this article to those county sheriff's departments, city  
23 police departments, or county boards of supervisors  
24 which, in the preceding year, used funds provided under  
25 this article to supplant other funds for substance abuse  
26 purposes, or otherwise did not use the funds for the  
27 purposes of this article.

28 16419.4. The Senate Select Committee on Substance  
29 Abuse shall evaluate the California Anti-drug Superfund  
30 program provided by this article and make a report of  
31 that evaluation to the Legislature before January 1, 1997.  
32 The report shall include, among other things, the  
33 following:

34 (a) An accounting of how the funds were expended by  
35 local law enforcement agencies and county boards of  
36 supervisors.

37 (b) The effect of the program on controlled  
38 substance-related arrests, criminal activity, and  
39 prosecutions.

40 (c) The effect of the program on controlled substance

1 *abuse and treatment.*

2 *16419.5. This article shall remain in effect only until*  
3 *December 31, 1997, and as of that date is repealed.*

4 *SEC. 1.5. Section 17008.5 is added to the Revenue and*  
5 *Taxation Code, to read:*

6 *17008.5. (a) The provisions of Section 7704 of the*  
7 *Internal Revenue Code, relating to certain publicly*  
8 *traded partnerships treated as corporations, shall apply to*  
9 *taxable years beginning on or after January 1, 1989 1990,*  
10 *except that Section 10211(c) (2) of Public Law 100-203*  
11 *shall apply.*

12 *(b) The amendments to Section 7704 of the Internal*  
13 *Revenue Code made by Section 2004 of Public Law*  
14 *100-647, relating to certain publicly traded partnerships*  
15 *treated as corporations, shall apply to taxable years*  
16 *beginning on or after January 1, 1989 1990.*

17 *SEC. 2. Section 17064 is added to the Revenue and*  
18 *Taxation Code, to read:*

19 *17064. The amendments to Section 56(a) (6) of the*  
20 *Internal Revenue Code by Section 10202(d) of Public*  
21 *Law 100/203, relating to minimum tax, shall apply to*  
22 *taxable years beginning on or after January 1, 1989.*

23 *SEC. 3. Section 17279 is added to the Revenue and*  
24 *Taxation Code, to read:*

25 *17279. (a) For purposes of applying the provisions of*  
26 *Section 263A of the Internal Revenue Code, relating to*  
27 *capitalization and inclusion in inventory costs of certain*  
28 *expenses, the provisions of Section 10204 of Public Law*  
29 *100/203, relating to amortization of past service pension*  
30 *costs, shall apply to taxable years beginning on or after*  
31 *January 1, 1989.*

32 *(b) The provisions of Section 10204(b) (2) (B) of*  
33 *Public Law 100/203, relating to change in method of*  
34 *accounting, are modified to provide that any adjustments*  
35 *required by Section 481 of the Internal Revenue Code*  
36 *shall be included in gross income as follows:*

37 *(1) Twenty-five percent in the first taxable year*  
38 *beginning on or after January 1, 1989.*

39 *(2) Twenty-five percent in the second taxable year*  
40 *beginning on or after January 1, 1989.*

- (2) Fifty percent in the third taxable year beginning or after January 1, 1980.
- REG. 4. Section 17560 of the Revenue and Taxation Code is amended to read:
7560. (a) For taxable years beginning in 1987 and 8.
- 1) At the election of the taxpayer, the provisions of Section 452G of the Internal Revenue Code, relating to joint indebtedness treated as payment on installment obligations, shall not be applicable.
- 2) If an election is not made under paragraph (1), for purposes of applying the provisions of Section G of the Internal Revenue Code, relating to certain indebtedness treated as a payment on installment obligations, the provisions of Sections 811(e)(2), (e)(4), 811(e)(6), and 811(e)(7) of Public Law 99/514, modified by Section 1008 (F) of Public Law 100/647, shall apply.
- 3) The provisions of Section 812 of Public Law 99/514, relating to disallowance of use of installment method for joint obligations, as modified by Section 1008 (G) of the Law 100/647, shall apply to taxable years beginning after January 1, 1987.
- 4) The repeal of Section 452G of the Internal Revenue Code by Section 10202(a) of Public Law 100, relating to repeal of the proportionate allowance of the installment method, shall apply to sections on or after January 1, 1989, in taxable years ending on or after January 1, 1989.
- 5) (1) The amendments to Section 452 of the Internal Revenue Code by Section 10202(b) of Public Law 100/203, relating to repeal of the installment method dealers in property, shall apply to taxable years ending on or after January 1, 1989.
- 6) The amendments to Section 453 of the Internal Revenue Code by Section 2004 of Public Law 100/647, relating to the installment method, shall apply to taxable years beginning on or after January 1, 1989.
- 7) In the case of any installment obligation to which on 453(d)(2)(B) of the Internal Revenue Code.

1 applies, in lieu of the provisions of Section 453(1)(3)(A)  
2 of the Internal Revenue Code, the tax imposed under  
3 Section 17041 or 17048 for any taxable year for which  
4 payment is received on that obligation shall be increased  
5 by the amount of interest determined in the manner  
6 provided under Section 453(1)(3)(B) of the Internal  
7 Revenue Code.

8 (4) The provisions of Section 10202(e)(2) of Public  
9 Law 100/203, relating to special rules for dealers, shall  
10 apply to taxable years beginning on or after January 1,  
11 1989, and are modified to provide that any adjustments  
12 required by Section 481 of the Internal Revenue Code  
13 shall be included in gross income as follows:

14 (A) Twenty-five percent in the first taxable year  
15 beginning on or after January 1, 1989.

16 (B) Twenty-five percent in the second taxable year  
17 beginning on or after January 1, 1989.

18 (C) Fifty percent in the third taxable year beginning  
19 on or after January 1, 1989.

20 (d) (1) The amendments to Section 453A of the  
21 Internal Revenue Code made by Section 10202(e) of  
22 Public Law 100/203, relating to treatment of installment  
23 obligations of nondealers, shall apply to taxable years  
24 beginning on or after January 1, 1989.

25 (2) The amendments to Section 453A of the Internal  
26 Revenue Code made by Section 2004 of Public Law  
27 100/647, relating to special rules for nondealers, and  
28 Section 5076 of Public Law 100/647, relating to interest  
29 charges on installment sales of certain property, shall  
30 apply to taxable years beginning on or after January 1,  
31 1989.

32 (3) In the case of any installment obligation to which  
33 Section 453A of the Internal Revenue Code applies and  
34 which is outstanding as of the close of the taxable year, in  
35 lieu of the provisions of Section 453A(e)(1) of the  
36 Internal Revenue Code, the tax imposed under Section  
37 17041 or 17048 for the taxable year shall be increased by  
38 the amount of interest determined in the manner  
39 provided under Section 453A(e)(2) of the Internal  
40 Revenue Code.

4) The provisions of Section 453A(e)(3)(B) of the Internal Revenue Code, relating to the maximum rate used in calculating the deferred tax liability, are modified to refer to the maximum rate of tax imposed under Section 17041, in lieu of the maximum rate of tax imposed under Section 1 of the Internal Revenue Code.

5) The provisions of Section 10202(e)(3) of Public Law 100/203, relating to special rule for nondealers, shall only apply to taxable years beginning on or after January 1, 1989.

6) The provisions of Section 6031 of Public Law 100/647, relating to certain repledges permitted, shall only apply to taxable years beginning on or after January 1, 1989.

*SEC. 2. Section 17062 of the Revenue and Taxation Code, as amended by Assembly Bill 802 of the 1989-90 Regular Session, is amended to read:*

17062. (a) In addition to the other taxes imposed by this part, there is hereby imposed for each taxable year, a tax equal to the excess, if any, of—

- 1) The tentative minimum tax for the taxable year,
  - or
  - 2) The regular tax for the taxable year.
- b) For purposes of this chapter, each of the following shall apply:

1) The tentative minimum tax shall be computed in accordance with Sections 55 to 59, inclusive, of the Internal Revenue Code, except as otherwise provided in this part.

2) The regular tax shall be the amount of tax imposed under Section 17041 or 17048, reduced by credits for taxes to other states allowed by Chapter 12 (commencing with Section 18001).

3) (A) The provisions of Section 55(b)(1) of the Internal Revenue Code shall be modified to provide that the tentative minimum tax for the taxable year shall be equal to 7 percent of so much of the alternative minimum taxable income for the taxable year as exceeds the exemption amount, reduced by the alternative credit for taxes paid to other states as allowed by Chapter 12.

1 (commencing with Section 18001).

2 (B) In the case of a nonresident or part-year resident,  
3 the tentative minimum tax shall be computed as if the  
4 nonresident or part-year resident were a resident for the  
5 entire year multiplied by the ratio of California adjusted  
6 gross income (as modified for purposes of this chapter)  
7 to total adjusted gross income from all sources (as  
8 modified for purposes of this chapter). For purposes of  
9 computing the tax under subparagraph (A) and gross  
10 income from all sources, the net operating loss deduction  
11 provided in Section 56(d) of the Internal Revenue Code  
12 shall be computed as if the taxpayer were a resident for  
13 all prior years.

14 (C) For purposes of this section, the term "California  
15 adjusted gross income" includes each of the following:

16 (i) For any period during which the taxpayer was a  
17 resident of this state (as defined by Section 17014), all  
18 items of adjusted gross income (as modified for purposes  
19 of this chapter), regardless of source.

20 (ii) For any period during which the taxpayer was not  
21 a resident of this state, only those items of adjusted gross  
22 income (as modified for purposes of this chapter) which  
23 were derived from sources within this state, determined  
24 in accordance with Chapter 11 (commencing with  
25 Section 17951).

26 (4) (A) If there was a deferral of preference tax under  
27 former Section 17064.8 for any taxable year beginning  
28 before January 1, 1987, and the amount of the deferred  
29 tax has not been paid for any taxable year beginning  
30 before January 1, 1987, the amount of the net operating  
31 loss carryovers which may be carried to taxable years  
32 beginning after December 31, 1986, for purposes of this  
33 chapter, shall be reduced by the amount of the tax  
34 preferences attributable to the deferred tax which has  
35 not been paid.

36 (B) In the case of a net operating loss allowed to be  
37 carried forward under subdivision (d) of Section 17276,  
38 subparagraph (A) shall apply to the extent that such a loss  
39 would have resulted in a deferred tax under prior law.

40 (5) The provisions of Section 57(a)(5) of the Internal

1 Revenue Code, relating to tax-exempt interest shall not  
2 be applicable.

3 (6) The provisions of Section 59(a) of the Internal  
4 Revenue Code, relating to the alternative minimum tax  
5 foreign tax credit, shall not be applicable.

6 (7) Section 56(b)(1)(E) of the Internal Revenue  
7 Code, relating to standard deduction and deduction for  
8 personal exemptions not allowed, is modified, for  
9 purposes of this part, to deny the standard deduction  
10 allowed by Section 17073.5.

11 ~~(e) The amendments to Section 56(a)(6) of the~~  
12 ~~Internal Revenue Code made by Section 10202(d) of~~  
13 ~~Public Law 100/203, relating to minimum tax, shall not~~  
14 ~~apply.~~

15 *SEC. 3. Section 17094 of the Revenue and Taxation*  
16 *Code, as added by Assembly Bill 802, is repealed.*

17 ~~17094. The provisions of Section 81 of the Internal~~  
18 ~~Revenue Code, relating to increases in vacation pay~~  
19 ~~suspense account, shall apply as amended by Public Law~~  
20 ~~99/514.~~

21 *SEC. 4. Section 17279 of the Revenue and Taxation*  
22 *Code, as added by Assembly Bill 802 of the 1989-90*  
23 *Regular Session, is repealed.*

24 ~~17279. The provisions of Section 10204 of Public Law~~  
25 ~~100/203, relating to amortization of past service pension~~  
26 ~~costs, shall not apply.~~

27 *SEC. 5. Section 17560 of the Revenue and Taxation*  
28 *Code, as amended by Assembly Bill 802 of the 1989-90*  
29 *Regular Session, is amended to read:*

30 17560. (a) At the election of the taxpayer, the  
31 provisions of Section 453C of the Internal Revenue Code,  
32 relating to certain indebtedness treated as payment on  
33 installment obligations, shall not be applicable.

