

AMENDED IN SENATE JULY 15, 2009

AMENDED IN SENATE JUNE 29, 2009

AMENDED IN ASSEMBLY APRIL 14, 2009

CALIFORNIA LEGISLATURE—2009—10 REGULAR SESSION

ASSEMBLY BILL

No. 759

Introduced by Assembly Member Ma

February 26, 2009

An act to amend Section 10286.1 of the Public Contract Code, *and to amend Sections 24411 and 25110 of, and to add Section 25117 to, the Revenue and Taxation Code*, relating to ~~public~~ contracts corporations.

LEGISLATIVE COUNSEL'S DIGEST

AB 759, as amended, Ma. ~~Public contracts;~~ *contracts with expatriate corporations: corporation tax law water's-edge election.*

Existing

(1) *Existing* law regarding contracting between state agencies and private contractors sets forth requirements for the procurement of materials, supplies, equipment, and services by state agencies. Existing law sets out the various responsibilities of the Department of General Services, and other state agencies, in overseeing and implementing state contracting procedures and policies.

Existing law prohibits a state agency from entering into any contract with an expatriate corporation, as defined, or its subsidiary, unless certain conditions are met. Existing law defines an expatriate corporation as a foreign incorporated entity that is publicly traded in the United States and that meets specified criteria.

This bill would revise the definition of an expatriate corporation to also require that the entity be domiciled in a jurisdiction that does not have an income tax treaty in force with the United States.

(2) Existing law provides that, in the case of a business with income derived from, or attributable to, sources both within and without this state, the income is apportioned between this state and other states and foreign countries for tax purposes in accordance with a specified formula based on the property, payroll, and sales within and without this state, except as otherwise provided. Existing law permits certain taxpayers, as provided, to elect to determine their income under a water’s edge election and specifies certain requirements under that election.

This bill would conform specified provisions relating to, among other things, the water’s-edge election to specified federal income tax laws relating to the taxation of certain shareholders of controlled foreign corporations, as provided.

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

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

- 1 SECTION 1. It is the intent of the Legislature in enacting this
- 2 statute to clarify that an expatriate corporation located in a foreign
- 3 jurisdiction that does not have an income tax treaty with the United
- 4 States shall not enter into any contracts with a state agency.
- 5 SEC. 2. Section 10286.1 of the Public Contract Code is
- 6 amended to read:
- 7 10286.1. (a) For purposes of this part, except as otherwise
- 8 provided in subdivisions (b) and (c), a state agency shall not enter
- 9 into any contract with an expatriate corporation or its subsidiaries.
- 10 (b) (1) For purposes of this article, an “expatriate corporation”
- 11 means a foreign incorporated entity that is publicly traded in the
- 12 United States to which all of the following apply:
- 13 (A) The United States is the principal market for the public
- 14 trading of the foreign incorporated entity.
- 15 (B) The foreign incorporated entity has no substantial business
- 16 activities in the place of incorporation.
- 17 (C) The foreign incorporated entity is domiciled in a jurisdiction
- 18 that does not have an income tax treaty in force with the United
- 19 States.

1 (D) Either clause (i) or clause (ii) applies:

2 (i) The foreign entity was established in connection with a
3 transaction or series of related transactions pursuant to which (I)
4 the foreign entity directly or indirectly acquired substantially all
5 of the properties held by a domestic corporation or all of the
6 properties constituting a trade or business of a domestic partnership
7 or related foreign partnership, and (II) immediately after the
8 acquisition, more than 50 percent of the publicly traded stock, by
9 vote or value, of the foreign entity is held by former shareholders
10 of the domestic corporation or by former partners of the domestic
11 partnership or related foreign partnership. For purposes of
12 subclause (II), any stock sold in a public offering related to the
13 transaction or a series of transactions is disregarded.

