An act to amend Sections 17564, 24422.3, 24652, 24654, 24673.2, and 24701 of, and to add Sections 17563.51 and 24652.6 to, the Revenue and Taxation Code, relating to taxation.

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THE PEOPLE OF THE STATE OF CALIFORNIA DO ENACT AS FOLLOWS:

SECTION 1. Section 17563.51 is added to the Revenue and Taxation Code, to read:

17563.51. (a) For taxable years beginning on or after January 1, 2019, the amendments made by Section 13102(a) of the Tax Cuts and Jobs Act (Public Law 115-97) to Section 447 of the Internal Revenue Code, relating to method of accounting for corporations engaged in farming, shall apply, except as otherwise provided.

(b) For taxable years beginning on or after January 1, 2019, the amendments made by Section 13102(e)(2) of the Tax Cuts and Jobs Act (Public Law 115-97), relating to preservation of suspense account rules with respect to any existing suspense accounts, shall apply to any suspense account existing as of the effective date of the act adding this subdivision.

(c) For taxable years beginning on or after January 1, 2019, the amendments made by Section 13102(a) of the Tax Cuts and Jobs Act (Public Law 115-97) to Section 448 of the Internal Revenue Code, relating to limitation on use of cash method of accounting, shall apply, except as otherwise provided.

(d) For taxable years beginning on or after January 1, 2019, the amendments made by Section 13102(b) of the Tax Cuts and Jobs Act (Public Law 115-97) to Section 263A of the Internal Revenue Code, relating to capitalization and inclusion in inventory cost of certain expenses, shall apply, except as otherwise provided.

(e) For taxable years beginning on or after January 1, 2019, the amendments made by Section 13102(c) of the Tax Cuts and Jobs Act (Public Law 115-97) to Section 471 of the Internal Revenue Code, relating to the general rule for inventories, shall apply, except as otherwise provided.

(f) (1) Any change in method of accounting made pursuant to this section shall be treated for purposes of applying Section 481 of the Internal Revenue Code, as applicable for California purposes under Section 17551, as initiated by the taxpayer and made with the consent of the Franchise Tax Board.

(2) Section 13102(e)(1) of the Tax Cuts and Jobs Act (Public Law 115-97) does not apply to subdivisions (a) to (e), inclusive.

(3) (A) Notwithstanding paragraph (2) and except as provided in subparagraph (B), a taxpayer may elect to apply the provisions of this section to taxable years beginning on or after January 1, 2018, and before January 1, 2019.

(B) Notwithstanding paragraph (2), a taxpayer may elect to apply the provisions of subdivision (b) to suspense accounts established before the effective date of the act adding this subdivision.

SEC. 2. Section 17564 of the Revenue and Taxation Code is amended to read:

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

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

(2) In the case of a contract entered into after February 28, 1986, during a taxable year beginning before January 1, 1987, an adjustment to income shall be made upon completion of the contract, if necessary, to correct any underreporting or overreporting

of income, for purposes of this part, resulting from differences between state and federal law for the taxable year in which the contract began.

(c) (1) The amendments to Section 460 of the Internal Revenue Code made by Section 10203 of Public Law 100-203, relating to a reduction in the percentage of items taken into account under the completed contract method, shall apply to taxable years beginning on or after January 1, 1990.

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

(d) (1) The amendments to Section 460 of the Internal Revenue Code made by Section 5041 of Public Law 100-647, relating to a reduction in the percentage of items taken into account under the completed contract method, shall apply to taxable years beginning on or after January 1, 1990.

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

(e) (1) The amendments to Section 460 of the Internal Revenue Code made by Section 7621 of Public Law 101-239, relating to the repeal of the completed contract method of accounting for long-term contracts, shall apply to taxable years beginning on or after January 1, 1990.

(2) In the case of a contract entered into after July 10, 1989, during a taxable year beginning before January 1, 1990, an adjustment to income shall be made upon completion of the contract, if necessary, to correct any underreporting or overreporting of income, for purposes of this part, resulting from differences between California and federal law for taxable years beginning prior to January 1, 1990.