34 (b) (1) If an election is not made under subdivision  
35 (a), then for purposes of applying the provisions of  
36 Section 453C of the Internal Revenue Code, relating to  
37 certain indebtedness treated as a payment on installment  
38 obligations, the provisions of Sections 811(c)(2),  
39 811(c)(4), 811(c)(6), and 811(c)(7) of Public Law 99-514,  
40 as modified by Section 1008(f) of Public Law 100-647,

1 shall apply.

2 (2) The provisions of Section 812 of Public Law 99-514,  
3 relating to the disallowance of use of installment method  
4 for certain obligations as modified by Section 1008(g) of  
5 Public Law 100-647, shall apply to taxable years beginning  
6 on or after January 1, 1987.

7 ~~(e) The amendments to Sections 453, 453A, and 453C~~  
8 ~~made by Section 10202 of Public Law 100-203, relating to~~  
9 ~~installment sales, shall not apply.~~

10 ~~(d) The amendments to Sections 453, 453A, and 453C~~  
11 ~~made by Public Law 100-647, relating to installment~~  
12 ~~sales, shall not apply.~~

13 (c) The repeal of Section 453C of the Internal  
14 Revenue Code by Section 10202(a) of Public Law  
15 100-203, relating to repeal of the proportionate  
16 disallowance of the installment method, shall apply to  
17 dispositions in taxable years beginning on or after January  
18 1, 1990.

19 (d) (1) The amendments to Section 453 of the  
20 Internal Revenue Code by Section 2004 of Public Law  
21 100-647, relating to the installment method, shall apply to  
22 taxable years beginning on or after January 1, 1990.

23 (2) In the case of any installment obligation to which  
24 Section 453(l)(2)(B) of the Internal Revenue Code  
25 applies, in lieu of the provisions of Section 453(l)(3)(A)  
26 of the Internal Revenue Code, the tax imposed under  
27 Section 17041 or 17048 for any taxable year for which  
28 payment is received on that obligation shall be increased  
29 by the amount of interest determined in the manner  
30 provided under Section 453(l)(3)(B) of the Internal  
31 Revenue Code.

32 (3) The provisions of Section 10202(e)(2) and  
33 10204(b)(2)(B) of Public Law 100-203, relating to change  
34 in method of accounting, are modified to provide that  
35 any adjustments required by Section 481 of the Internal  
36 Revenue Code shall be included in gross income as  
37 follows:

38 (A) Fifty percent in the first taxable year beginning on  
39 or after January 1, 1990.

40 (B) Fifty percent in the second taxable year beginning

1 on or after January 1, 1990.

2 (e) (1) The amendments to Section 453A of the  
3 Internal Revenue Code made by Section 2004 of Public  
4 Law 100-647, relating to special rules for nondealers, shall  
5 apply to taxable years beginning on or after January 1,  
6 1990.

7 (2) In the case of any installment obligation to which  
8 Section 453A of the Internal Revenue Code applies and  
9 which is outstanding as of the close of the taxable year, in  
10 lieu of the provisions of Section 453A(c)(1) of the  
11 Internal Revenue Code, the tax imposed under Section  
12 17041 or 17048 for any taxable year shall be increased by  
13 the amount of interest determined in the manner  
14 provided under Section 453A(c)(2) of the Internal  
15 Revenue Code.

16 (3) The provisions of Section 453A(c)(3)(B) of the  
17 Internal Revenue Code, relating to the maximum rate  
18 used in calculating the deferred tax liability, are modified  
19 to refer to the maximum rate of tax imposed under  
20 Section 17041 in lieu of the maximum rate of tax imposed  
21 under Section 1 or 11 of the Internal Revenue Code.

22 ~~SEC. 5.~~

23 **SEC. 6.** Section 17561 of the Revenue and Taxation  
24 Code is amended to read:

25 17561. (a) For purposes of this part, the provisions of  
26 Section 469(d)(2) of the Internal Revenue Code, relating  
27 to passive activity credits, are modified to refer to the  
28 following credits:

29 (1) The credit for research expenses allowed by  
30 Section 17052.12.

31 (2) The credit for certain wages paid (targeted jobs)  
32 allowed by Section 17053.7.

33 (3) The credit for clinical testing expenses allowed by  
34 Section 17057.

35 (4) The credit for low-income housing allowed by  
36 Section 17058.

37 (b) For purposes of applying the provisions of Section  
38 469(i) of the Internal Revenue Code, relating to the  
39 twenty-five thousand dollars (\$25,000) offset for rental  
40 real estate activities:

1 (1) The dollar limitation for the credit allowed under  
2 Section 17058 (relating to low-income housing) shall be  
3 equal to seventy-five thousand dollars (\$75,000) in lieu of  
4 the amount specified in Section 469 (i) (2) of the Internal  
5 Revenue Code.

6 (2) The term "adjusted gross income," as defined in  
7 Section 469 (i) (3) (D), shall mean the amount required to  
8 be shown as adjusted gross income on the federal tax  
9 return for the same taxable year determined without  
10 regard to—

11 (A) Any amount includable in gross income on the  
12 federal tax return under Section 86 of the Internal  
13 Revenue Code.

14 (B) Any amount allowed as a deduction on the federal  
15 tax return under Section 219 of the Internal Revenue  
16 Code.

17 (C) Any passive activity loss.

18 (c) Section 502 of the Tax Reform Act of 1986 (Public  
19 Law 99-514) shall apply.

20 (d) For taxable years beginning on or after January 1,  
21 1987, the provisions of Section 10212 of Public Law  
22 100-203, relating to treatment of publicly traded  
23 partnerships under Section 469 of the Internal Revenue  
24 Code, shall be applicable.

25 (e) The amendments to Section 469(k) of the Internal  
26 Revenue Code made by Section 2004 of Public Law  
27 100-647, relating to separate application of section in case  
28 of publicly traded partnerships, shall apply to taxable  
29 years beginning on or after January 1, 1989.

30 SEC. 6. Section 17563 is added to the Revenue and  
31 Taxation Code, to read:

32 17563. (a) The provisions of Sections 10201(a) and  
33 10201(b) of Public Law 100/203, relating to repeal of the  
34 reserve for accrual of vacation pay, shall be applicable to  
35 taxable years beginning on or after January 1, 1989,  
36 except as otherwise provided.

37 (b) In the case of any taxpayer who elected to have  
38 Section 463 of the Internal Revenue Code of 1986 apply  
39 for that taxpayer's last taxable year beginning prior to  
40 January 1, 1989, and who is required to change his or her

1 method of accounting by reason of the amendments  
2 made by the net adding this section, each of the following  
3 shall apply.

4 (1) The change shall be treated as initiated by the  
5 taxpayer;

6 (2) The change shall be treated as having been made  
7 with the consent of the Franchise Tax Board; and

8 (3) The net amount of adjustments required by  
9 Chapter 6 (commencing with Section 17551) to be taken  
10 into account by the taxpayer.

11 (A) Shall be reduced by the balance in the suspense  
12 account, under Section 463(e) of the Internal Revenue  
13 Code as of the close of the last taxable year beginning  
14 before January 1, 1989, and

15 (B) Shall be taken into account over the three taxable  
16 year period beginning with the taxable year following  
17 that last taxable year, as follows:  
18

19			
20	In the case of the:	The percentage to be	
21	1st Year	taken into account is:	
22	2nd Year		30
23	3rd Year		35
24			35

25 (e) Notwithstanding subparagraph (B) of paragraph  
26 (3) of subdivision (b), if the period during which the  
27 adjustments are required to be taken into account under  
28 Chapter 6 (commencing with Section 17551) is less than  
29 three years, those adjustments shall be taken into account  
30 ratably over the shorter period.

31 SEC. 7. Section 17564 is added to the Revenue and  
32 Taxation Code, to read:

33 17564. (a) Long-term contracts shall be accounted  
34 for in accordance with the special rules set forth in  
35 Section 460 of the Internal Revenue Code.

36 (1) The provisions of Section 804(d) of Public Law  
37 99/514, relating to the effective date of modifications in  
38 the method of accounting for long-term contracts, shall  
39 be applicable to taxable years beginning on or after  
40 January 1, 1987.

1     (2) In the case of a contract entered into after  
2 February 28, 1986, during a taxable year beginning before  
3 January 1, 1987, an adjustment to income shall be made  
4 upon completion of the contract, if necessary, to correct  
5 any underreporting or overreporting of income, for  
6 purposes of this part, resulting from differences between  
7 state and federal law for the taxable year in which the  
8 contract began.

9     (b) (1) The amendments to Section 460 of the  
10 Internal Revenue Code made by Section 10203 of Public  
11 Law 100/203, relating to a reduction in the percentage of  
12 items taken into account under the completed contract  
13 method, shall be applicable to taxable years beginning on  
14 or after January 1, 1989.

15     (2) The provisions of Section 10203(b) of Public Law  
16 100/203, relating to the effective date of a reduction in the  
17 percentage of items taken into account under the  
18 completed contract method, shall be applicable to  
19 taxable years beginning on or after January 1, 1989.

20     (3) In the case of a contract entered into after October  
21 13, 1987, during a taxable year beginning before January  
22 1, 1989, an adjustment to income shall be made upon  
23 completion of the contract, if necessary, to correct any  
24 underreporting or overreporting of income, for purposes  
25 of this part, resulting from differences between state and  
26 federal law for taxable years beginning prior to January  
27 1, 1989.

28     (e) (1) The amendments to Section 460 of the  
29 Internal Revenue Code made by Section 5041 of Public  
30 Law 100/647, relating to a reduction in the percentage of  
31 items taken into account under the completed contract  
32 method, shall be applicable to taxable years beginning on  
33 or after January 1, 1989.

34     (2) The provisions of Section 5041(e) of Public Law  
35 100/647, relating to the effective date of a reduction in the  
36 percentage of items taken into account under the  
37 completed contract method, shall be applicable to  
38 taxable years beginning on or after January 1, 1989.

39     (3) In the case of a contract entered into after June 20,  
40 1988, during a taxable year beginning before January 1,

1 1989, an adjustment to income shall be made upon  
 2 completion of the contract, if necessary, to correct any  
 3 underreporting or overreporting of income, for purposes  
 4 of this part, resulting from differences between state and  
 5 federal law for taxable years beginning prior to January  
 6 1, 1989.

7 (d) For purposes of applying the provisions of Section  
 8 460 of the Internal Revenue Code, relating to special  
 9 rules for long-term contracts, the provisions of Section  
 10 10201 of Public Law 100/203, relating to amortization of  
 11 past service pension costs, shall apply to costs incurred  
 12 after December 31, 1988, in taxable years ending after  
 13 that date.

14 SEC. 8. Section 17738 is added to the Revenue and  
 15 Taxation Code, to read:

16 17738. The amendments to Section 691 of the Internal  
 17 Revenue Code made by Section 10202 of Public Law  
 18 100/203, relating to installment sales, shall apply to taxable  
 19 years beginning on or after January 1, 1990.