14 (ii) The foreign entity was established in connection with a
15 transaction or series of related transactions pursuant to which (I)
16 the foreign entity directly or indirectly acquired substantially all
17 of the properties held by a domestic corporation or all of the
18 properties constituting a trade or business of a domestic partnership
19 or related foreign partnership, and (II) the acquiring foreign entity
20 is more than 50 percent owned, by vote or value, by domestic
21 shareholders or partners.

22 (iii) For purposes of this subparagraph, indirect acquisition of
23 property includes the acquisition of a stock share, or any portion
24 thereof, of the owner of that property.

25 (2) Notwithstanding subdivision (a), a state agency may contract
26 with an expatriate corporation, or its subsidiary, if it was an
27 expatriate corporation before January 1, 2004, to which both of
28 the following apply:

29 (A) The foreign entity provides, by operation of law, by
30 provisions of its governing documents, by resolution of its board
31 of directors, or in any other manner, at least the following
32 shareholders' rights:

33 (i) Shareholders of the entity have the right to inspect, at a
34 principal place of business in the United States, copies of the
35 entity's books and records, including, but not limited to,
36 shareholder names, addresses, and shareholdings in accordance
37 with the corporation law, as amended from time to time and as
38 that law is interpreted by the courts, of the United States
39 jurisdiction in which the entity was previously incorporated, or, if
40 the entity was not previously incorporated, in accordance with the

1 terms set forth in the Model Business Corporation Act, as that act
2 may be amended from time to time, provided that, if the corporate
3 law of the United States jurisdiction in which the entity was
4 previously incorporated or the Model Business Corporation Act
5 does not provide access to the shareholder names, addresses, and
6 shareholdings, these books and records are available for inspection
7 by shareholders for purposes properly related to their status as
8 shareholders of the entity.

9 (ii) The entity permits its shareholders to bring derivative
10 proceedings on behalf of the entity, provided that these derivative
11 proceedings are brought on a basis and under the terms applicable
12 under the law, as amended from time to time and as interpreted
13 by, or required by, the courts of the United States jurisdiction in
14 which the entity was previously incorporated, or, if the entity was
15 not previously incorporated, on a basis and under the terms set
16 forth in the Model Business Corporations Act as that act may be
17 amended from time to time and as it is interpreted by, or required
18 by, the courts.

19 (iii) Entity transactions in which any director is interested are
20 approved in accordance with the applicable law, as amended from
21 time to time and as interpreted by the courts, of the United States
22 jurisdiction in which the entity was previously incorporated, or, if
23 the entity was not previously incorporated, in accordance with the
24 terms set forth in the Model Business Corporations Act, as may
25 be amended from time to time and as interpreted by the courts.

26 (iv) The entity has consented to the jurisdiction, for any
27 otherwise available cause of action by or on behalf of the entity's
28 shareholders, including any pendent state causes of action, of all
29 of the following courts:

30 (I) The state courts of one or more states.

31 (II) The United States federal courts in any state in which the
32 entity consents to the jurisdiction of that state's courts pursuant to
33 subclause (I).

34 (v) The entity has appointed an agent for service of process in
35 the state or states in which the entity has consented to jurisdiction,
36 as described in clause (iv), and the entity meets at least one of the
37 following conditions:

38 (I) The entity has unencumbered assets in the United States,
39 which assets may include equity or debt investments in United
40 States companies, with a book value in excess of fifty million

1 dollars (\$50,000,000), and the entity delivers to the Secretary of
2 State an opinion of an attorney licensed in the United States that
3 judgments rendered against the entity may be satisfied by using
4 these assets.

5 (II) The entity posts a bond or similar security in an amount of
6 at least fifty million dollars (\$50,000,000).

7 (III) The entity has directors' and officers' insurance in an
8 amount of at least fifty million dollars (\$50,000,000).

9 (vi) The entity agrees that, in connection with any lawsuit
10 brought against it by its shareholders in any court in which the
11 entity has consented to jurisdiction as described in clause (iv), the
12 entity will provide to the court notice of the manner in which the
13 entity complied with clause (v) and, if the entity complied with
14 that clause in the manner specified in subclause (I) of clause (v),
15 a copy of the opinion described in that subclause.

