



MULTISTATE INCOME/FRANCHISE TAX

California addresses IRC section 163(j) and section 1446(f) conformity

Tax Alert

Overview

On September 14, 2026, California [Senate Bill 1435](#) ("S.B. 1435") was signed into law. S.B. 1435 provides that the federal limitation on the deduction for business interest under Internal Revenue Code ("IRC") section 163(j) does not apply under California's Personal Income Tax Law, and that the federal withholding rules for dispositions of partnership interests under IRC section 1446(f) do not apply.

S.B. 1435 amends provisions of the California Revenue and Taxation Code ("CRTC") that were enacted or amended by [Senate Bill 711](#) ("S.B. 711"), which advanced California's general conformity date to the IRC from January 1, 2015, to January 1, 2025, for taxable years beginning on or after January 1, 2025. S.B. 1435 is a tax levy and took effect immediately upon enactment. Except as otherwise provided, its provisions apply to taxable years beginning on or after January 1, 2025.

S.B. 1435 also conforms to a federal clarification that an excess business loss of a noncorporate taxpayer is determined without regard to amounts attributable to a trade or business of performing services as an employee. S.B. 1435 makes additional changes to the Personal Income Tax Law and the Corporation Tax Law, including amendments to the water's-edge election provisions, repeals of obsolete sections, and cross-reference and operative date corrections.

This Tax Alert summarizes the provisions of S.B. 1435 relating to IRC sections 163(j) and 1446(f).

IRC section 163(j) does not apply under the Personal Income Tax Law

S.B. 711 addressed IRC section 163(j) under the Corporation Tax Law and not under the Personal Income Tax Law. S.B. 711 amended CRTC section 24344 to add subdivision (e), providing that IRC section 163(j), relating to the limitation on the deduction for business interest, shall not apply. S.B. 711 added no corresponding provision to the Personal Income Tax Law. For taxable years beginning on or after January 1, 2025, the Personal Income Tax Law therefore applied IRC section 163(j) as that section read on January 1, 2025. Under that version, the deduction for business interest expense is limited to the sum of business interest income, 30 percent of adjusted taxable income, and floor plan financing interest, and adjusted taxable income is computed after taking depreciation, amortization, and depletion into account. The amendments to IRC section 163(j) made by the One Big Beautiful Bill Act were enacted after January 1, 2025, and are not incorporated.

S.B. 1435 adds subdivision (c) to CRTC section 17225, providing that IRC section 163(j) shall not apply. California therefore does not apply IRC section 163(j) under either the Personal Income Tax Law or the Corporation Tax Law for taxable years beginning on or after January 1, 2025.

IRC section 1446(f) does not apply

IRC section 1446(f) requires the transferee of a partnership interest to withhold 10 percent of the amount realized on the disposition where the transferor is a foreign person and any portion of the gain would be treated as effectively connected with the conduct of a trade or business within the United States. Where the transferee fails to withhold, the partnership deducts and withholds from distributions to the transferee.

CRTC section 18666(a) applies IRC section 1446, relating to withholding of tax on foreign partners' share of effectively connected income, to the extent the amounts represent income from California sources. S.B. 711 added CRTC section 18666(b)(3), which substituted the rates specified in CRTC sections 17041 and 17043 for the rate referred to in IRC section 1446(f)(1).

S.B. 1435 amends CRTC section 18666(b)(3) to provide that IRC section 1446(f), relating to special rules for withholding on dispositions of partnership interests, shall not apply. The rate substitutions in CRTC section 18666(b)(1) and (b)(2), which apply to the rates referred to in IRC sections 1446(b)(2)(A) and 1446(b)(2)(B) for withholding on a foreign partner's distributive share of effectively connected taxable income, are unchanged. CRTC section 18666(a) continues to apply the balance of IRC section 1446 to the extent the amounts represent income from California sources.

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