20 SEC. 7. Section 17563 of the Revenue and Taxation  
 21 Code, as added by Assembly Bill 802 of the 1989-90  
 22 Regular Session, is amended to read:

23 17563. The repeal of Section 463 of the Internal  
 24 Revenue Code by Section 10201 of Public Law 100/203,  
 25 relating to accrual of vacation pay, shall not apply. (a) In  
 26 the case of any taxpayer who elected to have Section 463  
 27 of the Internal Revenue Code of 1986 apply for that  
 28 taxpayer's last taxable year beginning prior to January 1,  
 29 1990, and who is required to change his or her method of  
 30 accounting by reason of the amendments made by the act  
 31 adding this provision, each of the following shall apply:

32 (1) The change shall be treated as initiated by the  
 33 taxpayer.

34 (2) The change shall be treated as having been made  
 35 with the consent of the Franchise Tax Board.

36 (3) The net amount of adjustments required by  
 37 Chapter 6 (commencing with Section 17551) to be taken  
 38 into account by the taxpayer:

39 (A) Shall be reduced by the balance in the suspense  
 40 account, under Section 463(c) of the Internal Revenue

1 Code as of the close of the last taxable year beginning  
 2 before January 1, 1990, and  
 3 (B) Shall be taken into account over the three taxable  
 4 year period beginning with the taxable year following  
 5 that last taxable year, as follows:

6		
7		The percentage to be
8	In the case of the:	taken into account is:
9	1st Year	50
10	2nd Year	50

11  
 12 (b) Notwithstanding subparagraph (B) of paragraph  
 13 (3) of subdivision (a), if the period during which the  
 14 adjustments are required to be taken into account under  
 15 Chapter 6 (commencing with Section 17551) is less than  
 16 three years, those adjustments shall be taken into account  
 17 ratably over the shorter period.

18 SEC. 8. Section 17564 of the Revenue and Taxation  
 19 Code, as added by Assembly Bill 802 of the 1989-90  
 20 Regular Session, is amended to read:

21 17564. (a) Long-term contracts shall be accounted  
 22 for in accordance with the special rules set forth in  
 23 Section 460 of the Internal Revenue Code.

24 (b) (1) The provisions of Section 804(d) of Public  
 25 Law 99-514, relating to the effective date of modifications  
 26 in the method of accounting for long-term contracts, shall  
 27 be applicable to taxable years beginning on or after  
 28 January 1, 1987.

29 (2) In the case of a contract entered into after  
 30 February 28, 1986, during a taxable year beginning before  
 31 January 1, 1987, an adjustment to income shall be made  
 32 upon completion of the contract, if necessary, to correct  
 33 any underreporting or overreporting of income, for  
 34 purposes of this part, resulting from differences between  
 35 state and federal law for the taxable year in which the  
 36 contract began.

37 (c) The amendments to Section 460 of the Internal  
 38 Revenue Code made by Section 10203 of Public Law  
 39 100/203, relating to a reduction in the percentage of items  
 40 taken into account under the completed contract

1 method, shall not apply.

2 (d) The amendments to Section 460 of the Internal  
3 Revenue Code made by Section 5041 of Public Law  
4 100-647, relating to a reduction in the percentage of items  
5 taken into account under the completed contract  
6 method, shall not apply.

7 (c) In the case of a contract entered into after October  
8 13, 1987, during a taxable year beginning before January  
9 1, 1990, an adjustment to income shall be made upon  
10 completion of the contract, if necessary, to correct any  
11 underreporting or overreporting of income, for purposes  
12 of this part, resulting from differences between state and  
13 federal law for taxable years beginning prior to January  
14 1, 1990.

15 (d) In the case of a contract entered into after June 20,  
16 1988, during a taxable year beginning before January 1,  
17 1990, an adjustment to income shall be made upon  
18 completion of the contract, if necessary, to correct any  
19 underreporting or overreporting of income, for purposes  
20 of this part, resulting from differences between state and  
21 federal law for taxable years beginning prior to January  
22 1, 1990.

23 (e) For purposes of applying Section 460(a) (2) of the  
24 Internal Revenue Code, relating to 90 percent look-back  
25 method, any adjustment to income computed under  
26 subdivision (b), (c), or (d) shall be deemed to have been  
27 reported in the taxable year from which the adjustment  
28 arose, rather than the taxable year in which the contract  
29 was completed.

30 SEC. 9. Section 23038.5 is added to the Revenue and  
31 Taxation Code, to read:

32 23038.5. (a) The provisions of Section 7704 of the  
33 Internal Revenue Code, relating to certain publicly  
34 traded partnerships treated as corporations, shall apply to  
35 income years beginning on or after January 1, 1989 1990,  
36 except that Section 10211(c) (2) of Public Law 100-203  
37 shall apply.

38 (b) The amendments to Section 7704 of the Internal  
39 Revenue Code made by Section 2004 of Public Law  
40 100-647, relating to certain publicly traded partnerships

1 treated as corporations, shall apply to income years  
2 beginning on or after January 1, 1989 1990.

3 SEC. 10. Section 23456 of the Revenue and Taxation  
4 Code is amended to read:

5 23456. For purposes of this part, the provisions of  
6 Section 56 of the Internal Revenue Code are modified as  
7 follows:

8 (a) (1) Section 56(a)(2) of the Internal Revenue  
9 Code, relating to mining exploration and development  
10 costs, shall apply only to expenses incurred during  
11 income years beginning on or after January 1, 1988.

12 (2) Section 56(a)(5) of the Internal Revenue Code,  
13 relating to pollution control facilities, shall apply only to  
14 amounts allowable as a deduction under Section 24372.3.

15 (b) Section 56(e)(2) of the Internal Revenue Code,  
16 relating to Merchant Marine Capital Construction Funds,  
17 shall not be applicable.

18 (c) (1) For purposes of applying the provisions of  
19 Section 56(d) of the Internal Revenue Code, all  
20 references to "December 31, 1986," are modified to read  
21 "December 31, 1987," and all references to "January 1,  
22 1987," are modified to read "January 1, 1988."

23 (2) (A) If there was a deferral of preference tax under  
24 former Section 23405 for any income year beginning  
25 before January 1, 1988, and the amount of the deferred  
26 tax has not been paid for any income year beginning  
27 before January 1, 1988, the amount of the net operating  
28 loss carryovers which may be carried to income years  
29 beginning after December 31, 1987, for purposes of this  
30 chapter, shall be reduced by the amount of the tax  
31 preferences attributable to the deferred tax which has  
32 not been paid.

33 (B) In the case of a net operating loss allowed to be  
34 carried forward under subdivision (c) of Section 24416,  
35 subparagraph (A) shall apply to the extent that such a loss  
36 would have resulted in a deferred tax under prior law.

37 (d) (1) Section 56(f)(2)(B), relating to adjustments  
38 for certain taxes, is modified to read: The amount  
39 determined under subparagraph (A) shall be  
40 appropriately adjusted to disregard any tax on or

1 measured by income.

2 ~~(2)~~ The last sentence of Section 56(A)(2)(B), relating  
3 to taxes imposed by a foreign country or possession, shall  
4 not be applicable.

5 ~~(3)~~ Section 56(A)(2)(C)(i) of the Internal Revenue  
6 Code, relating to consolidated returns, is modified to  
7 substitute "combined report" for "consolidated return."

8 ~~(4)~~ Section 56(A)(2)(C)(ii) of the Internal Revenue  
9 Code, relating to treatment of dividends of related  
10 corporations, is modified to read: Adjusted net book  
11 income shall take into account only those dividends for  
12 portions thereof which have been included in net  
13 income for purposes of determining the regular tax.

14 ~~(5)~~ Section 56(A)(2)(F) of the Internal Revenue  
15 Code, relating to treatment of dividends from Section 936  
16 corporations, shall not be applicable.

17 ~~(6)~~ Section 56(A)(2)(G) of the Internal Revenue  
18 Code, relating to rules for Alaska native corporations,  
19 shall not be applicable.

20 ~~(7)~~ With respect to corporations which are not subject  
21 to the tax imposed under Chapter 2 (commencing with  
22 Section 93101), the amount of interest income included  
23 in book income shall not exceed the amount of interest  
24 income included for purposes of the regular tax.

25 ~~(9)~~ Appropriate adjustments shall be made to limit  
26 deductions from book income for interest expense in  
27 accordance with the provisions of Sections 242K4 and  
28 242K5.

29 ~~(e)~~ The provisions of Section 56(g)(1)(A) of the  
30 Internal Revenue Code shall be modified to provide that  
31 in the case of any property placed in service on or after  
32 January 1, 1991, and prior to January 1, 1997, and not  
33 described in clause (i), (ii), or (iii) of Section  
34 56(g)(1)(A) of the Internal Revenue Code, the amount  
35 allowable as depreciation or amortization with respect to  
36 that property shall be the same amount that would have  
37 been allowable for the same year had the taxpayer  
38 depreciated the property under the straight-line method  
39 for each income year of the useful life (determined  
40 without regard to Section 242K4.2 or 242K1) for which the

1 taxpayer has held the property.

2     ~~(A)~~ ~~Section 56(g)(4)(C)~~ of the Internal Revenue  
3 Code, relating to disallowance of items not deductible in  
4 computing earnings and profits, shall be modified as  
5 follows:

6     ~~(A)~~ A deduction shall be allowed for amounts  
7 allowable as a deduction for purposes of the regular tax  
8 under Sections 24302, 24410, 24411, and 25106.

9     ~~(B)~~ Section 56(g)(4)(C)(ii) of the Internal Revenue  
10 Code, relating to special rule for 100 percent dividends,  
11 shall not be applicable.

12     ~~(C)~~ Section 56(g)(4)(C)(iii) of the Internal Revenue  
13 Code, relating to special rule for dividends from Section  
14 986 companies, shall not be applicable.

15     ~~(2)~~ With respect to corporations which are not subject  
16 to the tax imposed under Chapter 2 (commencing with  
17 Section 23101), the amount of interest income included  
18 in the adjusted current earnings shall not exceed the  
19 amount of interest income included for purposes of the  
20 regular tax:

21     ~~(3)~~ Appropriate adjustments shall be made to limit  
22 deductions from adjusted current earnings for interest  
23 expense in accordance with the provisions of Sections  
24 24344 and 24425.

25     ~~(g)~~ The amendments to Section 56(a)(6) of the  
26 Internal Revenue Code by Section 10202(d) of Public  
27 Law 100/202, relating to minimum tax, shall apply to  
28 taxable years beginning on or after January 1, 1989.

29     ~~SEC. 11.~~ Section 22732 of the Revenue and Taxation  
30 Code is amended to read:

31     22732. The provisions of Section 512 of the Internal  
32 Revenue Code, relating to unrelated business taxable  
33 income, shall be applicable, except as otherwise  
34 provided.

35     ~~(a)~~ Section 512(a)(2) of the Internal Revenue Code,  
36 relating to special rules for foreign organizations, shall  
37 not be applicable.

38     ~~(b)~~ Section 512(a)(3) of the Internal Revenue Code,  
39 relating to special rules applicable to certain  
40 organizations, shall be modified as follows:

1 (4) The reference to Section 501(c)(7) of the Internal  
2 Revenue Code, relating to clubs organized for pleasure,  
3 recreation, and other nonprofitable purposes, shall be  
4 modified to refer to Section 22701g.

5 (2) The reference to Section 501(c)(9) of the Internal  
6 Revenue Code, relating to voluntary employees'  
7 beneficiary associations, shall be modified to refer to  
8 Section 22701i.