16 (vii) Shareholder approval is required for any sale of all or
17 substantially all of the entity's assets in accordance with the law,
18 as amended from time to time and as it is interpreted by the courts,
19 of the United States jurisdiction in which it was previously
20 incorporated, or, if it was not previously incorporated, in
21 accordance with the terms set forth in the Model Business
22 Corporations Act, as it may be amended from time to time.

23 (viii) The directors and officers of the entity occupy a fiduciary
24 relationship with the entity and its shareholders and these directors
25 and officers, in performing their duties, act in good faith in a
26 manner that a director or officer believes to be in the best interests
27 of the entity and its shareholders, as that standard of care is
28 interpreted by the courts.

29 (ix) The entity agrees to hold no more than one of every four
30 annual shareholder meetings in a location outside the United States
31 and, in the event that the entity holds an annual meeting outside
32 the United States, the entity agrees to provide access to that meeting
33 through a Web cast or other technology that allows the entity's
34 shareholders to do both of the following:

35 (I) Listen to the meeting, watch the meeting, or both.

36 (II) Send questions that will be addressed at the meeting.

37 (x) The entity provides a description of the shareholder rights
38 described in clauses (i) to (ix), inclusive, and any subsequent
39 changes to these rights, on the entity's Web site or in its 10K filings
40 with the United States Securities and Exchange Commission.

1 (B) The entity uses worldwide combined reporting to calculate
2 the income on which it pays taxes to the state.

3 (c) The chief executive officer of a state agency or his or her
4 designee may waive the prohibition specified in subdivision (a) if
5 the executive officer or his or her designee has made a written
6 finding that the contract is necessary to meet a compelling public
7 interest. For purposes of this section, a “compelling public interest”
8 includes, but is not limited to, ensuring the provision of essential
9 services, ensuring the public health and safety, or an emergency
10 as defined in Section 1102. If a waiver is granted to a vendor
11 pursuant to this subdivision, the requirement to submit a declaration
12 of compliance, as set forth in paragraph (1) of subdivision (d),
13 does not apply to that vendor.

14 (d) (1) For purposes of this chapter, “state agency” means every
15 state office, department, division, bureau, board, commission, and
16 the California State University, but does not include the University
17 of California, the Legislature, the courts, or any agency in the
18 judicial branch of government.

19 (2) On or after January 1, 2004, all state agencies shall, as a
20 condition of the contract, require any vendor that is offered a
21 contract to do business with the state to submit a declaration stating
22 that the vendor is eligible to contract with the state pursuant to this
23 section.

24 (3) A vendor that declares as true any material matter in a
25 declaration described in this subdivision that he or she knows to
26 be false is guilty of a misdemeanor.

27 (e) (1) Except as provided in paragraph (2) and subdivision (f),
28 this section applies to contracts that are entered into on or after
29 January 1, 2004.

30 (2) With respect to an entity that was an expatriate corporation,
31 as defined in paragraph (1) of subdivision (b), before January 1,
32 2004, this section applies to contracts that are entered into on or
33 after April 1, 2004.

34 (f) (1) The declaration requirement set forth in subdivision (d)
35 does not apply to a credit card purchase of goods of two thousand
36 five hundred dollars (\$2,500) or less.

37 (2) The total amount of exemption authorized herein shall not
38 exceed seven thousand five hundred dollars (\$7,500) per year for
39 each company from which a state agency is purchasing goods by
40 credit card. It shall be the responsibility of each state agency to

1 monitor the use of this exemption and adhere to these restrictions
2 on these purchases.

