

SUMMARY ANALYSIS OF AMENDED BILL

Author: Block Analyst: Gail Hall Bill Number: AB 1178
 Related Bills: See Prior Analysis Telephone: 845-6111 Amended Date: January 4 and 6, 2010
 Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Water's-Edge Election/Include Income Derived From Or Attributed To A Tax Haven

- DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced February 27, 2009.
- AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.
- AMENDMENTS DID NOT RESOLVE THE DEPARTMENTS CONCERNS stated in the previous analysis of bill as introduced/amended _____.
- FURTHER AMENDMENTS NECESSARY.
- _____ DEPARTMENT POSITION CHANGED TO _____.
- REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED FEBRUARY 27, 2009, STILL APPLIES.
- OTHER – See comments below.

SUMMARY

This bill would require multinational corporations that elect to file tax returns based only on income earned inside the U.S., known as the water's-edge method, to include the income of related corporations doing business in or derived from or attributable to a tax haven country.

This analysis will not address the bill's sales and use tax provision added by the January 4, 2010, amendments, as it does not impact the department or state income tax revenue.

Board Position:	Legislative Director	Date
<input type="checkbox"/> S <input type="checkbox"/> NA <input type="checkbox"/> NP <input type="checkbox"/> SA <input type="checkbox"/> O <input type="checkbox"/> NAR <input type="checkbox"/> N <input type="checkbox"/> OUA <input checked="" type="checkbox"/> PENDING	Brian Putler	01/08/10

SUMMARY OF AMENDMENTS

The January 4, 2010, and January 6, 2010, amendments result in the following changes to the provisions of the bill relating to Corporation Tax Law:

- Revised the operative date.
- Revised the due date for the report due to the Legislature from January 1, 2011, to January 1, 2012.
- Eliminated the need for Implementation Consideration No. 5 discussed in the department's analysis of the bill as introduced February 27, 2009, because the tax haven provision would be repealed after three years. (See Appendix A)
- Resolved the Technical Considerations discussed in the department's analysis of the bill as introduced February 27, 2009. (See Appendix A).
- Added a repeal date.
- Restored current law on July 1, 2014.

Except for the Effective/Operative Date, This Bill, and Economic Impact discussions, the remainder of the department's analysis of the bill as introduced February 27, 2009, still applies. The unresolved Implementation Considerations and Fiscal Impact discussions have been included in this analysis for convenience.

CORPORATIONS DOING BUSINESS IN A TAX HAVEN COUNTRY

EFFECTIVE/OPERATIVE DATE

As a tax levy, this provision would become effective immediately upon enactment and specifically apply for taxable years beginning on or after July 1, 2011, and before July 1, 2014. In addition, Revenue and Taxation Code (R&TC) section 25110 containing this provision would be repealed on June 1, 2015. This bill would also restore current law R&TC section 25110¹ operative on July 1, 2014, and applicable to taxable years beginning on or after July 1, 2014.

POSITION

Pending.

ANALYSIS

THIS PROVISION

This provision would amend the version of R&TC section 25110 added by SB 663 (Migden, Stats. 2006, Ch. 22).

¹ Section 25110 of the Revenue and Taxation Code (R&TC) as added by Section 2 of Chapter 22 of the Statutes of 2006.

This provision would include in a water's-edge taxpayer's return the entire income and apportionment factors of any corporation that was doing business in or had income derived from or attributable to a tax haven.

The term "tax haven" would be defined by reference to 39 jurisdictions identified as tax havens by the Organization for Economic Cooperation and Development (OECD)² as of December, 2002.

This provision would allow a taxpayer to petition the Franchise Tax Board (FTB) to exclude the income and apportionment factors of a tax haven corporation from the water's-edge return if that corporation's activities in a tax haven jurisdiction constitute either a "substantial economic presence" or "significant economic activity."