9 (3) The reference to Section 501(c)(17) of the  
10 Internal Revenue Code, relating to trusts providing for  
11 payment of supplemental unemployment compensation  
12 benefits, shall be modified to refer to Section 22701n.

13 (4) The reference to Section 501(c)(20) of the  
14 Internal Revenue Code, relating to qualified group legal  
15 services plans, shall be modified to refer to Section  
16 22701q.

17 (c) Section 512(b)(10) of the Internal Revenue Code,  
18 relating to charitable contributions, shall be modified to  
19 provide that such deductions shall not exceed 5 percent  
20 of the unrelated business taxable income, rather than 10  
21 percent.

22 (d) The provisions of Section 10213 of Public Law  
23 100/203, relating to treatment of publicly traded  
24 partnerships for unrelated business tax, shall apply to  
25 income years beginning on or after January 1, 1989, for  
26 partnership interests acquired after December 17, 1987.  
27 SEC. 12. Section 22733 of the Revenue and Taxation  
28 Code is repealed.

29 SEC. 13. Section 22735 of the Revenue and Taxation  
30 Code is amended to read:

31 22735. (a) The provisions of Section 514 of the  
32 Internal Revenue Code, relating to unrelated  
33 debt/financed income, shall be applicable, except as  
34 otherwise provided.

35 (b) The provisions of Section 10214 of Public Law  
36 100/203, relating to treatment of certain partnership  
37 allocations, shall apply to income years beginning on or  
38 after January 1, 1989, for property acquired by the  
39 partnership after October 13, 1987, and partnership  
40 interests acquired after October 13, 1987.

1 SEC. 14. Section 23802 of the Revenue and Taxation  
2 Code is amended to read:

3 23802. (a) Section 1363(a) of the Internal Revenue  
4 Code, relating to the taxability of an S corporation, shall  
5 not be applicable.

6 (b) Corporations qualifying under this chapter shall  
7 continue to be subject to the taxes imposed under  
8 Chapter 3 (commencing with Section 23101) and  
9 Chapter 3 (commencing with Section 23501), except as  
10 follows.

11 (1) The tax imposed under Section 23151 or 23501 shall  
12 be imposed at a rate of 2 1/2 percent rather than the rate  
13 specified in those sections.

14 (2) In the case of an "S corporation" which is also a  
15 financial corporation, the rate of tax specified in  
16 paragraph (1) shall be increased by the excess of the rate  
17 imposed under Section 23183 over the rate imposed  
18 under Section 23151 and Section 23184 shall be applicable.

19 (3) An "S corporation" shall not be subject to the  
20 alternative minimum tax (or preference tax) imposed  
21 under Section 23400.

22 (c) An "S corporation" shall be subject to the  
23 minimum tax imposed under Section 23152.

24 (d) (1) For purposes of subdivision (b), an "S  
25 corporation" shall be allowed a deduction under Section  
26 2416 (relating to net operating loss deductions), but only  
27 with respect to losses incurred during periods in which  
28 the corporation had in effect a valid election to be treated  
29 as an "S corporation" for purposes of this part.

30 (2) Section 1371(b) of the Internal Revenue Code,  
31 relating to denial of carryovers between "C years" and "S  
32 years", shall apply for purposes of the tax imposed under  
33 subdivision (b), except as provided in paragraph (1) of  
34 this subdivision.

35 (3) The provisions of this subdivision shall not affect  
36 the amount of any item of income or loss computed in  
37 accordance with the provisions of Section 1366 of the  
38 Internal Revenue Code, relating to pass/thru items to  
39 shareholders.

40 (4) For purposes of subdivision (b) of Section 17276,

1 relating to limitations on loss carryovers, losses passed  
2 through to shareholders of an "S corporation," to the  
3 extent otherwise allowable without application of that  
4 subdivision, shall be fully included in the net operating  
5 loss of that shareholder and then that subdivision shall be  
6 applied to the entire net operating loss.

7 (e) For purposes of computing the taxes specified in  
8 subdivision (b), an "S corporation" shall be allowed a  
9 deduction from income for built/in gains and passive  
10 investment income for which a tax has been imposed  
11 under this part in accordance with the provisions of  
12 Section 1374 of the Internal Revenue Code, relating to tax  
13 imposed on certain built/in gains, or Section 1375 of the  
14 Internal Revenue Code, relating to tax imposed on  
15 passive investment income.

16 (f) For purposes of computing taxes imposed under  
17 this part, as provided in subdivision (b) -

18 (1) An "S corporation" shall compute its deductions  
19 for amortization and depreciation in accordance with the  
20 provisions of Part 10 (commencing with Section 17001) of  
21 Division 2.

22 (2) The provisions of Section 465 of the Internal  
23 Revenue Code, relating to limitation of deductions to the  
24 amount at risk, shall be applied in the same manner as in  
25 the case of an individual.

26 (3) (A) The provisions of Section 469 of the Internal  
27 Revenue Code, relating to limitations on passive activity  
28 losses and credits, shall be applied in the same manner as  
29 in the case of an individual.

30 (B) For purposes of this paragraph, the "adjusted  
31 gross income" of the "S corporation" shall be equal to its  
32 "net income," as determined under Section 24311 with  
33 the modifications required by this subdivision.

34 (g) (1) The amendments to Section 1363 of the  
35 Internal Revenue Code made by Section 10227 of Public  
36 Law 100/203, relating to recapture of LIFO amount in the  
37 case of elections by S corporations, shall apply to income  
38 years beginning on or after January 1, 1989.

39 (2) The provisions of Section 10227 (b) of Public Law  
40 100/203, relating to effective dates for recapture of LIFO

1 amount in the case of elections by S corporations; shall  
2 apply to income years beginning on or after January 1,  
3 1989.

4 ~~(h)~~ The amendments to Section 1363 of the Internal  
5 Revenue Code made by Section 2004 of Public Law  
6 100/647, relating to effect of election on corporation, shall  
7 apply to income years beginning on or after January 1,  
8 1989.

9 ~~(i)~~ The provisions of Section 1363(d) of the Internal  
10 Revenue Code, relating to recapture of LIFO benefits,  
11 shall be modified for purposes of this part to refer to  
12 Section 25901a in lieu of Section 6601 of the Internal  
13 Revenue Code.

14 **SEC. 15.** Section 24274 of the Revenue and Taxation  
15 Code is repealed.

16 **SEC. 16.**

17 *SEC. 10.* Section 23456 of the Revenue and Taxation  
18 Code, as amended by Assembly Bill 802 of the 1989-90  
19 Regular Session, is amended to read:

20 23456. For purposes of this part, the provisions of  
21 Section 56 of the Internal Revenue Code are is modified  
22 as follows:

23 (a) (1) Section 56(a) (2) of the Internal Revenue  
24 Code, relating to mining exploration and development  
25 costs, shall apply only to expenses incurred during  
26 income years beginning on or after January 1, 1988.

27 (2) Section 56(a) (5) of the Internal Revenue Code,  
28 relating to pollution control facilities, shall apply only to  
29 amounts allowable as a deduction under Section 24372.3.

30 ~~(3)~~ The amendments to Section 56(a) (6) of the  
31 Internal Revenue Code made by Section 10202(d) of  
32 Public Law 100/203, relating to minimum tax, shall not  
33 apply.

34 (b) Section 56(c) (2) of the Internal Revenue Code,  
35 relating to Merchant Marine Capital Construction Funds,  
36 shall not be applicable.

37 (c) (1) For purposes of applying the provisions of  
38 Section 56(d) of the Internal Revenue Code, all  
39 references to "December 31, 1986," are modified to read  
40 "December 31, 1987," and all references to "January 1,

1 1987," are modified to read "January 1, 1988."

2 (2) (A) If there was a deferral of preference tax under  
3 former Section 23405 for any income year beginning  
4 before January 1, 1988, and the amount of the deferred  
5 tax has not been paid for any income year beginning  
6 before January 1, 1988, the amount of the net operating  
7 loss carryovers which may be carried to income years  
8 beginning after December 31, 1987, for purposes of this  
9 chapter, shall be reduced by the amount of the tax  
10 preferences attributable to the deferred tax which has  
11 not been paid.

12 (B) In the case of a net operating loss allowed to be  
13 carried forward under subdivision (e) of Section 24416,  
14 subparagraph (A) shall apply to the extent that such a loss  
15 would have resulted in a deferred tax under prior law.

16 (d) (1) Section 56(f) (2) (B) of the Internal Revenue  
17 Code, relating to adjustments for certain taxes, is  
18 modified to read: The amount determined under  
19 subparagraph (A) shall be appropriately adjusted to  
20 disregard any tax on or measured by income.

21 (2) The last sentence of Section 56(f) (2) (B) of the  
22 Internal Revenue Code, relating to taxes imposed by a  
23 foreign country or possession, shall not be applicable.

24 (3) Section 56(f) (2) (C) (i) of the Internal Revenue  
25 Code, relating to consolidated returns, is modified to  
26 substitute "combined report" for "consolidated return."

27 (4) Section 56(f) (2) (C) (ii) of the Internal Revenue  
28 Code, relating to treatment of dividends of related  
29 corporations, is modified to read: Adjusted net book  
30 income shall take into account only those dividends (or  
31 portions thereof) which have been included in net  
32 income for purposes of determining the regular tax.

33 (5) Section 56(f) (2) (F) of the Internal Revenue  
34 Code, relating to treatment of dividends from 936  
35 corporations, shall not be applicable.

36 (6) Section 56(f) (2) (G) of the Internal Revenue  
37 Code, relating to rules for Alaska native corporations,  
38 shall not be applicable.

39 (7) With respect to corporations which are not subject  
40 to the tax imposed under Chapter 2 (commencing with

1 Section 23101), the amount of interest income included  
2 in book income shall not exceed the amount of interest  
3 income included for purposes of the regular tax.

4 (8) Appropriate adjustments shall be made to limit  
5 deductions from book income for interest expense in  
6 accordance with the provisions of Sections 24344 and  
7 24425.

8 (e) ~~The provisions of Section 56(g)(4)(A) of the~~  
9 ~~Internal Revenue Code shall be~~ is modified to provide  
10 that in the case of any property placed in service on or  
11 after January 1, 1981, and prior to January 1, 1987, and not  
12 described in clause (i), (ii), or (iii) of Section  
13 56(g)(4)(A) of the Internal Revenue Code, the amount  
14 allowable as depreciation or amortization with respect to  
15 that property shall be the same amount that would have  
16 been allowable for the income year had the taxpayer  
17 depreciated the property under the straight-line method  
18 for each income year of the useful life (determined  
19 without regard to Section 24354.2 or 24381) for which the  
20 taxpayer has held the property.

21 (f) (1) Section 56(g)(4)(C) of the Internal Revenue  
22 Code, relating to disallowance of items not deductible in  
23 computing earnings and profits, shall be modified as  
24 follows:

25 (A) A deduction shall be allowed for amounts  
26 allowable as a deduction for purposes of the regular tax  
27 under Sections 24402, 24410, 24411, and 25106.

28 (B) Section 56(g)(4)(C)(ii) of the Internal Revenue  
29 Code, relating to special rule for 100 percent dividends,  
30 shall not be applicable.

31 (C) Section 56(g)(4)(C)(iii) of the Internal Revenue  
32 Code, relating to special rule for dividends from Section  
33 936 companies, shall not be applicable.

34 (2) With respect to corporations which are not subject  
35 to the tax imposed under Chapter 2 (commencing with  
36 Section 23101), the amount of interest income included  
37 in the adjusted current earnings shall not exceed the  
38 amount of interest income included for purposes of the  
39 regular tax.