3 *SEC. 2. Section 24411 of the Revenue and Taxation Code is*
4 *amended to read:*

5 24411. (a) For purposes of those taxpayers electing to compute
6 income under Section 25110, ~~100 percent of the qualifying~~
7 ~~dividends described in subdivision (c) and 75 percent of other~~
8 ~~qualifying dividends to the extent not otherwise allowed as a~~
9 ~~deduction or eliminated from income. “Qualifying dividends”~~
10 ~~means those received by the water’s-edge group from corporations~~
11 ~~if both of the following conditions are satisfied to the extent not~~
12 ~~otherwise allowed as a deduction or eliminated from income:~~

13 (1) *One hundred percent of the qualifying dividends described*
14 *in subdivision (d).*

15 (2) *Twenty-seven percent of qualifying dividends described in*
16 *Section 25117.*

17 (3) *Seventy-five percent of qualifying dividends, other than those*
18 *referred to in paragraph (1) or (2).*

19 (b) *“Qualifying dividends” means those received by the*
20 *water’s-edge group from corporations if both of the following*
21 *conditions are satisfied:*

22 (1) *The average of the property, payroll, and sales factors within*
23 *the United States for the corporation is less than 20 percent.*

24 (2) *More than 50 percent of the total combined voting power*
25 *of all classes of stock entitled to vote is owned directly or indirectly*
26 *by the water’s-edge group.*

27 ~~(b)~~

28 (c) *The water’s-edge group consists of corporations whose*
29 *income and apportionment factors are taken into account pursuant*
30 *to Section 25110.*

31 ~~(e)~~

32 (d) *Dividends derived from a construction project, the location*
33 *of which is not subject to the taxpayer’s control.*

34 *For purposes of this subdivision:*

35 (1) *“Construction project” means any activity which meets the*
36 *following requirements:*

37 (A) *Is undertaken for any entity, including a governmental*
38 *entity, which is not affiliated with the taxpayer.*

39 (B) *The majority of its cost of performance is attributable to an*
40 *addition to real property or an alteration of land or any*

1 improvement thereto as those terms are utilized for purposes of
 2 this code.

3 “Construction project” does not include the operation, rental,
 4 leasing, or depletion of real property, land, or any improvement
 5 thereto.

6 (2) “Location of which is not subject to the taxpayer’s control”
 7 means that the place at which the majority of the construction takes
 8 place results from the nature or character of the construction project
 9 and not as a result of the terms of the contract or agreement
 10 governing the construction project.

11 *SEC. 3. Section 25110 of the Revenue and Taxation Code, as*
 12 *amended by Section 1 of Chapter 22 of the Statutes of 2006, is*
 13 *amended to read:*

14 25110. (a) Notwithstanding Section 25101, a qualified
 15 taxpayer, as defined in paragraph (2) of subdivision (b), that is
 16 subject to the tax imposed under this part, may elect to determine
 17 its income derived from or attributable to sources within this state
 18 pursuant to a water’s-edge election in accordance with the
 19 provisions of this part, as modified by this article. A taxpayer, that
 20 made a water’s-edge election prior to January 1, 2006, shall take
 21 into account the income and apportionment factors of the following
 22 affiliated entities only:

23 (1) Domestic international sales corporations, as described in
 24 Sections 991 to 994, inclusive, of the Internal Revenue Code and
 25 foreign sales corporations as described in Sections 921 to 927,
 26 inclusive, of the Internal Revenue Code.

27 (2) Any corporation (other than a bank), regardless of the place
 28 where it is incorporated if the average of its property, payroll, and
 29 sales factors within the United States is 20 percent or more.

30 (3) Corporations that are incorporated in the United States,
 31 excluding corporations making an election pursuant to Sections
 32 931 to 936, inclusive, of the Internal Revenue Code, of which more
 33 than 50 percent of their voting stock is owned or controlled directly
 34 or indirectly by the same interests.

35 (4) A corporation that is not described in paragraphs (1) to (3),
 36 inclusive, or paragraph (5), but only to the extent of its income
 37 derived from or attributable to sources within the United States
 38 and its factors assignable to a location within the United States in
 39 accordance with paragraph (3) of subdivision (b). Income of that
 40 corporation derived from or attributable to sources within the

1 United States as determined by federal income tax laws shall be
2 limited to and determined from the books of account maintained
3 by the corporation with respect to its activities conducted within
4 the United States.

