

AMENDED IN ASSEMBLY JANUARY 25, 2010

AMENDED IN ASSEMBLY JANUARY 13, 2010

AMENDED IN ASSEMBLY JANUARY 6, 2010

AMENDED IN ASSEMBLY JANUARY 4, 2010

CALIFORNIA LEGISLATURE—2009–10 REGULAR SESSION

ASSEMBLY BILL

No. 1178

Introduced by Assembly Member Block
(Coauthors: Assembly Members Blumenfield, Nava, and Ruskin)

February 27, 2009

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

LEGISLATIVE COUNSEL'S DIGEST

AB 1178, as amended, Block. 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 provide a partial exemption from those taxes, on and after July 1, 2011, and before January 1, 2015, for the sale of, and the storage, use, or other consumption of, textbooks and supplies, as defined, purchased by a student enrolled in an institution of higher education, as defined to mean the University of California, the California State University, or a California community college.

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 further authorizes various local governmental entities to levy transactions and use taxes in accordance with the procedures and requirements of 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 sales and use 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 July 1, 2011, and before July 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 as tax havens and to report to the Legislature, no later than January 1, 2012, as to whether the definition of the term "tax haven" should be revised.~~

This bill would take effect immediately as a tax levy.

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

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

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

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

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

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

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

25 (c) In granting regulatory authority to the Franchise Tax Board
26 with regard to a determination of whether a corporation has
27 established a ~~substantial economic presence or conducts significant~~
28 ~~economic activity~~ *the active conduct of a trade or business* in a
29 tax haven country, the Legislature intends that the Franchise Tax
30 Board examine whether economic factors, including payroll and
31 property, are located in the tax haven in a manner proportionate
32 to the income attributable to the tax haven.

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

35 6361.7. (a) On and after July 1, 2011, and before January 1,
36 2015, there are exempted from the taxes imposed by this part, the
37 gross receipts from the sale in this state of, and the storage, use,
38 or other consumption in this state of, textbooks or supplies that

1 are purchased by a student enrolled in an institution of higher
2 education, and the textbooks or supplies are recommended or
3 required for a course in which the student is enrolled.

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

5 (1) "Institution of higher education" means the University of
6 California, the California State University, or a California
7 community college.

8 (2) "Supplies" means pens, paper, blue books, notebooks, art
9 supplies, uniforms, safety equipment, tools, computer paper, and
10 flashdrives necessary for the course of study in which a student is
11 enrolled at the institution of higher education. Supplies shall not
12 include computers, printers, or related hardware and software.

13 (3) "Textbooks" means any published material that is principally
14 designed for use by a student at an institution of higher education
15 as a source of instructional material and includes, but is not limited
16 to, any book or edition of a book that is directed or recommended
17 by an instructor at an institution of higher education to a student
18 to purchase for use as a basis for a course of study in which that
19 student is enrolled at that institution.

20 (c) (1) (A) Notwithstanding subdivision (a), on and after July
21 1, 2011, and before July 1, 2012, the exemption provided by this
22 section shall not apply with respect to any tax levied pursuant to
23 Section 6051.2, 6051.5, 6201.2, or 6201.5, pursuant to Section 35
24 of Article XIII of the California Constitution, or with respect to
25 that portion of the tax levied at a rate of 2 percent pursuant to
26 Section 6051 or 6201.

27 (B) Notwithstanding subdivision (a), on and after July 1, 2012,
28 the exemption provided by this section shall not apply with respect
29 to any tax levied pursuant to Section 6051.2, 6051.5, 6201.2, or
30 6201.5, or pursuant to Section 35 of Article XIII of the California
31 Constitution.

32 (2) Notwithstanding any provision of the Bradley-Burns
33 Uniform Local Sales and Use Tax Law (Part 1.5 (commencing
34 with Section 7200)) or the Transactions and Use Tax Law (Part
35 1.6 (commencing with Section 7251)), the exemption established
36 by this section shall not apply with respect to any tax levied by a
37 county, city, or district pursuant to, or in accordance with, either
38 of those laws.

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 July 1, 2011, and before July 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. For purposes of this subparagraph, ~~"doing business in a tax haven"~~ means *in* or *"doing business within"* means being engaged in activity that is sufficient for a tax haven jurisdiction to impose a tax under United States constitutional standards.