40 (3) Appropriate adjustments shall be made to limit

1 deductions from adjusted current earnings for interest  
2 expense in accordance with the provisions of Sections  
3 24344 and 24425.

4 *SEC. 11. Section 23732 of the Revenue and Taxation*  
5 *Code, as amended by Assembly Bill 802 of the 1989-90*  
6 *Regular Session, is amended to read:*

7 23732. The provisions of Section 512 of the Internal  
8 Revenue Code, relating to unrelated business taxable  
9 income, shall apply as amended by Public Law 99/514,  
10 except as otherwise provided.

11 (a) Section 512(a)(2) of the Internal Revenue Code,  
12 relating to special rules for foreign organizations, shall  
13 not be applicable.

14 (b) Section 512(a)(3) of the Internal Revenue Code,  
15 relating to special rules applicable to certain  
16 organizations, shall be modified as follows:

17 (1) The reference to Section 501(c)(7) of the Internal  
18 Revenue Code, relating to clubs organized for pleasure,  
19 recreation, and other non-profitable purposes, shall be  
20 modified to refer to Section 23701g.

21 (2) The reference to Section 501(c)(9) of the Internal  
22 Revenue Code, relating to voluntary employees'  
23 beneficiary associations, shall be modified to refer to  
24 Section 23701i.

25 (3) The reference to Section 501(c)(17) of the  
26 Internal Revenue Code, relating to trusts providing for  
27 payment of supplemental unemployment compensation  
28 benefits, shall be modified to refer to Section 23701n.

29 (4) The reference to Section 501(c)(20) of the  
30 Internal Revenue Code, relating to qualified group legal  
31 services plans, shall be modified to refer to Section  
32 23701q.

33 (c) Section 512(b)(10) of the Internal Revenue Code,  
34 relating to charitable contributions, shall be modified to  
35 provide that such deductions shall not exceed 5 percent  
36 of the unrelated business taxable income, rather than 10  
37 percent.

38 *SEC. 12. Section 23735 of the Revenue and Taxation*  
39 *Code, as amended by Assembly Bill 802 of the 1989-90*  
40 *Regular Session, is amended to read:*

1 23735. (a) The provisions of Section 514 of the  
2 Internal Revenue Code, relating to unrelated  
3 debt-financed income, shall be ~~applicable~~ apply, except  
4 as otherwise provided.

5 (b) The provisions of Section 10214 of Public Law  
6 100-203, relating to the treatment of certain partnership  
7 allocations, shall ~~not~~ apply to income years beginning on  
8 or after January 1, 1990, for property acquired by the  
9 partnership after October 13, 1987, and partnership  
10 interests acquired after October 13, 1987.

11 SEC. 13. Section 23802 of the Revenue and Taxation  
12 Code, as amended by Assembly Bill 802 of the 1989-90  
13 Regular Session, is amended to read:

14 23802. (a) Section 1363(a) of the Internal Revenue  
15 Code, relating to the taxability of an S corporation, shall  
16 not be applicable.

17 (b) Corporations qualifying under this chapter shall  
18 continue to be subject to the taxes imposed under  
19 Chapter 2 (commencing with Section 23101) and  
20 Chapter 3 (commencing with Section 23501), except as  
21 follows:

22 (1) The tax imposed under Section 23151 or 23501 shall  
23 be imposed at a rate of 2½ percent rather than the rate  
24 specified in those sections.

25 (2) In the case of an "S corporation" which is also a  
26 financial corporation, the rate of tax specified in  
27 paragraph (1) shall be increased by the excess of the rate  
28 imposed under Section 23183 over the rate imposed  
29 under Section 23151 and Section 23184 shall be applicable.

30 (3) An "S corporation" shall not be subject to the  
31 alternative minimum tax (or preference tax) imposed  
32 under Section 23400.

33 (c) An "S corporation" shall be subject to the  
34 minimum tax imposed under Section 23153.

35 (d) (1) For purposes of subdivision (b), an "S  
36 corporation" shall be allowed a deduction under Section  
37 24416 (relating to net operating loss deductions), but only  
38 with respect to losses incurred during periods in which  
39 the corporation had in effect a valid election to be treated  
40 as an "S corporation" for purposes of this part.

1 (2) Section 1371(b) of the Internal Revenue Code,  
2 relating to denial of carryovers between "C years" and "S  
3 years", shall apply for purposes of the tax imposed under  
4 subdivision (b), except as provided in paragraph (1) of  
5 this subdivision.

6 (3) The provisions of this subdivision shall not affect  
7 the amount of any item of income or loss computed in  
8 accordance with the provisions of Section 1366 of the  
9 Internal Revenue Code, relating to pass-thru items to  
10 shareholders.

11 (4) For purposes of subdivision (b) of Section 17276,  
12 relating to limitations on loss carryovers, losses passed  
13 through to shareholders of an "S corporation," to the  
14 extent otherwise allowable without application of that  
15 subdivision, shall be fully included in the net operating  
16 loss of that shareholder and then that subdivision shall be  
17 applied to the entire net operating loss.

18 (e) For purposes of computing the taxes specified in  
19 subdivision (b), an "S corporation" shall be allowed a  
20 deduction from income for built-in gains and passive  
21 investment income for which a tax has been imposed  
22 under this part in accordance with the provisions of  
23 Section 1374 of the Internal Revenue Code, relating to tax  
24 imposed on certain built-in gains, or Section 1375 of the  
25 Internal Revenue Code, relating to tax imposed on  
26 passive investment income.

27 (f) For purposes of computing taxes imposed under  
28 this part, as provided in subdivision (b)—

29 (1) An "S corporation" shall compute its deductions  
30 for amortization and depreciation in accordance with the  
31 provisions of Part 10 (commencing with Section 17001) of  
32 Division 2.

33 (2) The provisions of Section 465 of the Internal  
34 Revenue Code, relating to limitation of deductions to the  
35 amount at risk, shall be applied in the same manner as in  
36 the case of an individual.

37 (3) (A) The provisions of Section 469 of the Internal  
38 Revenue Code, relating to limitations on passive activity  
39 losses and credits, shall be applied in the same manner as  
40 in the case of an individual.

1 (B) For purposes of this paragraph, the "adjusted  
2 gross income" of the "S corporation" shall be equal to its  
3 "net income," as determined under Section 24341 with  
4 the modifications required by this subdivision.

5 (g) ~~The amendments to Section 1363 of the Internal~~  
6 ~~Revenue Code made by Section 10227 of Public Law~~  
7 ~~100/203, relating to recapture of LIFO amount in the case~~  
8 ~~of elections by S corporations, shall not apply. The~~  
9 ~~amendments to Section 1363 of the Internal Revenue~~  
10 ~~Code made by Section 2004 of Public Law 100-647,~~  
11 ~~relating to effect of election on corporation, shall apply to~~  
12 ~~income years beginning on or after January 1, 1990.~~

13 (h) *The provisions of Section 1363(d) of the Internal*  
14 *Revenue Code, relating to recapture of LIFO benefits,*  
15 *shall be modified for purposes of this part to refer to*  
16 *Section 25901a in lieu of Section 6601 of the Internal*  
17 *Revenue Code.*

18 *SEC. 14. Section 24274 of the Revenue and Taxation*  
19 *Code, as amended by Assembly Bill 802 of the 1989-90*  
20 *Regular Session, is repealed.*

21 ~~24274. The provisions of Section 81 of the Internal~~  
22 ~~Revenue Code, relating to increases in vacation pay~~  
23 ~~suspense account, shall apply as amended by Public Law~~  
24 ~~99/514.~~

25 *SEC. 15. Section 24402 of the Revenue and Taxation*  
26 *Code is amended to read:*

27 24402. (a) A portion of the dividends received  
28 during the income year declared from income which has  
29 been included in the measure of the taxes imposed under  
30 Chapter 2 (commencing with Section 23101), Chapter 2.5  
31 (commencing with Section 23400), or Chapter 3  
32 (commencing with Section 23501) upon the taxpayer  
33 declaring the dividends.

34 (b) The portion of dividends which may be deducted  
35 under this section shall be as follows:

36 (1) In the case of any dividend described in  
37 subdivision (a), received from a "more than 50 percent  
38 owned corporation," 100 percent.

39 (2) In the case of any dividend described in  
40 subdivision (a), received from a "20 percent owned

1 corporation," 80 percent.

2 (3) In the case of any dividend described in  
3 subdivision (a), received from a bank or corporation  
4 which is less than 20 percent owned, 70 percent.

5 (c) For purposes of this section:

6 (1) The term "more than 50 percent owned  
7 corporation" means any bank or corporation if more than  
8 50 percent of the stock of that bank or corporation (by  
9 vote and value) is owned by the taxpayer. For purposes  
10 of the preceding sentence, stock described in Section  
11 1504(a)(4) of the Internal Revenue Code shall not be  
12 taken into account.

13 (2) The term "20 percent owned corporation" means  
14 any bank or corporation if 20 percent or more of the stock  
15 of that bank or corporation (by vote and value) is owned  
16 by the taxpayer. For purposes of the preceding sentence,  
17 stock described in Section 1504(a)(4) of the Internal  
18 Revenue Code shall not be taken into account.

19 ~~SEC. 17. Section 24412 of the Revenue and Taxation~~  
20 ~~Code is amended to read:~~

21 ~~24412. Sections 851 to 855, inclusive, and 860 of the~~  
22 ~~Internal Revenue Code, relating to regulated investment~~  
23 ~~companies, shall be applicable for purposes of this~~  
24 ~~chapter, except that—~~

25 ~~(a) Section 852(b)(1) of the Internal Revenue Code,~~  
26 ~~relating to imposition of tax on regulated investment~~  
27 ~~companies, shall not apply.~~

28 ~~(b) Section 852(b)(2)(D) of the Internal Revenue~~  
29 ~~Code, relating to investment company taxable income, is~~  
30 ~~modified to allow a deduction, determined in accordance~~  
31 ~~with Section 852(b)(5), relating to exempt interest~~  
32 ~~dividends, to the extent that such interest is included in~~  
33 ~~gross income under this part.~~

34 ~~(c) Section 852(b)(3)(A) of the Internal Revenue~~  
35 ~~Code, relating to capital gains, shall not apply.~~

36 ~~(d) Section 852(b)(5)(B) of the Internal Revenue~~  
37 ~~Code, relating to treatment of exempt interest dividends~~  
38 ~~by shareholders, shall not apply.~~

39 ~~(e) The amendments to Section 854 of the Internal~~  
40 ~~Revenue Code made by Section 10221 of Public Law~~

3

1 100/202; relating to reduction in dividends received;  
2 deduction for dividends from corporations not  
3 20/percent owned, shall apply to income years beginning  
4 on or after January 1, 1989.

5 SEC. 18. Section 24422.3 of the Revenue and Taxation  
6 Code is amended to read:

7 24422.3. (a) Capitalization and inclusion in inventory,  
8 costs of certain expenses shall be determined in  
9 accordance with Section 2652A of the Internal Revenue  
10 Code.

11 (b) (1) For purposes of applying the provisions of  
12 Section 263A of the Internal Revenue Code, relating to  
13 capitalization and inclusion in inventory of certain  
14 expenses, the provisions of Section 10204 of Public Law  
15 100/202, relating to amortization of past service pension  
16 costs, shall apply to income years beginning on or after  
17 January 1, 1989.

18 (2) The provisions of Section 10204(b)(2)(B) of  
19 Public Law 100/202, relating to change in method of  
20 accounting, are modified to provide that any adjustments  
21 required by Section 481 of the Internal Revenue Code  
22 shall be included in gross income as follows:

23 (A) Twenty/five percent in the first income year  
24 beginning on or after January 1, 1989.