5 (5) Export trade corporations, as described in Sections 970 to
6 972, inclusive, of the Internal Revenue Code.

7 ~~(6) Any affiliated corporation which is a “controlled foreign~~
8 ~~corporation,” as defined in Section 957 of the Internal Revenue~~
9 ~~Code, if all or part of the income of that affiliate is defined in~~
10 ~~Section 952 of Subpart F of the Internal Revenue Code (“Subpart~~
11 ~~F income”). The income and apportionment factors of any affiliate~~
12 ~~to be included under this paragraph shall be determined by~~
13 ~~multiplying the income and apportionment factors of that affiliate~~
14 ~~without application of this paragraph by a fraction (not to exceed~~
15 ~~one), the numerator of which is the “Subpart F income” of that~~
16 ~~corporation for that taxable year and the denominator of which is~~
17 ~~the “earnings and profits” of that corporation for that taxable year;~~
18 ~~as defined in Section 964 of the Internal Revenue Code.~~

19 ~~(7)~~

20 (6) (A) The income and factors of the above-enumerated
21 corporations shall be taken into account only if the income and
22 factors would have been taken into account under Section 25101
23 if this section had not been enacted.

24 (B) The income and factors of a corporation that is not described
25 in paragraphs (1) to (3), inclusive, and paragraph (5) and that is
26 an electing taxpayer under this subdivision shall be taken into
27 account in determining its income only to the extent set forth in
28 paragraph (4).

29 (b) For purposes of this article and Section 24411 all of the
30 following definitions apply:

31 (1) An “affiliated corporation” means a corporation that is a
32 member of a commonly controlled group as defined in Section
33 25105.

34 (2) A “qualified taxpayer” means a corporation which does both
35 of the following:

36 (A) Files with the state tax return on which the water’s-edge
37 election is made a consent to the taking of depositions at the time
38 and place most reasonably convenient to all parties from key
39 domestic corporate individuals and to the acceptance of subpoenas
40 duces tecum requiring reasonable production of documents to the

1 Franchise Tax Board as provided in Section 19504 or by the State
2 Board of Equalization as provided in Title 18, California Code of
3 Regulations, Section 5005, or by the courts of this state as provided
4 in Chapter 2 (commencing with Section 1985) of Title 3 of Part 4
5 of, and Chapter 9 (commencing with Section 2025.010) of Title
6 4 of Part 4 of, the Code of Civil Procedure. The consent relates to
7 issues of jurisdiction and service and does not waive any defenses
8 a taxpayer may otherwise have. The consent shall remain in effect
9 so long as the water's-edge election is in effect and shall be limited
10 to providing that information necessary to review or to adjust
11 income or deductions in a manner authorized under Sections 482,
12 861, Subpart F of Part III of Subchapter N, or similar provisions
13 of the Internal Revenue Code, together with the regulations adopted
14 pursuant to those provisions, and for the conduct of an investigation
15 with respect to any unitary business in which the taxpayer may be
16 involved.

17 (B) Agrees that for purposes of this article, dividends received
18 by any corporation whose income and apportionment factors are
19 taken into account pursuant to subdivision (a) from either of the
20 following are functionally related dividends and shall be presumed
21 to be business income:

22 (i) A corporation of which more than 50 percent of the voting
23 stock is owned, directly or indirectly, by members of the unitary
24 group and which is engaged in the same general line of business.

25 (ii) Any corporation that is either a significant source of supply
26 for the unitary business or a significant purchaser of the output of
27 the unitary business, or that sells a significant part of its output or
28 obtains a significant part of its raw materials or input from the
29 unitary business. "Significant," as used in this subparagraph, means
30 an amount of 15 percent or more of either input or output.

31 All other dividends shall be classified as business or nonbusiness
32 income without regard to this subparagraph.

33 (3) The definitions and locations of property, payroll, and sales
34 shall be determined under the laws and regulations that set forth
35 the apportionment formulas used by the individual states to assign
36 net income subject to taxes on or measured by net income in that
37 state. If a state does not impose a tax on or measured by net income
38 or does not have laws or regulations with respect to the assignment
39 of property, payroll, and sales, the laws and regulations provided
40 in Article 2 (commencing with Section 25120) shall apply.

