

Date of Hearing: June 29, 2026

ASSEMBLY COMMITTEE ON REVENUE AND TAXATION

Mike Gipson, Chair

SB 1435 (Committee on Revenue and Taxation) – As Amended June 22, 2026

Majority vote. Tax levy. Fiscal committee.

SENATE VOTE: 33-0

SUBJECT: Personal Income Tax Law and Corporation Tax Law: federal conformity

SUMMARY: Updates California tax law that conforms, with certain modifications, to federal tax law. Specifically, **this bill:**

- 1) Clarifies, under the California Earned Income Tax Credit (CalEITC), that the maximum amount of disqualified income a taxpayer may earn is \$3,400, regardless of the federally stipulated threshold.
- 2) Decouples, under the Personal Income Tax (PIT) Law, from the federal limitation on the business interest expense deduction.
- 3) Conforms to the federal clarification that the excess business loss of a noncorporate taxpayer is determined without regard to any tax attributes resulting from any trade or business for services performed as an employee.
- 4) Decouples from special federal withholding rules related to dispositions of partnership interests.
- 5) Removes deadwood provisions, adjusts or removes certain operative dates, removes certain repeal dates, updates or removes certain cross references, and renumbers certain sections.
- 6) Applies the provisions of this bill to taxable years beginning on or after January 1, 2025, except as otherwise provided.
- 7) Provides that specified technical corrections included in this bill are declaratory of existing law and must be applied in the same manner and for the same periods as specified for federal purposes, as conditioned, to the extent that the provisions of this bill are correct.
- 8) Takes immediate effect as a tax levy.

EXISTING FEDERAL LAW:

- 1) Defines gross income as all income from whatever source derived, unless specifically excluded. (Internal Revenue Code (IRC) Section 61.)
- 2) Authorizes a refundable credit equal to a certain percentage of qualifying income earned by a taxpayer, based on the number of the taxpayer's qualifying children, and subject to adjusted

gross income limitations and phase-outs. This credit is commonly referred to as the EITC. A taxpayer is ineligible for the EITC if they earn disqualified income in excess of \$10,000. Disqualified income is generally defined as income resulting from investment activities. (IRC Section 32.)

- 3) Authorizes an itemized deduction equal to the amount of interest paid or accrued within the taxable year on indebtedness. The amount of business interest expense allowed as a deduction is limited to the sum of the following:
 - a) The business interest income of the taxpayer during the taxable year;
 - b) 30% of the adjusted taxable income of the taxpayer during the taxable year; and,
 - c) The floor plan financing interest of the taxpayer during the taxable year.

For taxable years beginning in 2019 or 2020, the limitation on the business interest expense deduction is modified such that the consideration of 30% of adjusted taxable income included in the calculation of the deduction increased to 50% of adjusted taxable income. (IRC Section 163.)

- 4) Requires that the amount of any deduction or credit is taken in the taxable year which is the proper taxable year, as specified. Any excess business loss of a noncorporate taxpayer for the taxable year is disallowed and is treated as a net operating loss carryover. An excess business loss is the remainder of a taxpayer's aggregate deductions resulting from a taxpayer's trade or business against the aggregate gross income or gain of the taxpayer plus a threshold amount. The determination of an excess business loss does not include any deductions, gross income, or gains resulting from any trade or business for services performed as an employee. (IRC Section 461.)
- 5) Requires certain partnerships with effectively connected taxable income allocable to a foreign partner to pay a withholding tax at certain rates. (IRC Section 1446.) The gain or loss resulting from the sale or exchange of any portion of interest in a partnership that is owned by a nonresident alien individual or foreign corporation and that is engaged in any trade or business within the United States is treated as effectively connected with the conduct of such trade or business, as specified. (IRC Section 864(c)(8).) In turn, if any portion of any gain on the disposition of an interest in a partnership would be treated as effectively connected income, then the transferee of the interest must deduct and withhold a tax equal to 10% of the amount realized on disposition. (IRC Section 1446(f).)

EXISTING STATE LAW:

- 1) Conforms, with certain modifications, to federal tax law as of January 1, 2025. (Revenue and Taxation Code (R&TC) Sections 17024.5 and 23051.5.)
- 2) Conforms to the federal refundable EITC with certain modifications. This state credit is commonly referred to as the CalEITC. The CalEITC is modified to, among other changes, substitute "\$3,400" for "\$2,200" regarding the maximum amount of allowable disqualified income. (R&TC Section 17052.)

- 3) Conforms, with certain modifications, to the itemized deduction for amounts paid or accrued as interest on indebtedness, including the limitation on the amount of business interest eligible for deduction. (R&TC Section 17201.)
- 4) Conforms to the federal treatment of excess business losses, with certain modifications, including that a disallowed excess business loss is treated as a carryover excess business loss for the following taxable year, rather than a net operating loss. California specifically decouples from federal extensions of the disallowance of excess business losses for noncorporate taxpayers. (R&TC Section 17560.5.)
- 5) Conforms to the requirement that certain partnerships with effectively connected taxable income allocable to a foreign partner pay a withholding tax at certain rates, but substitutes alternative rates in lieu of those specified in the IRC. (R&TC Section 18666.)

FISCAL EFFECT: The Franchise Tax Board (FTB) estimates that this bill would result in a revenue loss of \$240 million in the 2025-26 fiscal year (FY), \$550 million in FY 2026-27, \$360 million in FY 2027-28, and \$350 million in FY 2028-29.