In addition, this provision would provide the following:

- Authorize the FTB to prescribe regulations necessary or appropriate to carry out the purposes of this bill, including regulations prescribing the extent to which activities in a tax haven jurisdiction are presumed to constitute "substantial economic presence" or "significant economic activity," and therefore, the related tax haven income and apportionment factors that would be excluded from the water's-edge return.
- Require the FTB to issue a notice identifying the jurisdictions that are considered tax havens.
- Require the Legislative Analyst in consultation with the FTB to conduct a study regarding the jurisdictions identified by the OECD as tax havens and report to the Legislature no later than January 1, 2012, about whether the definition of the term "tax haven" should be revised.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

1. The term "doing business in" as it applies to activities in a foreign country (including a tax haven) is undefined for California tax purposes and could result in disputes with taxpayers. The statute that defines "doing business" for purposes of imposing the corporate franchise tax was recently amended to provide bright line rules but those rules may be inconsistent with the author's intent with respect to activity in a tax haven. A broader or narrower definition than current law's definition of "doing business in" the state³ may better serve the author's intent.

² OECD is an organization that brings together the governments of countries committed to democracy and the market economy from around the world to support economic growth, boost employment, raise living standards, maintain financial stability, assist countries with economic development, and contribute to growth in world trade.

³ Revenue & Taxation Code section 23101.

2. The terms “substantial economic presence” and “significant economic activity” are not defined. The absence of definitions to clarify these terms could lead to disputes with taxpayers and would complicate the administration of this provision. The author may consider providing definitions for these terms or regulatory authority could be expanded to explicitly authorize the FTB to define these terms and to prescribe the presumptions and safe harbors.
3. The bill would allow a taxpayer to petition the FTB to exclude the income and apportionment factors of a tax haven corporation from the water’s-edge return if that corporation’s activities in a tax haven jurisdiction constitute either a “substantial economic presence” or “significant economic activity.” The author should consider adding that the petition would be in a form and manner determined by the FTB.
4. The term “tax haven” is defined in the provision by reference to 39 jurisdictions identified as tax havens by the OECD as of December, 2002. The author should consider listing the 39 tax haven countries specifically in the bill in a manner similar to Montana’s current law because department staff was unable to confirm OECD’s December, 2002, list of tax havens on OECD’s website.⁴ In addition, countries that were considered tax havens by the OECD as of December, 2002, may not be considered tax havens by the OECD currently, therefore, taxpayers may challenge using a definition for tax haven from a list identified in 2002.

FISCAL IMPACT

This bill would allow a taxpayer to petition the FTB to exclude the income and apportionment factors of a tax haven corporation from the water’s-edge return if that corporation’s activities in a tax haven jurisdiction constitute either a “substantial economic presence” or “significant economic activity.” As a result, the bill would impact the filing and audit processes. The additional costs have not been determined at this time. As the bill continues to move through the legislative process, costs will be identified and an appropriation may be requested, if necessary.

⁴ <http://www.oecd.org>

ECONOMIC IMPACT

Revenue Estimate

Fiscal Year Cash Flow Impact Enactment Assumed After June 30,2010 Assumed Effective Tax Years BOA July 1, 2011 and Before July 1, 2014 (\$ In Millions)		
2010-11	2011-12	2012-13
-	\$70	\$120

LEGISLATIVE STAFF CONTACT

Legislative Analyst
Gail Hall
(916) 845-6111
gail.hall@ftb.ca.gov

Revenue Director
Jay Chamberlain
(916) 845-3375
jay_chamberlain@ftb.ca.gov

Legislative Director
Brian Putler
(916) 845-6333
brian.putler@ftb.ca.gov

APPENDIX A
RESOLVED IMPLEMENTATION AND TECHNICAL CONSIDERATIONS

Eliminate Implementation Consideration No. 5 Discussed in the Department's Analysis Of The Bill As Introduced February 27, 2009.

5. The bill requires the Legislative Analyst in consultation with FTB to conduct a study regarding the jurisdictions identified by OECD as tax havens and report to the Legislature no later than January 11, 2011, about whether the definition of "tax havens" should be revised. The author should consider requiring that this study be conducted every few years to ensure the list of tax havens is consistent with the OECD's current list of tax havens.

Resolved Technical Considerations Discussed in the Department's Analysis Of The Bill As Introduced February 27, 2009.

1. In SECTION 1 of the bill, the Legislative findings and declarations refer to enacting "this section" instead of referring to "this act." Amendment 1 is attached to correct this referencing error.
2. This bill adds an affiliated corporation to the list of entities whose entire income and apportionment factors are included in the water's-edge return, therefore, paragraph (2) on page 4 of the bill needs to be updated to include the added subparagraph.