(ii) If the application of clause (i) would result in the inclusion of the income and apportionment factors of a corporation engaged in the active conduct of trade or business, within the meaning of Section 367(a)(3)(A) of the Internal Revenue Code and the regulations thereunder, in a tax haven, the taxpayer may petition

1 the Franchise Tax Board to treat the corporation as not doing
2 business within, or having income derived from or attributable to,
3 the tax haven. *The procedure to petition as described in this clause*
4 *shall be developed in a form and manner determined by the*
5 *Franchise Tax Board and in accordance with Section 25137. The*
6 *determination of the Franchise Tax Board may be appealed to the*
7 *State Board of Equalization in the form and manner described in*
8 *Article 3 (commencing with Section 19031) of Chapter 4 of Part*
9 *10.2.*

10 (iii) The Franchise Tax Board shall prescribe any regulations
11 that may be necessary or appropriate to carry out the purposes of
12 the amendments made to this section by the act adding this clause,
13 including regulations prescribing the extent to which an activity
14 in, or income derived from or attributable to, a tax haven will be
15 presumed to be from the active conduct of a trade or business in
16 the tax haven, and the extent to which income will be presumed
17 to be not derived from or attributable to a tax haven.

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

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

30 (ii) The income and apportionment factors of that corporation
31 that is a “controlled foreign corporation,” as defined in Section
32 957 of the Internal Revenue Code, to the extent determined by
33 multiplying the income and apportionment factors of that
34 corporation without application of this subparagraph by a fraction
35 not to exceed one, the numerator of which is the “Subpart F
36 income” of that corporation for that taxable year and the
37 denominator of which is the “earnings and profits” of that
38 corporation for that taxable year.

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

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

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

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

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

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

16 (1) An “affiliated corporation” means a corporation that is a
17 member of a commonly controlled group as defined in Section
18 25105.

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

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

1 conduct of an investigation with respect to any unitary business
2 in which the taxpayer may be involved.

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

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

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

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

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

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

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

38 (5) (A) For purposes of this section, a “tax haven” means any
39 jurisdictions identified in Table 1 of Appendix I to the December
40 2008 Report of the United States Government Accountability

1 Office on International Taxation (GAO-09-157) as a jurisdiction
2 for which a United States District Court order granted leave for
3 the federal Internal Revenue Service to serve a “John Doe”
4 summons.

5 (B) *An additional jurisdiction shall be considered a “tax haven”*
6 *for purposes of this section if the Secretary of the Treasury of the*
7 *United States issues notice after January 1, 2011, declaring that*
8 *the jurisdiction is recognized as a tax haven by the United States.*
9 *A jurisdiction shall not be considered a “tax haven” for purposes*
10 *of this section if the Secretary of the Treasury of the United States*
11 *issues notice after January 1, 2011, declaring the jurisdiction is*
12 *no longer recognized as a tax haven by the United States.*

13 ~~(B)~~

14 (C) The Franchise Tax Board shall *annually* issue a notice
15 identifying the jurisdictions that are tax havens for purposes of
16 this section *for that tax year*.

17 ~~(C) The Legislative Analyst, in consultation with the Franchise~~
18 ~~Tax Board, shall conduct a study regarding the jurisdictions~~
19 ~~identified in subparagraph (A) as tax havens and shall report to~~
20 ~~the Legislature, no later than January 1, 2012, as to whether the~~
21 ~~definition of the term “tax haven” should be revised.~~

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

25 (d) This section shall remain in effect only until June 1, 2015,
26 and as of that date is repealed.

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

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

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

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

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

8 (C) Corporations that are incorporated in the United States,
9 excluding corporations making an election pursuant to Sections
10 931 to 936, inclusive, of the Internal Revenue Code.

11 (D) Export trade corporations, as described in Sections 970 to
12 972, inclusive, of the Internal Revenue Code.

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

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

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

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

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

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

39 (3) The income and apportionment factors of the corporations
40 described in this subdivision shall be taken into account only to

1 the extent that they would have been taken into account had no
2 election under this section been made.

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

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

9 (1) An “affiliated corporation” means a corporation that is a
10 member of a commonly controlled group as defined in Section
11 25105.

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

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

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

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

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

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

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

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

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

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

34 (d) This section shall become operative on July 1, 2014, and
35 apply to taxable years beginning on or after July 1, 2014.

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