(f) For purposes of applying paragraphs (2) to (6), inclusive, of Section 460(b) of the Internal Revenue Code, relating to the look-back method, any adjustment to income computed under paragraph (2) of subdivision (b), (c), (d), or (e) shall be deemed to have been reported in the taxable year from which the adjustment arose, rather than the taxable year in which the contract was completed.

(g) (1) For contracts entered into on or after the effective date of the act adding this subdivision, the amendments made by Section 13102(d) of the Tax Cuts and Jobs Act (Public Law 115-97) to Section 460 of the Internal Revenue Code, relating to special rules for long-term contracts, shall apply, except as otherwise provided.

(2) For contracts entered into on or after the effective date of the act adding this subdivision, the amendments made by Section 13102(e)(3) of the Tax Cuts and Jobs Act (Public Law 115-97), relating to exemption from percentage completion for long-term contracts, shall apply, except as otherwise provided.

(3) (A) Any change in method of accounting made pursuant to this section shall be treated for purposes of applying Section 481 of the Internal Revenue Code, as applicable for California purposes under Section 17551, as initiated by the taxpayer and made with the consent of the Franchise Tax Board.

(B) Section 13102(e)(1) of the Tax Cuts and Jobs Act (Public Law 115-97) do not apply to this subdivision.

(C) Notwithstanding subparagraph (B), a taxpayer may elect to apply the provisions of this subdivision, where otherwise allowed, to contracts entered into on or after January 1, 2018, in taxable years ending after January 1, 2018.

SEC. 3. Section 24422.3 of the Revenue and Taxation Code is amended to read:

24422.3. (a) Section 263A of the Internal Revenue Code, relating to capitalization and inclusion in inventory costs of certain expenses, shall apply, except as otherwise provided.

(b) (1) For taxable years beginning on or after January 1, 2019, the amendments made by Section 13102(b) of the Tax Cuts and Jobs Act (Public Law 115-97) to Section 263A of the Internal Revenue Code, relating to capitalization and inclusion in inventory cost of certain expenses, shall apply, except as otherwise provided.

(2) (A) Any change in method of accounting made pursuant to this subdivision shall be treated for purposes of applying Section 24721, as initiated by the taxpayer and made with the consent of the Franchise Tax Board.

(B) Section 13102(e)(1) of the Tax Cuts and Jobs Act (Public Law 115-97) does not apply to this subdivision.

(C) Notwithstanding subparagraph (B), a taxpayer may elect to apply the provisions of this subdivision to taxable years beginning on or after January 1, 2018, and before January 1, 2019.

SEC. 4. Section 24652 of the Revenue and Taxation Code is amended to read:

24652. (a) Section 447 of the Internal Revenue Code, relating to method of accounting for corporations engaged in farming, shall apply, except as otherwise provided.

(b) (1) For taxable years beginning on or after January 1, 2019, the amendments made by Section 13102(a) of the Tax Cuts and Jobs Act (Public Law 115-97) to Section 447 of the Internal Revenue Code, relating to method of accounting for corporations engaged in farming, shall apply, except as otherwise provided.

(2) (A) Any change in method of accounting made pursuant to this subdivision shall be treated for purposes of applying Section 24721, as initiated by the taxpayer and made with the consent of the Franchise Tax Board.

(B) Section 13102(e)(1) of the Tax Cuts and Jobs Act (Public Law 115-97) does not apply to this subdivision.

(C) Notwithstanding subparagraph (B), a taxpayer may elect to apply the provisions of this subdivision to taxable years beginning on or after January 1, 2018, and before January 1, 2019.

