AMENDED IN ASSEMBLY JANUARY 4, 2010

CALIFORNIA LEGISLATURE—2009–10 REGULAR SESSION

ASSEMBLY BILL No. 1178

Introduced by Assembly Member Block

February 27, 2009

An act to ~~amend Section 25110 of~~ *amend, repeal, and add Section 25110 of, and to add Section 6361.7 of,* the Revenue and Taxation Code, relating to taxation, to take effect immediately, tax levy.

LEGISLATIVE COUNSEL'S DIGEST

AB 1178, as amended, Block. ~~Corporation tax: water's edge election: tax havens.~~ *Sales, use, and corporation taxes.*

The Sales and Use Tax Law imposes a tax on retailers measured by the gross receipts from the sale of tangible personal property sold at retail in this state, or on the storage, use, or other consumption in this state of tangible personal property purchased from a retailer for storage, use, or other consumption in this state. That law provides various exemptions from those taxes.

This bill would exempt from those taxes, beginning on January 1, 2011, and ending on January 1, 2014, the sale of, and the storage, use, or other consumption of qualified educational property, as defined, sold at an institution of higher education, defined to include the University of California, the California State University, or a California Community College, the exemptions would be from only a portion of those taxes for the period from January 1, 2011, to July 1, 2011, as provided.

The Bradley-Burns Uniform Local Sales and Use Tax Law authorizes counties and cities to impose local sales and use taxes in conformity with the Sales and Use Tax Law, and existing law authorizes various *local governmental entities to levy transactions and use taxes in accordance with the procedures and requirements set forth in the Transactions and Use Tax Law.*

Exemptions from state sales and use taxes are incorporated in these laws. Section 2230 of the Revenue and Taxation Code provides that the state will reimburse counties and cities for revenue losses caused by the enactment of sales and use tax exemptions.

This bill would specify that this exemption does not apply to local sales and use taxes, transactions and use taxes, and specified state taxes.

The Corporation Tax Law imposes taxes measured by income and, in the case of a business with income derived from or attributable to sources both within and without this state, apportions the income between this state and other states and foreign countries in accordance with a specified apportionment formula based on the property, payroll, and sales within and without this state, except as otherwise provided. That law allows corporations to elect whether their income is determined on a water's-edge basis or on a worldwide unitary basis. In general, a corporation that makes a water's-edge election is subject to tax on income only from sources within the United States but is required to take into account the income and apportionment factors of certain specified affiliated entities.

This bill would expand the list of specified affiliated entities for taxable years beginning on or after January 1~~, 2010,~~ *2011, and ending before January 1, 2014*, to include a corporation that is incorporated, headquartered, or located in a country that is a tax haven, as defined, and would make related legislative findings and declarations.

This bill would also require the Legislative Analyst, in consultation with the Franchise Tax Board, to conduct a study regarding the jurisdictions identified by the Organization for Economic Cooperation and Development (OECD) as tax havens and to report to the Legislature, no later than January 1, ~~2011~~ *2012*, as to whether the definition of the term "tax haven" should be revised.

~~This bill would result in a change in state taxes for the purpose of increasing state revenues within the meaning of Section 3 of Article XIII A of the California Constitution, and thus would require for passage the approval of ⅔ of the membership of each house of the Legislature.~~

This bill would take effect immediately as a tax levy.

Vote: ~~⅔~~ *majority*. Appropriation: no. Fiscal committee: yes. State-mandated local program: no.

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

SECTION 1. (a) The Legislature finds and declares all of the following:

(1) The sheltering of income in offshore tax haven countries has been a major means of tax avoidance for multinational corporations.

(2) In many cases the sheltering occurs because income that should be properly attributed to activities in the United States is being attributed to those tax haven countries.

(3) The water's-edge election provisions enacted by California addressed these concerns by requiring that some foreign incorporated entities be included within a corporate taxpayer's water's-edge combined report. However, additional strategies have been developed by multinational corporations to assign income to foreign incorporated entities that perform limited economic activity in those countries and are not included within the water's-edge combined report.

(b) It is the intent of the Legislature, therefore, in ~~enacting this section~~ *amending Section 25110 of the Revenue and Taxation Code by this act,* to further limit the ability of multinational corporations to use tax haven countries to exclude income from the water's-edge combined report as a means of domestic tax avoidance, to the extent that such income is not derived from, or attributable to, substantial economic presence or significant economic activity in the tax haven country.

(c) In granting regulatory authority to the Franchise Tax Board with regard to a determination of whether a corporation has established a substantial economic presence or conducts significant economic activity in a tax haven country, the Legislature intends that the Franchise Tax Board examine whether economic factors, including payroll and property, are located in the tax haven in a manner proportionate to the income attributable to the tax haven.

SEC. 2. Section 6361.7 is added to the Revenue and Taxation Code, to read:

6361.7. (a) On and after January 1, 2011, and before January 1, 2014, there are exempted from the taxes imposed by this part, the gross receipts from the sale in this state of, and the storage, use, or other consumption in this state of, qualified educational *property that is purchased by a student at an institution of higher education.*

(b) For purposes of this section, the following definitions apply:

(1) An "institution of higher education" means the University of California, the California State University, or a California Community College.

(2) "Qualified educational property" means books, supplies, and equipment required for the enrollment or attendance of a designated beneficiary at an institution of higher education.

(c) (1) (A) Notwithstanding subdivision (a), on and after January, 1, 2011, and before July, 1, 2011, the exemption provided by this section shall not apply with respect to any tax levied pursuant to Section 6051.2, 6051.5, 6201.2, or 6201.5, pursuant to Section 35 of Article XIII of the California Constitution, or with respect to that portion of the tax levied at a rate of 3.75 percent pursuant to Section 6051 or 6201.