25 (B) Twenty/five percent in the second income year  
26 beginning on or after January 1, 1989.

27 (C) Fifty percent in the third income year beginning  
28 on or after January 1, 1989.

29 (e) The provisions of Section 6026(d)(2)(B) of Public  
30 Law 100/647, relating to revocation of election, shall  
31 apply.

32 SEC. 19. Section 24457 of the Revenue and Taxation  
33 Code is amended to read:

34 24457. (a) Section 304 of the Internal Revenue Code,  
35 relating to redemption through the use of related  
36 corporations, shall be applicable, except as otherwise  
37 provided.

38 (b) For purposes of applying the provisions of Section  
39 304(b)(4) of the Internal Revenue Code, the term  
40 "affiliated group" means a controlled group within the

1 meaning of Section 24564.

2 ~~(c) (1)~~ Except as provided in paragraph ~~(2)~~, the  
3 amendments to Section 304 of the Internal Revenue  
4 Code by Section 10223 of Public Law 100/203, relating to  
5 treatment of mirror subsidiary transactions, shall apply to  
6 income years beginning on or after January 1, 1989, for  
7 distributions or transfers after December 15, 1987.

8 ~~(2)~~ The provisions of Section 10223(d)(2) of Public  
9 Law 100/203, relating to exceptions for the effective date  
10 of treatment of mirror subsidiary transactions, shall apply  
11 to income years beginning on or after January 1, 1989.

12 SEC. 20. Section 24513 of the Revenue and Taxation  
13 Code is amended to read:

14 24513. (a) For purposes of this part, the provisions of  
15 Section 633 of Public Law 99/514 shall apply, except as  
16 otherwise provided.

17 (b) The provisions of Section 633(c) of Public Law  
18 99/514, relating to other transition rules, shall not apply.

19 (c) The amendments to Section 633 of Public Law  
20 99/514 made by Sections 1006(g)(1) to 1006(g)(8),  
21 inclusive, of Public Law 100/647, relating to effective  
22 dates for recognition of gain and loss on distributions of  
23 property in liquidation, are declaratory of existing law  
24 and shall take effect as if included in Section 633 of Public  
25 Law 99/514.

26 SEC. 16. Section 24422.3 of the Revenue and Taxation  
27 Code, as amended by Assembly Bill 802 of the 1989-90  
28 Regular Session, is amended to read:

29 24422.3. (a) Capitalization and inclusion in  
30 inventory costs of certain expenses shall be determined  
31 in accordance with Section 263A of the Internal Revenue  
32 Code.

33 (b) The provisions of Section 10204 of Public Law  
34 100/203, relating to amortization of past service pension  
35 costs, shall not apply.

36 SEC. 17. Section 24457 of the Revenue and Taxation  
37 Code, as amended by Assembly Bill 802 of the 1989-90  
38 Regular Session, is amended to read:

39 24457. (a) Section 304 of the Internal Revenue Code,  
40 relating to redemption through the use of related

1 corporations, shall be applicable, except as otherwise  
2 provided.

3 (b) For purposes of applying the provisions of Section  
4 304(b)(4) of the Internal Revenue Code, the term  
5 "affiliated group" means a controlled group within the  
6 meaning of Section 24564.

7 ~~(c) The amendments to Section 304 of the Internal~~  
8 ~~Revenue Code made by Section 10223 of Public Law~~  
9 ~~100/202, relating to redemption through use of related~~  
10 ~~corporations, shall not apply.~~

11 ~~SEC. 21.~~

12 *SEC. 18.* Section 24533 of the Revenue and Taxation  
13 Code is amended to read:

14 24533. (a) Section 24532 shall apply only if either—

15 (1) The distributing corporation, and the controlled  
16 corporation (or, if stock of more than one controlled  
17 corporation is distributed, each of such corporations) is  
18 engaged immediately after the distribution in the active  
19 conduct of a trade or business; or

20 (2) Immediately before the distribution, the  
21 distributing corporation had no assets other than stock or  
22 securities in the controlled corporations and each of the  
23 controlled corporations is engaged immediately after the  
24 distribution in the active conduct of a trade or business.

25 (b) For purposes of subsection (a), a corporation shall  
26 be treated as engaged in the active conduct of a trade or  
27 business if and only if—

28 (1) It is engaged in the active conduct of a trade or  
29 business, or substantially all of its assets consist of stock  
30 and securities of a corporation controlled by it  
31 (immediately after the distribution) which is so engaged;

32 (2) Such trade or business has been actively conducted  
33 throughout the five-year period ending on the date of the  
34 distribution;

35 (3) Such trade or business was not acquired within the  
36 period described in paragraph (2) in a transaction in  
37 which gain or loss was recognized in whole or in part; and

38 (4) Control of a corporation which (at the time of  
39 acquisition of control) was conducting such trade or  
40 business—

1 (A) Was not acquired by any distributee corporation  
 2 directly (or through one or more corporations, whether  
 3 through the distributing corporation or otherwise)  
 4 within the period described in paragraph (2) and was not  
 5 acquired by the distributing corporation directly (or  
 6 through one or more corporations) within that period; or

7 (B) Was so acquired by any such corporation within  
 8 that period, but, in each case in which such control was  
 9 so acquired, it was so acquired, only by reason of  
 10 transactions in which gain or loss was not recognized in  
 11 whole or in part, or only by reason of such transactions  
 12 combined with acquisitions before the beginning of that  
 13 period.

14 (C) For purposes of this paragraph, all distributee  
 15 corporations which are members of a controlled group  
 16 (within the meaning of Section 24564) shall be treated as  
 17 one distributee corporation.

18 (c) For income years beginning on or after January 1,  
 19 1989, Section 311 of the Internal Revenue Code (as  
 20 incorporated by Section 24481) shall apply to any  
 21 distribution:

22 (1) To which this section (or so much of Sections 24535  
 23 to 24539, inclusive, as relates to this section) applies, and

24 (2) Which is not in pursuance of a plan of  
 25 reorganization, in the same manner as if the distribution  
 26 were a distribution to which Chapter 2 (commencing  
 27 with Section 23101) or Chapter 2.5 (commencing with  
 28 Section 23400) applies, except that Section 311(b) of the  
 29 Internal Revenue Code shall not apply to any distribution  
 30 of stock or securities in the controlled corporation.

31 (d) (1) Except as provided in paragraph (2), the  
 32 amendments to this section by the act adding this  
 33 subdivision shall apply to income years beginning on or  
 34 after January 1, 1989, for distributions or transfers after  
 35 December 15, 1987.

36 ~~(2) The provisions of Section 10223(d)(2) of Public~~  
 37 ~~Law 100/203, relating to exceptions for the effective date~~  
 38 ~~of treatment of mirror subsidiary transactions, shall apply~~  
 39 ~~to income years beginning on or after January 1, 1989.~~

40 SEC. 22. Section 24591 of the Revenue and Taxation

1 Code is amended to read:

2 24501. (a) Section 391 of the Internal Revenue Code,

3 relating to carryovers in certain corporate acquisitions,

4 shall apply to the acquisition of assets by another

5 corporation to the extent the corporate attributes

6 enumerated are applicable under this part.

7 (b) The amendments to Section 391 of the Internal

8 Revenue Code made by Section 10202 of Public Law

9 100/203, relating to installment sales, shall apply to

10 income years beginning on or after January 1, 1989.

11 SEC. 28. Section 24604 is added to the Revenue and

12 Taxation Code, to read:

13 24604. The amendments to Sections 404 and 419 of the

14 Internal Revenue Code made by Section 10201 of Public

15 Law 100/203, relating to repeal of the reserve for accrual

16 of vacation pay, shall apply to income years beginning on

17 or after January 1, 1989.

18 SEC. 24. Section 24652 of the Revenue and Taxation

19 Code is amended to read:

20 24652. (a) The method of accounting for

21 corporations engaged in farming shall be determined in

22 accordance with Section 447 of the Internal Revenue

23 Code.

24 (b) The provisions of Section 10205 of Public Law

25 100/203, relating to certain farm corporations required to

26 use accrual method of accounting, shall apply to income

27 years beginning on or after January 1, 1989.

28 SEC. 25. Section 24667 of the Revenue and Taxation

29 Code is amended to read:

30 24667. (a) (1) Installment sales shall be treated in

31 accordance with Sections 453, 453A, and 453B of the

32 Internal Revenue Code, except as otherwise provided.

33 (2) For purposes of applying the provisions of Section

34 453C of the Internal Revenue Code, relating to certain

35 indebtedness treated as payment on installment

36 obligations, the provisions of Sections 811(e)(2),

37 811(e)(4), 811(e)(6), and 811(e)(7) of Public Law 99/514,

38 as modified by Section 1008(f) of Public Law 100/647,

39 shall apply to income years beginning on or after January

40 1, 1989.

- 3
- 1 (2) The provisions of Section 812 of Public Law 99/514,
  - 2 relating to the disallowance of use of the installment
  - 3 method for certain obligations, as modified by Section
  - 4 1008(g) of Public Law 100/647, shall apply to income
  - 5 years beginning on or after January 1, 1988.
  - 6 (b) For purposes of subdivision (a), any references in
  - 7 the Internal Revenue Code to sections that have not been
  - 8 incorporated into this part by reference shall be deemed
  - 9 to refer to the corresponding section, if any, of this part.
  - 10 (c) In the case of any taxpayer who made sales under
  - 11 a revolving credit plan and was on the installment
  - 12 method under former Section 24667 or 24668 for the
  - 13 taxpayer's last income year beginning before January 1,
  - 14 1988, the provisions of this section shall be treated as a
  - 15 change in method of accounting for its first income year
  - 16 beginning after December 31, 1987, and all of the
  - 17 following shall apply:
  - 18 (1) That change shall be treated as initiated by the
  - 19 taxpayer.
  - 20 (2) That change shall be treated as having been made
  - 21 with the consent of the Franchise Tax Board.
  - 22 (3) The period for taking into account adjustments
  - 23 under Article 6 (commencing with Section 24721) by
  - 24 reason of that change shall not exceed four years.
  - 25 (d) The repeal of Section 452C of the Internal
  - 26 Revenue Code by Section 10202(a) of Public Law
  - 27 100/202, relating to repeal of the proportionate
  - 28 disallowance of the installment method, shall apply to
  - 29 dispositions on or after January 1, 1989, in
  - 30 beginning on or after January 1, 1989.
  - 31 (e) (1) The amendments to Section 453 of the
  - 32 Internal Revenue Code made by Section 10202(b) of
  - 33 Public Law 100/202, relating to repeal of the installment
  - 34 method for dealers in property, shall apply to income
  - 35 years beginning on or after January 1, 1989.
  - 36 (2) The amendments to Section 453 of the Internal
  - 37 Revenue Code by Section 2004 of Public Law 100/647,
  - 38 relating to the installment method, shall apply to income
  - 39 years beginning on or after January 1, 1989.
  - 40 (3) In the case of any installment obligation to which

1 Section 452(f)(2)(B) of the Internal Revenue Code  
 2 applies, in lieu of the provisions of Section 452(f)(3)(A)  
 3 of the Internal Revenue Code, the "tax" (as defined by  
 4 subdivision (a) of Section 23026) for any income year for  
 5 which payment is received on that obligation shall be  
 6 increased by the amount of interest determined in the  
 7 manner provided under Section 452(f)(3)(B) of the  
 8 Internal Revenue Code.

