

ASSEMBLY BILL

No. 1618

Introduced by Assembly Member Havice

February 26, 1999

An act to amend Sections 25110 and 25111 of the Revenue and Taxation Code, relating to taxation.

LEGISLATIVE COUNSEL'S DIGEST

AB 1618, as introduced, Havice. Bank and corporation taxes: unitary taxation: water's-edge election.

The Bank and Corporation Tax Law provides, in the case of a business with income derived from, or attributable to, sources both within and without this state, that income is apportioned between this state and foreign jurisdictions in accordance with a specified formula. The Bank and Corporation Tax Law authorizes a taxpayer whose income is subject to apportionment to determine its income under a water's-edge election made in connection with a specified contract. Existing law includes among those entities, the income of which is attributed to a taxpayer who makes a water's-edge election, any corporation other than a bank, regardless of where it is incorporated, if the average of certain income apportionment factors with respect to the United States is 20% or more. Existing law also specifies, subject to certain exceptions, that the initial term of a contract for a water's-edge election is 84 months.

This bill would make technical, nonsubstantive changes to those provisions.

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

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

1 SECTION 1. Section 25110 of the Revenue and
2 Taxation Code is amended to read:
3 25110. (a) Notwithstanding Section 25101, a qualified
4 taxpayer, as defined in paragraph (2) of subdivision (b),
5 that is subject to the tax imposed under this part, may
6 elect to determine its income derived from or
7 attributable to sources within this state pursuant to a
8 water’s-edge election in accordance with ~~the provisions~~
9 ~~of~~ this part, as modified by this article. A taxpayer that
10 makes a water’s-edge election shall take into account the
11 income and apportionment factors of the following
12 affiliated entities only:

13 (1) Domestic international sales corporations, as
14 described in Sections 991 to 994, inclusive, of the Internal
15 Revenue Code and foreign sales corporations as
16 described in Sections 921 to 927, inclusive, of the Internal
17 Revenue Code.

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

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

28 (4) A corporation that is not described in paragraphs
29 (1) to (3), inclusive, or paragraph (5), but only to the
30 extent of its income derived from or attributable to
31 sources within the United States and its factors assignable
32 to a location within the United States in accordance with
33 paragraph (3) of subdivision (b). Income of that
34 corporation derived from or attributable to sources
35 within the United States as determined by federal income



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

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

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

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

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

32 (b) For purposes of this article and Section 24411:

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

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

38 (A) Files with the state tax return on which the
39 water’s-edge election is made a consent to the taking of
40 depositions at the time and place most reasonably



1 convenient to all parties from key domestic corporate
2 individuals and to the acceptance of subpoenas duces
3 tecum requiring reasonable production of documents to
4 the Franchise Tax Board as provided in Section 19504 or
5 by the State Board of Equalization as provided in Title 18,
6 California Code of Regulations, Section 5005, or by the
7 courts of this state as provided in Chapter 2 (commencing
8 with Section 1985) of Title 3 of Part 4 of, and Section 2025
9 of, the Code of Civil Procedure. The consent relates to
10 ~~issues—any issue~~ of jurisdiction and service and does not
11 waive any ~~defenses—defense~~ a taxpayer may otherwise
12 have. The consent shall remain in effect so long as the
13 water’s-edge election is in effect and shall be limited to
14 providing that information necessary to review or to
15 adjust income or deductions in a manner authorized
16 under Sections 482, 861, Subpart F of Part III of
17 Subchapter N, or similar provisions of the Internal
18 Revenue Code, together with the regulations adopted
19 pursuant to those provisions, and for the conduct of an
20 investigation with respect to any unitary business in
21 which the taxpayer may be involved.

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

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

32 (ii) Any corporation that is either a significant source
33 of supply for the unitary business or a significant
34 purchaser of the output of the unitary business, or that
35 sells a significant part of its output or obtains a significant
36 part of its raw materials or input from the unitary
37 business. “Significant,” as used in this subparagraph,
38 means an amount of 15 percent or more of either input
39 or output.



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

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

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

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

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

27 SEC. 2. Section 25111 of the Revenue and Taxation
28 Code is amended to read:

29 25111. (a) The making of a water’s-edge election as
30 provided for in Section 25110 shall be made by contract
31 with the Franchise Tax Board in the original return for a
32 year and shall be effective only if every taxpayer that is
33 a member of the water’s-edge group and which is subject
34 to tax under this part makes the election. A single
35 taxpayer that is engaged in more than one business
36 activity subject to allocation and apportionment as
37 provided in Article 2 (commencing with Section 25120)
38 of Chapter 17 may make a separate election for each
39 business. The form and manner of making the
40 water’s-edge election shall be prescribed by the



1 Franchise Tax Board. Each contract making a
2 water's-edge election shall be for an initial term of 84
3 months, except as provided in subdivision (b). Each
4 contract shall provide that on the anniversary date of the
5 contract or any other annual date specified by the
6 contract a year shall be added automatically to the initial
7 term unless notice of nonrenewal is given as provided in
8 subdivision (d). An affiliated corporation that is a
9 member of the water's-edge group and subsequently
10 becomes subject to tax under this part or is a nonelecting
11 taxpayer that is subsequently proved to be a member of
12 the water's-edge group pursuant to a Franchise Tax
13 Board audit determination, as evidenced by a notice of
14 deficiency proposed to be assessed or a notice of tax
15 change, shall be deemed to have elected.

16 No water's-edge election shall be made for an income
17 year beginning prior to January 1, 1988.

18 (b) A water's-edge election may be terminated by a
19 taxpayer prior to the end of the 84-month period if either
20 of the following occurs:

21 (1) The taxpayer is acquired directly or indirectly by
22 a nonelecting entity which alone or together with those
23 affiliates included in its combined report is larger than the
24 taxpayer as measured by equity capital.

25 (2) With the permission of the Franchise Tax Board.

26 (c) In granting a change of election, the Franchise Tax
27 Board shall impose any ~~conditions~~ *condition* that ~~are~~ *is*
28 necessary to prevent the avoidance of tax or to clearly
29 reflect income for the period the election was, or was
30 purported to be, in effect. ~~These conditions~~ *The condition*
31 may include a requirement that income, including
32 dividends paid from income earned while a water's-edge
33 election was in effect, which would have been included
34 in determining the income of the taxpayer from sources
35 within and without this state pursuant to Section 25101
36 but for the water's-edge election shall be included in
37 income in the year in which the election is changed.

38 (d) If the taxpayer desires in any year not to renew the
39 election, the taxpayer shall serve written notice of
40 nonrenewal upon the board at least 90 days in advance of



1 the annual renewal date. Unless that written notice is
2 provided to the board, the election shall be considered
3 renewed as provided in subdivision (a).

4 (e) If the taxpayer serves notice of intent in any year
5 not to renew the existing water's-edge election, that
6 existing election shall remain in effect for the balance of
7 the period remaining since the original election or the last
8 renewal of the election, as the case may be.