1 Sales shall be considered to be made to a state only if the
2 corporation making the sale may otherwise be subject to a tax on
3 or measured by net income under the Constitution or laws of the
4 United States, and shall not include sales made to a corporation
5 whose income and apportionment factors are taken into account
6 pursuant to subdivision (a) in determining the amount of income
7 of the taxpayer derived from or attributable to sources within this
8 state.

9 (4) “The United States” means the 50 states of the United States
10 and the District of Columbia.

11 (c) All references in this part to income determined pursuant to
12 Section 25101 shall also mean income determined pursuant to this
13 section.

14 (d) (1) This section shall apply only to a taxable year of a
15 taxpayer that determines its income derived from or attributable
16 to sources within this state pursuant to a water’s-edge election
17 made prior to January 1, 2006, where that election may not be
18 terminated for that taxable year without the consent of the
19 Franchise Tax Board pursuant to paragraph (9) of subdivision (c)
20 of Section 25113.

21 (2) This section shall be repealed on January 1, 2014.

22 *SEC. 4. Section 25110 of the Revenue and Taxation Code, as*
23 *added by Section 2 of Chapter 22 of the Statutes of 2006, is*
24 *amended to read:*

25 25110. (a) Notwithstanding Section 25101, a qualified
26 taxpayer, as defined in paragraph (2) of subdivision (b), that is
27 subject to the tax imposed under this part, may elect to determine
28 its income derived from or attributable to sources within this state
29 pursuant to a water’s-edge election in accordance with the
30 provisions of this part, as modified by this article. A taxpayer, that
31 makes a water’s-edge election on or after January 1, 2006, shall
32 take into account that portion of its own income and apportionment
33 factors and the income and apportionment factors of its affiliated
34 entities to the extent provided below:

35 (1) The entire income and apportionment factors of any of the
36 following corporations:

37 (A) Domestic international sales corporations, as described in
38 Sections 991 to 994, inclusive, of the Internal Revenue Code and
39 foreign sales corporations as described in Sections 921 to 927,
40 inclusive, of the Internal Revenue Code.

1 (B) Any corporation (other than a bank), regardless of the place
2 where it is incorporated if the average of its property, payroll, and
3 sales factors within the United States is 20 percent or more.

4 (C) Corporations that are incorporated in the United States,
5 excluding corporations making an election pursuant to Sections
6 931 to 936, inclusive, of the Internal Revenue Code.

7 (D) Export trade corporations, as described in Sections 970 to
8 972, inclusive, of the Internal Revenue Code.

9 (2) ~~(A)~~ With respect to a corporation that is not described in
10 subparagraphs (A), (B), (C), and (D) of paragraph (1), ~~as provided~~
11 ~~in either one or both of the following clauses:~~

12 ~~(i) The~~ *the* income and apportionment factors of that corporation
13 to the extent of its income derived from or attributable to sources
14 within the United States and its factors assignable to a location
15 within the United States in accordance with paragraph (3) of
16 subdivision (b). Income of that corporation derived from or
17 attributable to sources within the United States as determined by
18 federal income tax laws shall be limited to, and determined from,
19 the books of account maintained by the corporation with respect
20 to its activities conducted within the United States.

21 ~~(ii) The income and apportionment factors of that corporation~~
22 ~~that is a “controlled foreign corporation,” as defined in Section~~
23 ~~957 of the Internal Revenue Code, to the extent determined by~~
24 ~~multiplying the income and apportionment factors of that~~
25 ~~corporation without application of this subparagraph by a fraction~~
26 ~~not to exceed one, the numerator of which is the “Subpart F~~
27 ~~income” of that corporation for that taxable year and the~~
28 ~~denominator of which is the “earnings and profits” of that~~
29 ~~corporation for that taxable year.~~

30 ~~(B) For purposes of this paragraph, both of the following apply:~~

31 ~~(i) “Subpart F income” means “Subpart F income” as defined~~
32 ~~in Section 952 of the Internal Revenue Code.~~

33 ~~(ii) “Earnings and profits” means “earnings and profits” as~~
34 ~~described in Section 964 of the Internal Revenue Code.~~

35 (3) The income and apportionment factors of the corporations
36 described in this subdivision shall be taken into account only to
37 the extent that they would have been taken into account had no
38 election under this section been made.