SEC. 5. Section 24652.6 is added to the Revenue and Taxation Code, to read:

24652.6. (a) For taxable years beginning on or after January 1, 2019, amendments made by Section 13102(e)(2) of the Tax Cuts and Jobs Act (Public Law 115-97), relating to preservation of suspense account rules with respect to any existing suspense accounts, shall apply to any suspense account existing as of the effective date of the act adding this subdivision that was not otherwise precluded by Section 24652.5.

(b) (1) Any change in method of accounting made pursuant to this section shall be treated for purposes of applying Section 24721, as initiated by the taxpayer and made with the consent of the Franchise Tax Board.

(2) Section 13102(e)(1) of the Tax Cuts and Jobs Act (Public Law 115-97) does not apply to this section.

(3) Notwithstanding paragraph (2), a taxpayer may elect to apply the provisions of this section to suspense accounts established before the effective date of the act adding this section.

SEC. 6. Section 24654 of the Revenue and Taxation Code is amended to read:

24654. (a) Section 448 of the Internal Revenue Code, relating to limitation on use of cash method of accounting, shall apply, except as otherwise provided.

(b) For purposes of applying Section 448 of the Internal Revenue Code, Sections 801(d)(2), 801(d)(3), and 801(d)(5) of the Tax Reform Act of 1986 (Public Law 99-514), as modified by Section 1008(a) of Public Law 100-647, shall apply to each taxable year beginning on or after January 1, 1987.

<u>(c) (1) For taxable years beginning on or after January 1, 2019, the amendments made by Section 13102(a) of the Tax Cuts and Jobs Act (Public Law 115-97) to Section 448 of the Internal Revenue Code, relating to limitation on use of cash method of accounting, shall apply, except as otherwise provided.</u>

<u>(2) (A) Any change in method of accounting made pursuant to this subdivision shall be treated for purposes of applying Section 24721, as initiated by the taxpayer and made with the consent of the Franchise Tax Board.</u>

<u>(B) Section 13102(e)(1) of the Tax Cuts and Jobs Act (Public Law 115-97) does not apply to this subdivision.</u>

<u>(C) Notwithstanding subparagraph (B), a taxpayer may elect to apply the provisions of this subdivision to taxable years beginning on or after January 1, 2018, and before January 1, 2019.</u>

SEC. 7. Section 24673.2 of the Revenue and Taxation Code is amended to read:

24673.2. (a) Section 460 of the Internal Revenue Code, relating to special rules for long-term contracts, shall apply, except as otherwise provided.

(b) (1) Section 804(d) of Public Law 99-514, relating to the effective date of modifications in the method of accounting for long-term contracts, shall apply to taxable years beginning on or after January 1, 1987.

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

(c) (1) The amendments to Section 460 of the Internal Revenue Code made by Section 10203 of Public Law 100-203, relating to a reduction in the percentage of items taken into account under the completed contract method, shall apply to each taxable year beginning on or after January 1, 1990.

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

(d) (1) The amendments to Section 460 of the Internal Revenue Code made by Section 5041 of Public Law 100-647, relating to a reduction in the percentage of items taken into account under the completed contract method, shall apply to each taxable year beginning on or after January 1, 1990.

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

(e) (1) The amendments to Section 460 of the Internal Revenue Code made by Section 7621 of Public Law 101-239, relating to the repeal of the completed contract method of accounting for long-term contracts, shall apply to each taxable year beginning on or after January 1, 1990.

(2) In the case of a contract entered into after July 10, 1989, during a taxable year beginning on or before January 1, 1990, an adjustment to income shall be made upon completion of the contract, if necessary, to correct any underreporting or overreporting of income, for purposes of this part, resulting from differences between state and federal law for each taxable year beginning prior to January 1, 1990.

(f) For purposes of applying paragraphs (2) to (6), inclusive, of Section 460(b) of the Internal Revenue Code, relating to the look-back method, any adjustment to income computed under paragraph (2) of subdivision (b), (c), (d), or (e) shall be deemed to have been reported in the taxable year from which the adjustment arose, rather than the taxable year in which the contract was completed.