9 (A) The provisions of Section 10202(e)(2) of Public  
 10 Law 100/203, relating to special rules for dealers, shall  
 11 apply to income years beginning on or after January 1,  
 12 1989, and are modified to provide that any adjustments  
 13 required by Section 481 of the Internal Revenue Code  
 14 shall be included in gross income as follows:

- 15 (A) Twenty-five percent in the first income year
- 16 beginning on or after January 1, 1989.
- 17 (B) Twenty-five percent in the second income year
- 18 beginning on or after January 1, 1989.
- 19 (C) Fifty percent in the third income year beginning
- 20 on or after January 1, 1989.

21 (4) (1) The amendments to Section 452A of the  
 22 Internal Revenue Code made by Section 10202(e) of  
 23 Public Law 100/203, relating to treatment of installment  
 24 obligations of nondealers, shall apply to income years  
 25 beginning on or after January 1, 1989.

26 (2) The amendments to Section 452A of the Internal  
 27 Revenue Code made by Section 2004 of Public Law  
 28 100/647, relating to special rules for nondealers, and  
 29 Section 5076 of Public Law 100/647, relating to interest  
 30 charges on installment sales of certain property, shall  
 31 apply to income years beginning on or after January 1,  
 32 1989.

33 (3) In the case of any installment obligation to which  
 34 Section 452A of the Internal Revenue Code applies and  
 35 which is outstanding as of the close of the income year,  
 36 in lieu of the provisions of Section 452A(e)(1) of the  
 37 Internal Revenue Code, the "tax" (as defined by  
 38 subdivision (a) of Section 23026) for the income year shall  
 39 be increased by the amount of interest determined in the  
 40 manner provided under Section 452A(e)(2) of the

1 Internal Revenue Code.  
 2 (4) The provisions of Section 452A(e)(3)(B) of the  
 3 Internal Revenue Code, relating to the maximum rate  
 4 used in calculating the deferred tax liability, are modified  
 5 to refer to the maximum rate of tax imposed under  
 6 Section 23151, 23186, or 23202, whichever applies, in lieu  
 7 of the maximum rate of tax imposed under Section 11 of  
 8 the Internal Revenue Code.

9 (5) The provisions of Section 10202(e)(3) of Public  
 10 Law 100/203, relating to special rule for nondealers, shall  
 11 only apply to income years beginning on or after January  
 12 1, 1989.  
 13 (g) The provisions of Section 6021 of Public Law  
 14 100/647, relating to certain repurchases permitted, shall  
 15 apply to income years beginning on or after January 1,  
 16 1989.

17 SEC. 26. Section 24672.2 of the Revenue and Taxation  
 18 Code is amended to read:

19 24672.2. (a) Long-term contracts shall be accounted  
 20 for in accordance with the special rules set forth in  
 21 Section 460 of the Internal Revenue Code.

22 (b) (1) The provisions of Section 804(d) of Public  
 23 Law 99/514, relating to the effective date of modifications  
 24 in the method of accounting for long-term contracts, shall  
 25 be applicable to contracts entered into after February 28,  
 26 1986.

27 (2) In the case of a contract entered into after  
 28 February 28, 1986, during an income year beginning  
 29 before January 1, 1987, an adjustment to income shall be  
 30 made upon completion of the contract, if necessary, to  
 31 correct any under reporting or over reporting of income,  
 32 for purposes of this part, resulting from differences  
 33 between state and federal law for the income year in  
 34 which the contract began.

35 (c) (1) The amendments to Section 460 of the  
 36 Internal Revenue Code made by Section 10203 of Public  
 37 Law 100/203, relating to a reduction in the percentage of  
 38 items taken into account under the completed contract  
 39 method, shall be applicable to income years beginning on  
 40 or after January 1, 1989.

1 (2) The provisions of Section 10202(b) of Public Law  
 2 100/202, relating to the effective date of a reduction in the  
 3 percentage of items taken into account under the  
 4 completed contract method, shall be applicable to  
 5 income years beginning on or after January 1, 1989.  
 6 (3) In the case of a contract entered into after October  
 7 12, 1987, during an income year beginning before January  
 8 1, 1989, an adjustment to income shall be made upon  
 9 completion of the contract, if necessary, to correct any  
 10 underreporting or overreporting of income, for purposes  
 11 of this part, resulting from differences between state and  
 12 federal law for income years beginning prior to January  
 13 1, 1989.

14 (d) (1) The amendments to Section 460 of the  
 15 Internal Revenue Code made by Section 5041 of Public  
 16 Law 100/647, relating to a reduction in the percentage of  
 17 items taken into account under the completed contract  
 18 method, shall be applicable to income years beginning on  
 19 or after January 1, 1989.

20 (2) The provisions of Section 5041(e) of Public Law  
 21 100/647, relating to the effective date of a reduction in the  
 22 percentage of items taken into account under the  
 23 completed contract method, shall be applicable to  
 24 income years beginning on or after January 1, 1989.  
 25 (3) In the case of a contract entered into after June 20,  
 26 1988, during an income year beginning before January 1,  
 27 1989, an adjustment to income shall be made upon  
 28 completion of the contract, if necessary, to correct any  
 29 underreporting or overreporting of income, for purposes  
 30 of this part, resulting from differences between state and  
 31 federal law for income years beginning prior to January  
 32 1, 1989.

33 (e) For purposes of applying the provisions of Section  
 34 460 of the Internal Revenue Code, relating to special  
 35 rules for long-term contracts, the provisions of Section  
 36 10204 of Public Law 100/202, relating to amortization of  
 37 past service pension costs, shall apply to costs incurred  
 38 after December 31, 1988, in income years ending after  
 39 that date.

40 SEC. 27. Section 24681 of the Revenue and Taxation

1 Code is amended to read:

2 ~~24681.~~ (a) The provisions of Section 461 of the  
3 Internal Revenue Code, relating to the general rule for  
4 taxable year of deduction, shall be applicable.

5 (b) The amendments to Section 461 of the Internal  
6 Revenue Code made by Section 10201 of Public Law  
7 100/203, relating to repeal of the reserve for accrual of  
8 vacation pay, shall apply to income years beginning on or  
9 after January 1, 1989.

10 (2) The amendments to this section by the act adding  
11 this subdivision shall not apply to any distribution after  
12 December 15, 1987, and before January 1, 1993, if:

13 (A) Eighty percent or more of the stock of the  
14 distributing corporation was acquired by the distributee  
15 before December 15, 1987, or

16 (B) Eighty percent or more of the stock of the  
17 distributing corporation was acquired by the distributee  
18 before January 1, 1989, pursuant to a binding written  
19 contract or tender offer in effect on December 15, 1987.

20 For purposes of the preceding sentence, stock  
21 described in Section 1504(a) (4) of the Internal Revenue  
22 Code shall not be taken into account.

23 (3) (A) For purposes of paragraph (2), all corporations  
24 which were in existence on the designated date and were  
25 members of the same controlled group (as defined in  
26 Section 24564) which included the distributees on that  
27 date shall be treated as one distributee.

28 (B) Subparagraph (A) shall not exempt any  
29 distribution from the amendments made to this section  
30 by the act adding this subdivision if that distribution is  
31 with respect to stock not held by the distributee  
32 (determined without regard to subparagraph (A)) on  
33 the designated date directly or indirectly through a  
34 corporation which goes out of existence in the  
35 transaction.

36 (C) For purposes of this paragraph, the term  
37 "designated date" means the later of:

38 (i) December 15, 1987, or

39 (ii) The date on which the acquisition meeting the  
40 requirements of paragraph (2) occurred.

1 SEC. 19. Section 24601 of the Revenue and Taxation  
2 Code, as amended by Assembly Bill 802 of the 1989-90  
3 Regular Session, is amended to read:

4 24601. ~~(a)~~ The provisions of Sections 404, 404A, 406,  
5 407, 419, and 419A of the Internal Revenue Code shall  
6 apply, except as otherwise provided.

7 ~~(b)~~ The provisions of Section ~~10201~~ of Public Law  
8 ~~100/203~~, relating to accrual of vacation pay, shall not  
9 apply.

10 SEC. 20. Section 24652 of the Revenue and Taxation  
11 Code, as amended by Assembly Bill 802 of the 1989-90  
12 Regular Session, is amended to read:

13 24652. ~~(a)~~ The method of accounting for  
14 corporations engaged in farming shall be determined in  
15 accordance with Section 447 of the Internal Revenue  
16 Code.

17 ~~(b)~~ The provisions of Section ~~10205~~ of Public Law  
18 ~~100/203~~, relating to certain farm corporations required to  
19 use the accrual method of accounting, shall not apply.

20 SEC. 21. Section 24667 of the Revenue and Taxation  
21 Code, as amended by Assembly Bill 802 of the 1989-90  
22 Regular Session, is amended to read:

23 24667. (a) (1) Installment sales shall be treated in  
24 accordance with Sections 453, 453A, 453B, and 453C of the  
25 Internal Revenue Code, except as otherwise provided.

26 (2) For purposes of applying the provisions of Section  
27 453C of the Internal Revenue Code, relating to certain  
28 indebtedness treated as payment on installment  
29 obligations, the provisions of Sections 811(c)(2),  
30 811(c)(4), 811(c)(6), and 811(c)(7) of Public Law 99-514,  
31 as modified by Section 1008(f) of Public Law 100-647,  
32 shall apply to income years beginning on or after January  
33 1, 1988.

34 (3) The provisions of Section 812 of Public Law 99-514,  
35 relating to the disallowance of use of the installment  
36 method for certain obligations, as modified by Section  
37 1008(g) of Public Law 100-647, shall apply to income  
38 years beginning on or after January 1, 1988.

39 (b) For purposes of subdivision (a), any references in  
40 the Internal Revenue Code to sections that have not been.

1 incorporated into this part by reference shall be deemed  
2 to refer to the corresponding section, if any, of this part.

3 ~~(e) The amendments to Sections 453, 453A and 453C~~  
4 ~~made by Section 10202 of Public Law 100/203, relating to~~  
5 ~~installment sales, shall not apply.~~

6 ~~(d) The amendments to Sections 453, 453A and 453C~~  
7 ~~made by Public Law 100/647, relating to installment sales,~~  
8 ~~shall not apply.~~

9 (c) *In the case of any taxpayer who made sales under*  
10 *a revolving credit plan and was on the installment*  
11 *method under former Section 24667 or 24668 for the*  
12 *taxpayer's last income year beginning before January 1,*  
13 *1988, the provisions of this section shall be treated as a*  
14 *change in method of accounting for its first income year*  
15 *beginning after December 31, 1987, and all of the*  
16 *following shall apply:*

17 (1) *That change shall be treated as initiated by the*  
18 *taxpayer.*

19 (2) *That change shall be treated as having been made*  
20 *with the consent of the Franchise Tax Board.*

21 (3) *The period for taking into account adjustments*  
22 *under Article 6 (commencing with Section 24721) by*  
23 *reason of that change shall not exceed four years.*

24 (d) *The repeal of Section 453C of the Internal*  
25 *Revenue Code by Section 10202(a) of Public Law*  
26 *100-203, relating to repeal of the proportionate*  
27 *disallowance of the installment method, shall apply to*  
28 *dispositions on or after January 1, 1990.*

29 (e) (1) *The amendments to Section 453 of the*  
30 *Internal Revenue Code by Section 2004 of Public Law*  
31 *100-647, relating to the installment method, shall apply to*  
32 *income years beginning on or after January 1, 1990.*

33 (2) *In the case of any installment obligation to which*  
34 *Section 453(l) (2) (B) of the Internal Revenue Code*  
35 *applies, in lieu of the provisions of Section 453(l) (3) (A)*  
36 *of the Internal Revenue Code, the "tax" (as defined by*  
37 *subdivision (a) of Section 23036) for any income year for*  
38 *which payment is received on that obligation shall be*  
39 *increased by the amount of interest determined in the*  
40 *manner provided under Section 453(l) (3) (B) of the*

1 Internal Revenue Code.

2 (3) The provisions of Section 10202(e) (2) and  
3 10204(b) (2) (B) of Public Law 100-203, relating to change  
4 in method of accounting, are modified to provide that  
5 any adjustments required by Section 481 of the Internal  
6 Revenue Code shall be included in gross income as  
7 follows:

8 (A) Fifty percent in the first income year beginning  
9 on or after January 1, 1990.