39 ~~(4) The Franchise Tax Board shall prescribe regulations to~~
40 ~~coordinate implementation of subparagraph (A) of paragraph (2)~~

1 ~~to prevent multiple inclusion or exclusion of income and factors~~
2 ~~in situations where the same item of income is described in both~~
3 ~~clauses.~~

4 (b) For purposes of this article and Section 24411, all of the
5 following definitions apply:

6 (1) An “affiliated corporation” means a corporation that is a
7 member of a commonly controlled group as defined in Section
8 25105.

9 (2) A “qualified taxpayer” means a corporation that does both
10 of the following:

11 (A) Files with the state tax return, on which the water’s-edge
12 election is made, a consent to the taking of depositions, at the time
13 and place most reasonably convenient to all parties, from key
14 domestic corporate individuals and to the acceptance of subpoenas
15 duces tecum requiring reasonable production of documents to the
16 Franchise Tax Board, as provided in Section 19504, by the State
17 Board of Equalization, as provided in Section 5005 of Title 18 of
18 the California Code of Regulations, or by the courts of this state,
19 as provided in Chapter 2 (commencing with Section 1985) of Title
20 3 of Part 4 of, and Chapter 9 (commencing with Section 2025.010)
21 of Title 4 of Part 4 of, the Code of Civil Procedure. The consent
22 relates to issues of jurisdiction and service and does not waive any
23 defenses that a taxpayer may otherwise have. The consent shall
24 remain in effect as long as the water’s-edge election is in effect,
25 and shall be limited to providing that information necessary to
26 review or adjust income or deductions in a manner authorized by
27 Section 482, 861, Subpart F of Part III of Subchapter N, or similar
28 provisions, of the Internal Revenue Code, together with the
29 regulations adopted pursuant to those provisions, and for the
30 conduct of an investigation with respect to any unitary business
31 in which the taxpayer may be involved.

32 (B) Agrees that, for purposes of this article, dividends received
33 by any corporation whose income and apportionment factors are
34 taken into account pursuant to subdivision (a) from either of the
35 following are functionally related dividends and shall be presumed
36 to be business income:

37 (i) A corporation of which more than 50 percent of the voting
38 stock is owned, directly or indirectly, by members of the unitary
39 group and which is engaged in the same general line of business.

1 (ii) Any corporation that is either a significant source of supply
2 for the unitary business or a significant purchaser of the output of
3 the unitary business, or that sells a significant part of its output or
4 obtains a significant part of its raw materials or input from the
5 unitary business. “Significant,” as used in this subparagraph, means
6 an amount of 15 percent or more of either input or output.

7 All other dividends shall be classified as business or nonbusiness
8 income without regard to this subparagraph.

9 (3) The definitions and locations of property, payroll, and sales
10 shall be determined under the laws and regulations that set forth
11 the apportionment formulas used by the individual states to assign
12 net income subject to taxes on, or measured by, net income in that
13 state. If a state does not impose a tax on, or measured by, net
14 income or does not have laws or regulations with respect to the
15 assignment of property, payroll, and sales, the laws and regulations
16 provided in Article 2 (commencing with Section 25120) shall
17 apply.

18 Sales shall be considered to be made to a state only if the
19 corporation making the sale may otherwise be subject to a tax on,
20 or measured by, net income under the Constitution or laws of the
21 United States, and shall not include sales made to a corporation
22 whose income and apportionment factors are taken into account
23 pursuant to subdivision (a) in determining the amount of income
24 of the taxpayer derived from or attributable to sources within this
25 state.