<u>(g) (1) For contracts entered into on or after the effective date of the act adding this subdivision, the amendments made by Section 13102(d) of the Tax Cuts and Jobs Act (Public Law 115-97) to Section 460 of the Internal Revenue Code, relating to special rules for long-term contracts, shall apply, except as otherwise provided.</u>

<u>(2) For contracts entered into on or after the effective date of the act adding this subdivision, the amendments made by Section 13102(e)(3) of the Tax Cuts and Jobs Act (Public Law 115-97), relating to exemption from percentage completion for long-term contracts, shall apply, expect as otherwise provided.</u>

<u>(3) (A) Any change in method of accounting made pursuant to this paragraph shall be treated for purposes of applying Section 24721, as initiated by the taxpayer and made with the consent of the Franchise Tax Board.</u>

<u>(B) Section 13102(e)(1) of the Tax Cuts and Jobs Act (Public Law 115-97) does not apply to this subdivision.</u>

<u>(C) Notwithstanding subparagraph (B), a taxpayer may elect to apply the provisions of this subdivision, where otherwise allowed, to contracts entered into on or after January 1, 2018, in taxable years ending after January 1, 2018.</u>

SEC. 8. Section 24701 of the Revenue and Taxation Code is amended to read:

24701. (a) Section 471 of the Internal Revenue Code, relating to the general rule for inventories, shall apply, except as otherwise provided.

<u>(b) (1) For taxable years beginning on or after January 1, 2019, amendments made by Section 13102(c) of the Tax Cuts and Jobs Act (Public Law 115-97) to Section 471 of the Internal Revenue Code, relating to the general rule for inventories, shall apply, except as otherwise provided.</u>

<u>(2) (A) Any change in method of accounting made pursuant to this subdivision shall be treated for purposes of applying Section 24721, as initiated by the taxpayer and made with the consent of the Franchise Tax Board.</u>

(B) Section 13102(e)(1) of the Tax Cuts and Jobs Act (Public Law 115-97) does not apply to this subdivision.

(C) Notwithstanding subparagraph (B), a taxpayer may elect to apply the provisions of this subdivision to taxable years beginning on or after January 1, 2018, and before January 1, 2019.

~~(b)~~

(c) Section 472 of the Internal Revenue Code, relating to last-in, first-out inventories, shall apply, except as otherwise provided.

SEC. 9. The Legislature hereby finds and declares that allowing taxpayers to make an election in order to receive the same treatment for California tax purposes as the taxpayer receives for federal tax purposes with respect to the taxpayer's accounting method for an entire taxable year constitutes a public purpose and is not a prohibited gift of public funds within the meaning of Section 6 of Article XVI of the California Constitution.

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LEGISLATIVE COUNSEL'S DIGEST

Bill No.
as introduced, ______.
General Subject: Income taxes: small business accounting.

(1) Existing federal law, the Tax Cuts and Jobs Act, allows a small business to use the cash method of accounting if its average annual gross receipts for the 3 taxable years ending with the prior taxable year do not exceed $25,000,000.

Existing state law, the Personal Income Tax Law and the Corporation Tax Law, allows a small business to use the cash method of accounting if its average annual gross receipts for the 3 taxable years ending with the prior taxable year do not exceed $5,000,000.

This bill, for taxable years beginning on or after January 1, 2019, would conform the Personal Income Tax Law and the Corporation Tax Law to the increase to $25,000,000 made by the Tax Cuts and Jobs Act in the allowable amount of annual gross receipts of a small business allowed to use the cash method of accounting. The bill would allow a taxpayer to elect to have this conformity apply to taxable years beginning on or after January 1, 2018, and before January 1, 2019.

(2) Existing federal law, the Tax Cuts and Jobs Act, exempts a corporation engaged in farming that has average annual gross receipts for the 3 taxable years ending with the prior taxable year not exceeding $25,000,000 from computing its taxable income by using the accrual method of accounting.