10 (B) Fifty percent in the second income year  
11 beginning on or after January 1, 1990.

12 (f) (1) The amendments to Section 453A of the  
13 Internal Revenue Code made by Section 2004 of Public  
14 Law 100-647, relating to special rules for nondealers, shall  
15 apply to income years beginning on or after January 1,  
16 1990.

17 (2) In the case of any installment obligation to which  
18 Section 453A of the Internal Revenue Code applies and  
19 which is outstanding as of the close of the income year,  
20 in lieu of the provisions of Section 453A(c) (1) of the  
21 Internal Revenue Code, the "tax" (as defined by  
22 subdivision (a) of Section 23036) for the income year shall  
23 be increased by the amount of interest determined in the  
24 manner provided under Section 453A(c) (2) of the  
25 Internal Revenue Code.

26 (3) The provisions of Section 453A(c) (3) (B) of the  
27 Internal Revenue Code, relating to the maximum rate  
28 used in calculating the deferred tax liability, are modified  
29 to refer to the maximum rate of tax imposed under  
30 Section 23151, 23186, or 23802, whichever applies, in lieu  
31 of the maximum rate of tax imposed under Section 11 of  
32 the Internal Revenue Code.

33 SEC. 22. Section 24673.2 of the Revenue and Taxation  
34 Code, as amended by Assembly Bill 802 of the 1989-90  
35 Regular Session, is amended to read:

36 24673.2. (a) Long-term contracts shall be accounted  
37 for in accordance with the special rules set forth in  
38 Section 460 of the Internal Revenue Code.

39 (b) (1) The provisions of Section 804(d) of Public  
40 Law 99-514, relating to the effective date of modifications

1 in the method of accounting for long-term contracts; shall  
2 be applicable to income years beginning on or after  
3 January 1, 1987.

4 (2) In the case of a contract entered into after  
5 February 28, 1986, during an income year beginning  
6 before January 1, 1987, an adjustment to income shall be  
7 made upon completion of the contract, if necessary, to  
8 correct any under reporting or over reporting of income,  
9 for purposes of this part, resulting from differences  
10 between state and federal law for the income year in  
11 which the contract began.

12 ~~(c) The amendments to Section 460 of the Internal~~  
13 ~~Revenue Code made by Section 10203 of Public Law~~  
14 ~~100/203, relating to a reduction in the percentage of~~  
15 ~~items taken into account under the completed contract~~  
16 ~~method, shall not apply.~~

17 ~~(d) The amendments to Section 460 of the Internal~~  
18 ~~Revenue Code made by Section 5041 of Public Law~~  
19 ~~100/647, relating to a reduction in the percentage of~~  
20 ~~items taken into account under the completed contract~~  
21 ~~method, shall not apply.~~

22 *(c) In the case of a contract entered into after October*  
23 *13, 1987, during an income year beginning before January*  
24 *1, 1990, an adjustment to income shall be made upon*  
25 *completion of the contract, if necessary, to correct any*  
26 *underreporting or overreporting of income, for purposes*  
27 *of this part, resulting from differences between state and*  
28 *federal law for taxable years beginning prior to January*  
29 *1, 1990.*

30 *(d) In the case of a contract entered into after June 20,*  
31 *1988, during an income year beginning before January 1,*  
32 *1990, an adjustment to income shall be made upon*  
33 *completion of the contract, if necessary, to correct any*  
34 *underreporting or overreporting of income, for purposes*  
35 *of this part, resulting from differences between state and*  
36 *federal law for taxable years beginning prior to January*  
37 *1, 1990.*

38 (e) For purposes of applying Section 460(a)(2) of the  
39 Internal Revenue Code, relating to 90 percent look-back  
40 method, any adjustment to income computed under

1 subdivision (b), (c), or (d) shall be deemed to have been  
2 reported in the income year from which the adjustment  
3 arose, rather than the income year in which the contract  
4 was completed.

5 *SEC. 23. Section 24681 of the Revenue and Taxation*  
6 *Code, as amended by Assembly Bill 802 of the 1989-90*  
7 *Regular Session, is amended to read:*

8 24681. ~~(a)~~ The provisions of Section 461 of the  
9 Internal Revenue Code, relating to the general rule for  
10 taxable year of deduction, shall be applicable, except as  
11 otherwise provided.

12 ~~(b) The amendments to Section 461 of the Internal~~  
13 ~~Revenue Code made by Section 10201 of Public Law~~  
14 ~~100/203, relating to accrual of vacation pay, shall not~~  
15 ~~apply.~~

16 ~~SEC. 28.~~

17 *SEC. 24. Section 24685 of the Revenue and Taxation*  
18 *Code is repealed.*

19 ~~SEC. 29.~~

20 *SEC. 25. Section 24685 is added to the Revenue and*  
21 *Taxation Code, to read:*

22 24685. (a) In the case of any taxpayer who elected to  
23 have former Section 24685 apply to its last income year  
24 beginning prior to January 1, ~~1989~~ 1990, and who is  
25 required to change its method of accounting by reason of  
26 the amendments made by the act adding this section,  
27 each of the following shall apply:

28 (1) The change shall be treated as initiated by the  
29 taxpayer,

30 (2) The change shall be treated as having been made  
31 with the consent of the Franchise Tax Board, and

32 (3) The net amount of adjustments required by Article  
33 6 (commencing with Section 24721) to be taken into  
34 account by the taxpayer:

35 (A) Shall be reduced by the balance in the suspense  
36 account under subdivision (c) of former Section 24685 as  
37 of the close of the last income year beginning before  
38 January 1, ~~1989~~ 1990, and

39 (B) Shall be taken into account over the three income  
40 year period beginning with the income year following

1 that last income year, as follows:

2  
3  
4  
5  
6  
7  
8  
9  
10

In the case of the:  
1st Year  
2nd Year  
3rd Year

The percentage to be  
taken into account is:  
30  
50  
35  
50  
35

11 (b) Notwithstanding subparagraph (B) of paragraph  
12 (3) of subdivision (a), if the period during which the  
13 adjustments are required to be taken into account under  
14 Article 6 (commencing with Section 24271) is less than  
15 three years, those adjustments shall be taken into account  
16 ratably over the shorter period.

17 ~~SEC. 30.~~

18 *SEC. 26.* Section 24692 of the Revenue and Taxation  
19 Code is amended to read:

20 24692. (a) The treatment of passive activity losses  
21 and credits shall be determined in accordance with  
22 Section 469 of the Internal Revenue Code, except as  
23 otherwise provided.

24 (b) For purposes of this part, the provisions of Section  
25 469(d) (2) of the Internal Revenue Code, relating to  
26 passive activity credits, are modified to refer to the  
27 following credits:

28 (1) The credit for research expenses allowed by  
29 Section 23609.

30 (2) The credit for clinical testing expenses allowed by  
31 Section 23609.5.

32 (3) The credit for low-income housing allowed by  
33 Section 23610.5.

34 (4) The credit for certain wages paid (targeted jobs)  
35 allowed by Section 24330.

36 (c) For purposes of applying the provisions of Section  
37 469(i) of the Internal Revenue Code, relating to the  
38 twenty-five thousand dollars (\$25,000) offset for rental  
39 real estate activities, the dollar limitation for the credit  
40 allowed under Section 23610.5 (relating to low-income

1 housing) shall be equal to seventy-five thousand dollars  
2 (\$75,000) in lieu of the amount specified in Section  
3 469(i)(2) of the Internal Revenue Code.

4 (d) Section 502 of the Tax Reform Act of 1986 (Public  
5 Law 99-514) shall apply.

6 (e) For income years beginning on or after January 1,  
7 1987, the provisions of Section 10212 of Public Law  
8 100-203, relating to treatment of publicly traded  
9 partnerships under Section 469 of the Internal Revenue  
10 Code, shall be applicable.

11 (f) The amendments to Section 469(k) of the Internal  
12 Revenue Code made by Section 2004 of Public Law  
13 100-647, relating to separate application of section in case  
14 of publicly traded partnerships, shall apply to income  
15 years beginning on or after January 1, 1989.

16 ~~SEC. 31. Section 24701 of the Revenue and Taxation  
17 Code is amended to read:~~

18 ~~24701. (a) The provisions of Section 471 of the  
19 Internal Revenue Code, relating to the general rule for  
20 inventories, shall be applicable.~~

21 ~~(b) The provisions of Section 472 of the Internal  
22 Revenue Code, relating to last/in, first/out inventories,  
23 shall be applicable.~~

24 ~~SEC. 32. Section 24702 of the Revenue and Taxation  
25 Code is repealed.~~

26 ~~SEC. 33. Section 24703 of the Revenue and Taxation  
27 Code is repealed.~~

28 ~~SEC. 34. Section 24704 of the Revenue and Taxation  
29 Code is repealed.~~

30 ~~SEC. 35. Section 24705 of the Revenue and Taxation  
31 Code is repealed.~~

32 ~~SEC. 36. Section 24706 of the Revenue and Taxation  
33 Code is repealed.~~

34 ~~SEC. 37. Section 24707 of the Revenue and Taxation  
35 Code is repealed.~~

36 ~~SEC. 38. years beginning on or after January 1, 1990.~~

37 ~~SEC. 27. Section 24990.5 of the Revenue and Taxation  
38 Code is amended to read:~~

39 ~~24990.5. (a) Section 1201 of the Internal Revenue  
40 Code, relating to alternative tax for corporations, shall~~

1 not be applicable.

2 (b) The provisions of Section 1212 of the Internal  
3 Revenue Code, relating to capital loss carrybacks and  
4 carryovers, shall be modified as follows:

5 (1) Section 1212(a) (1) (A) of the Internal Revenue  
6 Code, relating to capital loss carrybacks, shall not apply.

7 (2) Section 1212(a) (3) of the Internal Revenue Code,  
8 relating to special rules on carrybacks, shall not apply.

9 (3) Sections 1212(b) and 1212(c) of the Internal  
10 Revenue Code, relating to taxpayers other than a  
11 corporation, shall not apply.

12 ~~SEC. 29. This act provides for a tax levy within the~~  
13 ~~meaning of Article IV of the Constitution and shall go into~~  
14 ~~immediate effect.~~

15 *SEC. 28. This act shall not become operative unless*  
16 *Assembly Bill 802 of the 1989-90 Regular Session is*  
17 *chapters before this act.*

18 *SEC. 29. Unless otherwise specifically provided, this*  
19 *act shall be applied in the computation of taxes for taxable*  
20 *or income years beginning on or after January 1, 1990.*

21 *SEC. 30. This act is an urgency statute necessary for*  
22 *the immediate preservation of the public peace, health,*  
23 *or safety within the meaning of Article IV of the*  
24 *Constitution and shall go into immediate effect. The facts*  
25 *constituting the necessity are:*

26 *In order to insure that taxpayers have timely*  
27 *notification of changes of tax law effective on January 1,*  
28 *1990, it is necessary that this act take effect immediately.*

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- 3 CORRECTIONS.
- 4 Text—Pages 12, 13, 14, 15, 18.
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