26 (4) “The United States” means the 50 states of the United States
27 and the District of Columbia.

28 (c) All references in this part to income determined pursuant to
29 Section 25101 shall also mean income determined pursuant to this
30 section.

31 *SEC. 5. Section 25117 is added to the Revenue and Taxation*
32 *Code, to read:*

33 *25117. (a) Except as otherwise provided, income taken into*
34 *account by all affiliated entities whose income and apportionment*
35 *factors are determined pursuant to Section 25110 shall include*
36 *income described in Subpart F of the Internal Revenue Code*
37 *(commencing with Section 951). The income that is taken into*
38 *account shall for all purposes be treated as a dividend actually*
39 *paid, and be subject to any provision or limitation related to the*
40 *treatment of dividends, including, but not limited to, Sections*

1 24344, 24410, 24411, and 25106. The amount taken into account
2 shall be treated as business or nonbusiness income as defined in
3 Section 25120, as the case may be.

4 (b) In the application of Subpart F of the Internal Revenue Code:

5 (1) Exclusions from gross income under Section 959 of the
6 Internal Revenue Code, relating to previously taxed income, shall
7 apply, including amounts related to income previously taxed under
8 federal law in years prior to the water's-edge election.

9 (2) Federal adjustments to stock basis made pursuant to Section
10 961 of the Internal Revenue Code, relating to adjustments to basis
11 of stock in controlled foreign corporations and of other property,
12 including adjustments made prior to the water's-edge election,
13 shall apply.

14 (3) The provisions of and any reference to Section 1248 of the
15 Internal Revenue Code, relating to gain from certain sales or
16 exchanges of stock in certain foreign corporations, shall not apply.

17 (4) Section 960 of the Internal Revenue Code, relating to special
18 rules for foreign tax credit, shall not apply.

19 (5) Section 965 of the Internal Revenue Code, relating to
20 temporary dividends received deduction, shall not apply.

21 (6) For purposes of this section, a federal election to exclude
22 from Subpart F income the income described in Section 954(b)(4)
23 of the Internal Revenue Code shall apply, including amounts
24 related to income previously taxed under federal law in years prior
25 to the water's-edge election. No election under this subparagraph
26 shall be allowed for state purposes unless a valid election was
27 made for federal purposes.

28 (c) In the event that a water's-edge election is terminated, for
29 taxable years thereafter, the following rules apply:

30 (1) Subpart F of the Internal Revenue Code shall not apply,
31 except as provided in this subdivision.

32 (2) Section 959 of the Internal Revenue Code, relating to
33 exclusion from gross income of previously taxed earnings and
34 profits, shall apply, but only to the extent attributable to income
35 that has been taken into account pursuant to subdivision (a) during
36 the period of the water's-edge election.

37 (3) Stock basis shall be determined as if this section did not
38 apply, except that stock basis shall be:

39 (A) Increased by income taken into account pursuant to
40 subdivision (a) during the period of the water's-edge election.

- 1 (B) *Reduced by both the following:*
- 2 (i) *That portion of amounts excluded from income under*
- 3 *paragraph (2) of subdivision (b) that are attributable to income*
- 4 *taken into account pursuant to subdivision (a) during the period*
- 5 *of the water's-edge election.*
- 6 (ii) *Amounts described by paragraph (2) of subdivision (c)*
- 7 *excluded from income after termination of the water's-edge*
- 8 *election.*
- 9 (d) (1) *Except as provided in paragraph (2), this section shall*
- 10 *apply to taxable years beginning on or after January 1, 2010.*
- 11 (2) *In the event that two or more taxpayers subject to the same*
- 12 *election under Section 25110 have different taxable years, this*
- 13 *section shall apply as of the first day of the first taxable year of*
- 14 *those respective taxpayers that begins on or after January 1, 2010.*
- 15 (e) *The Franchise Tax Board may prescribe regulations as may*
- 16 *be necessary and appropriate to carry out the purposes of this*
- 17 *section.*