Existing state law, the Personal Income Tax Law and the Corporation Tax Law, exempts a corporation engaged in farming that has average annual gross receipts for the 3 taxable years ending with the prior taxable year not exceeding $5,000,000 from computing taxable income by using the accrual method of accounting.

This bill, for taxable years beginning on or after January 1, 2019, would conform the Personal Income Tax Law and the Corporation Tax Law to the increase to $25,000,000 made by the Tax Cuts and Jobs Act in the amount of average annual gross receipts of a farming corporation that is exempt from using the accrual method of accounting. The bill would allow a taxpayer to elect to have this conformity apply to taxable years beginning on or after January 1, 2018, and before January 1, 2019. The bill would also make conforming changes related to suspense allowances, as provided.

(3) Existing federal law, the Tax Cuts and Jobs Act, exempts a taxpayer with average annual gross receipts for the 3 taxable years ending with the prior taxable year of $25,000,000 or less from the provisions that preclude the deduction of certain direct

and indirect costs and determine whether those property costs are inventory costs or are capitalized.

Existing state law, the Personal Income Tax Law and the Corporation Tax Law, exempts a taxpayer with average annual gross receipts for the 3 taxable years ending with the prior taxable year of $10,000,000 or less from the provisions that preclude the deduction of certain direct and indirect costs and determine whether those property costs are inventory costs or are capitalized.

This bill, for taxable years beginning on or after January 1, 2019, would conform the Personal Income Tax Law and the Corporation Tax Law to the increase to $25,000,000 made by the Tax Cuts and Jobs Act in the amount of average annual gross receipts of a taxpayer exempt from those provisions precluding the deductibility of certain property costs and determining whether those costs are inventory costs or are capitalized. The bill would allow a taxpayer to elect to have this conformity apply to taxable years beginning on or after January 1, 2018, and before January 1, 2019.

(4) Existing federal law, the Tax Cuts and Jobs Act, exempts a small business with average annual gross receipts for the 3 taxable years ending with the prior taxable year not exceeding $25,000,000 from the provisions that require a taxpayer to take inventories to clearly determine their income.

Existing state law, the Personal Income Tax Law and the Corporation Tax Law, conforms to the provisions of the Internal Revenue Code relating to the requirement that a taxpayer take inventories to clearly determine their income, but does not allow an exemption.

This bill, for taxable years beginning on or after January 1, 2019, would conform the Personal Income Tax Law and the Corporation Tax Law to the exemption in the Tax Cuts and Jobs Act of a small business with average annual gross receipts for the 3 taxable years ending with the prior taxable year not exceeding $25,000,000 from the provisions that require a taxpayer to take inventories to clearly determine their income. The bill would allow a taxpayer to elect to have this conformity apply to taxable years beginning on or after January 1, 2018, and before January 1, 2019.

(5) Existing federal law, the Tax Cuts and Jobs Act, exempts construction contracts entered into by a taxpayer with average annual gross receipts not exceeding $25,000,000 from the requirement that the taxable income from a long-term contract be determined by the percentage of completion method.

Existing state law, the Personal Income Tax Law and the Corporation Tax Law, exempts construction contracts entered into by a taxpayer with average annual gross receipts for the 3 taxable years ending with the prior taxable year not exceeding $10,000,000 from the requirement that the taxable income from a long-term contract be determined by the percentage of completion method.

This bill would conform the Personal Income Tax Law and the Corporation Tax Law to the exemption in the Tax Cuts and Jobs Act of construction contracts entered into by a taxpayer with average annual gross receipts not exceeding $25,000,000 from the requirement that the taxable income from a long-term contract be determined by the percentage of completion method. This conformity would apply to contracts entered into on or after the effective date of this act, as provided, and would allow, where applicable, a taxpayer to elect to have the conformity apply to contracts entered into on or after January 1, 2018, and before the effective date of this act.

(6) This bill would make a legislative finding and declaration that allowing taxpayers the ability to elect their accounting method serves a public purpose and does not constitute a prohibited gift of public funds.

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