Committee staff notes that while the FTB has estimated a revenue loss resulting from this bill, the estimated revenue impact of SB 711 (McNerney), Chapter 231, Statutes of 2025 included the estimated revenue losses resulting from this bill.

COMMENTS:

- 1) The author has submitted the following statement in support of this bill:

SB 1435 incorporates several technical and conforming clean-up items resulting from the enactment of SB 711 (McNerney), Chapter 231, Statutes of 2025, which updated the state's date of conformity to the [IRC]. SB 711 amended more than 119 sections of the [R&TC] and, given the state's complex structure of modified conformity to federal law, some follow-up changes are necessary. Committee staff distributed these proposals to affected parties for review before they were included in the bill. Should anyone object to an item in the bill, the Committee will remove said item.

- 2) The California Taxpayers Association, writing in support of this bill, states, in part:

California takes a selective approach to conforming to federal tax changes one provision at a time, allowing lawmakers to evaluate each amendment for its fiscal impact, equity implications, and alignment with the state's economic priorities before deciding whether to adopt it. For the nation's most populous and economically diverse state, this tailored approach preserves the flexibility to support key industries, protect low-income taxpayers, and maintain a stable revenue base rather than importing federal rules that may not suit California's unique housing, labor, and environmental policies and the state's economic growth needs.

- 3) Committee Staff Comments:

- a) *Conformity in California:* California tax law does not automatically conform to changes in federal tax law. Rather, state tax law conforms to federal tax law in two ways. The first is by way of the general date-change conformity. The second is by specific cross-

reference to certain sections of the IRC. Thus, for the state to adopt changes to federal tax law, individual tax bills conforming to specific federal changes, or an omnibus bill conforming to federal tax law as of a certain date are required.

Prior to 1983, the state's tax laws were stand-alone, meaning the provisions generally did not adopt federal law by way of cross-reference to IRC sections. Rather, the Legislature stipulated the provisions of the R&TC in their entirety. In 1983, however, California repealed significant sections of tax law and replaced them with references to federal tax law. Throughout the remainder of that decade and into the 1990s, California enacted conformity legislation nearly every year. By the late 1990's and early 2000's, general date-change conformity legislation became less frequent, occurring on a five-year basis.

- b) *Why conform?* Generally, conformity between federal and state law eases taxpayer compliance and reduces confusion. State taxation begins with a taxpayer's federal adjusted gross income, and makes adjustments to this amount to derive taxable income in the state. As the difference in federal and state law increases, further adjustments are needed, which can lead to errors and cause confusion as tax filers prepare their returns. Conformity eases the burden for state tax administration as well, given state tax agencies can more often rely on federal audits, case law, and regulations.

These advantages do not come without potential cost, namely to state revenues. Indeed, much of tax law is providing for various tax expenditures, which are generally defined as tax credits, deductions, exclusions, or exemptions. Both state and federal governments often use tax expenditures to encourage certain beneficial taxpayer behavior. A federal incentive, however, may not promote the same activity if adopted at the state level, and the foregone revenues resulting from conforming to that provision may not be worthwhile.

California, unlike the federal government, must pass a balanced budget. Section 12(g), Article IV of the California Constitution prohibits both the legislative and executive branches of state government from passing a budget that includes appropriations from the General Fund in excess of General Fund revenues. Moreover, California cannot control the supply of money in the state as the federal government can throughout the nation. In other words, the state cannot "print" money, or increase the monetary base, to subsidize any budget deficit for a given year.

Thus, the Legislature has chosen to selectively conform to federal tax law as of a certain date, allowing prudent examination of the changes made by the federal government before adoption by California.

- c) *Interest in intent:* Last year, the Legislature passed SB 711 (McNerney), Chapter 231, Statutes of 2025. With the enactment of that bill, California tax law now conforms to federal tax law, with certain modifications, as it read on January 1, 2025. After passage by both houses, an inadvertent drafting error was identified. Specifically, SB 711 decoupled California's conformity under the Corporation Tax Law from the federal limitation on business interest expense deduction, but did not provide for similar nonconformity under the PIT Law. To clarify the intent of SB 711, the author submitted a letter to the Senate Journal on September 12, 2025, stating that conforming to the

business interest expense deduction limitation under the PIT Law was not the author's intent. This bill would rectify the inadvertent conformity to the limitation.

- d) *This bill:* In addition to rectifying the drafting omission in SB 711, this bill makes further technical and clean-up changes identified by stakeholders and the FTB since the passage of SB 711. These additional changes include clarifying the amount of disqualified income a taxpayer may earn before being ineligible for the CalEITC, clarifying the calculation of excess business losses for noncorporate taxpayers, decoupling from special withholding rules on dispositions of certain partnerships, and code maintenance.
- e) *Prior legislation:*
- i) SB 711 (McNerney), Chapter 231, Statutes of 2025, updated California's reference date of conformity to federal law as it read on January 1, 2025.
 - ii) AB 154 (Ting), Chapter 359, Statutes of 2015, updated California's reference date of conformity to federal law as it read on January 1, 2015.

REGISTERED SUPPORT / OPPOSITION:

Support

California Taxpayers Association
California Society of Enrolled Agents (prior version)

Opposition

None on file

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