(B) Notwithstanding subdivision (a), or and after July 1, 2011, the exemption provided by this section shall not apply with respect to any tax levied pursuant to Section 6051.2, 6051.5, 6201.2, or 6201.5, or pursuant to Section 35 of Article XIII of the California Constitution.

(2) Notwithstanding any provision of the Bradley-Burns Uniform Local Sales and Use Tax Law (Part 1.5 (commencing with Section 7200)) or the Transactions and Use Tax Law (Part 1.6 (commencing with Section 7251)), the exemption established by this section shall not apply with respect to any tax levied by a county, city, or district pursuant to, or in accordance with, either of those laws.

~~SEC. 2.~~

SEC. 3. Section 25110 of the Revenue and Taxation Code, as added by Section 2 of Chapter 22 of the Statutes of 2006, is amended to read:

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

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

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

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

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

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

(E) (i) Subject to clause (ii), for taxable years beginning on or after January 1,~~ 2010~~ *2011, and ending before January 1, 2014,* any corporation that, for any portion of the taxable year, was doing business in, or had income derived from or attributable to, a tax haven.

(ii) If the application of clause (i) results in the inclusion of a business activity in, or income derived from or attributable to, a tax haven that constitutes either a substantial economic presence or significant economic activity in that jurisdiction, the taxpayer may petition the Franchise Tax Board to treat the activity and income of that corporation or activity as not having been conducted in, or derived from or attributable to, the tax haven.

(iii) The Franchise Tax Board shall prescribe any regulations that may be necessary or appropriate to carry out the purposes of the amendments made to this section by the act adding this clause, including regulations prescribing the extent to which an activity in, or income derived from or attributable to, a tax haven will be presumed to be either a substantial economic presence or significant economic activity, and the extent to which income will be presumed to be not derived from or attributable to a tax haven.

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

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

(ii) The income and apportionment factors of that corporation that is a "controlled foreign corporation," as defined in Section 957 of the Internal Revenue Code, to the extent determined by multiplying the income and apportionment factors of that corporation without application of this subparagraph by a fraction not to exceed one, the numerator of which is the "Subpart F income" of that corporation for that taxable year and the denominator of which is the "earnings and profits" of that corporation for that taxable year.

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

(i) "Subpart F income" means "Subpart F income" as defined in Section 952 of the Internal Revenue Code.

(ii) "Earnings and profits" means "earnings and profits" as described in Section 964 of the Internal Revenue Code.

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

(4) The Franchise Tax Board shall prescribe regulations to coordinate implementation of subparagraph (A) of paragraph (2) to prevent multiple inclusion or exclusion of income and factors in situations where the same item of income is described in both clauses.

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

(1) An "affiliated corporation" means a corporation that is a member of a commonly controlled group as defined in Section 25105.

(2) A "qualified taxpayer" means a corporation that does both of the following:

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

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

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

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

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

(3) The definitions and locations of property, payroll, and sales shall be determined under the laws and regulations that set forth the apportionment formulas used by the individual states to assign

net income subject to taxes on, or measured by, net income in that state. If a state does not impose a tax on, or measured by, net income or does not have laws or regulations with respect to the assignment of property, payroll, and sales, the laws and regulations provided in Article 2 (commencing with Section 25120) shall apply.

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

(4) "The United States" means the 50 states of the United States and the District of Columbia.

(5) (A) For purposes of this section, a "tax haven" means any of the 39 jurisdictions that, as of December of 2002, were identified as tax havens by the Organization for Economic Cooperation and Development (OECD).

(B) The Franchise Tax Board shall issue a notice identifying the jurisdictions that are tax havens for purposes of this section.

(C) The Legislative Analyst, in consultation with the Franchise Tax Board, shall conduct a study regarding the jurisdictions identified by the OECD as tax havens and shall report to the Legislature, no later than January 1, ~~2011~~ *2012*, as to whether the definition of the term "tax haven" should be revised.

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

(d) This section shall remain in effect only until January 1, 2014, and as of that date is repealed.

SEC. 4. Section 25110 is added to the Revenue and Taxation Code, to read:

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

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

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

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

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

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

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

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

(ii) The income and apportionment factors of that corporation that is a "controlled foreign corporation," as defined in Section 957 of the Internal Revenue Code, to the extent determined by multiplying the income and apportionment factors of that corporation without application of this subparagraph by a fraction not to exceed one, the numerator of which is the "Subpart F income" of that corporation for that taxable year and the denominator of which is the "earnings and profits" of that corporation for that taxable year.

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

(i) "Subpart F income" means "Subpart F income" as defined in Section 952 of the Internal Revenue Code.

(ii) "Earnings and profits" means "earnings and profits" as described in Section 964 of the Internal Revenue Code.

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

(4) The Franchise Tax Board shall prescribe regulations to coordinate implementation of subparagraph (A) of paragraph (2) to prevent multiple inclusion or exclusion of income and factors in situations where the same item of income is described in clauses.

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

(1) An "affiliated corporation" means a corporation that is a member of a commonly controlled group as defined in Section 25105.

(2) A "qualified taxpayer" means a corporation that does both of the following:

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

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

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

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

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

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

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

(4) "The United States" means the 50 states of the United States and the District of Columbia.

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

(d) This section shall become operative on January 1, 2014.

~~SEC. 3.~~ *SEC. 5.* This act provides for a tax levy within the meaning of Article IV of the Constitution and shall go into immediate effect.

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