GH&J
GREEN HASSON & JANKS LLP
BUSINESS ADVISORS AND CPAS

Tax Savvy

RELEVANT ALERTS DIRECT TO YOUR INBOX

October 29, 2010

California Budget Act of 2010

Dear Clients and Friends:

On October 8, 2010, the California budget impasse finally ended when Governor Arnold Schwarzenegger signed the California budget into law. In conjunction with the passage of the budget, a trailer bill, Senate Bill 858, was subsequently enacted into law on October 19, 2010.

This bill contains several key tax provisions noted below:

Net Operating Loss (NOL) Suspension and Delay of Carrybacks

The suspension of NOL deduction has been extended for tax years 2010 and 2011. In addition, the exemption for taxpayers with income less than $500,000 has been lowered to $300,000. As a result, taxpayers may incur substantial franchise tax liabilities during this period. Effected taxpayers may need to consider strategies to defer income until after December 31, 2011. Finally, NOL carrybacks will be limited to 50 percent of losses incurred in 2013 and 75 percent of losses incurred in 2014. There is no limitation on NOL carrybacks related to losses incurred in tax years after 2014.

New Rule for Taxpayers Using Standard Apportionment Method

Beginning in the 2011 tax year, multi-state taxpayers who elect to make an annual, irrevocable election to determine their California apportionment using a single sales factor formula will be required to source the sales of intangibles and services using a "market-based" sourcing methodology. The default method of apportionment is a standard formula (property, payroll and double-weighted sales factors). For those taxpayers who opt to use the standard apportionment formula, the sourcing of sales from intangibles and services will be based on the prior "cost of performance" rules.

Safe Harbor for Large Corporate Understatement Penalty

Under previously enacted law, a 20% penalty was imposed on large corporate understatements of tax exceeding $1 million. The new law modifies the penalty to understatements that exceed the greater of $1 million or 20 percent of the tax shown on the original or amended return.

These provisions need to be considered in light of the potential passage of Proposition 24, Repeal of Corporate Tax Breaks, in the upcoming November election. The targeted tax breaks include the use of the single sales factor apportionment method, the availability of NOL carrybacks, and the sharing of tax credits among affiliated entities.

Moreover, taxpayers who made estimated tax payments during 2010 based on the utilization of NOLs may need to adjust their 4th quarter payment accordingly. However, penalties for underpayment of tax will not be assessed as a result of these recently enacted provisions. In addition, deferred tax assets and liabilities related to state taxes may need to be re-evaluated due to the changes in the apportionment formula.

Please keep in mind that we have described only the highlights of the most important changes in the new law. If you would like more details about any aspect of the pending legislation, please contact your GH&J tax advisor for further details at (310) 873-1600.

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