

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 25, 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/amended _____.
- 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 AMENDED
- January 13, 2010, 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 in 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.

SUMMARY OF AMENDMENTS

The January 25, 2010, amendments made the following changes to the bill:

- Resolved the technical consideration discussed in the department's analysis of the bill as amended January 13, 2010.
- Resolved the implementation consideration discussed in the department's analysis of the bill as amended January 13, 2010.
- Created two new technical considerations.
- Revised the provision for updating the list of tax havens as defined by the bill. This revision created a new policy concern.

Board Position:	Legislative Director	Date
<input type="checkbox"/> S	Brian Putler	02/18/10
<input type="checkbox"/> NA		
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<input type="checkbox"/> N		
<input type="checkbox"/> OUA		
<input checked="" type="checkbox"/> PENDING		

Except for the This Provision, Technical Consideration, and Policy Concern discussions, the remainder of the department's analysis of the bill as amended January 13, 2010, still applies.

POSITION

Pending.

ANALYSIS: CORPORATIONS DOING BUSINESS IN A TAX HAVEN COUNTRY

THIS PROVISION

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

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 "doing business in" or "doing business within" would mean being engaged in activity that is sufficient to impose a tax under United States constitutional standards.

The term "tax haven" would be defined by reference to jurisdictions identified in Table 1 of Appendix I to the December 2008 Report of the United States Government Accountability Office (GAO) on International Taxation (GAO-09-157)¹ as a jurisdiction for which a United States District Court order granted leave for the federal Internal Revenue Service to serve a "John Doe" summons.

This provision would allow a taxpayer to petition the Franchise Tax Board (FTB) to exclude the income and apportionment factors of a corporation doing business in a tax haven jurisdiction from the water's-edge return if that corporation is engaged in the active conduct of a trade or business in the tax haven.² The procedure for petition would be developed in a form and manner determined by the FTB and in accordance with current law's provision that permits a taxpayer to petition the FTB to depart from the standard allocation and apportionment provisions.³ This provision would allow the determination of the FTB to be appealed to the State Board of Equalization.

¹ <http://www.gao.gov/new.items/d09157.pdf>

² Within the meaning of Section 367(a)(3)(A) of the Internal Revenue Code and the regulations thereunder.

³ Revenue and Taxation Code section 25137. In *Microsoft Corporation v. Franchise Tax Board* (2006) 39 Cal.4th 750, the court found that the party invoking section 25137 has the burden of proving by "clear and convincing evidence" that the standard formula is not a fair representation of the extent of the taxpayer's California business activity, and the proposed alternative is reasonable.

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 be from the active conduct of a trade or business in the tax haven.
- Provide that a jurisdiction would be added or removed from being considered a “tax haven” if the Secretary of the Treasury of the United States issues a notice after January 1, 2011, declaring that the jurisdiction is added or removed as a recognized “tax haven.”
- Require the FTB to issue a notice annually identifying the jurisdictions that are considered tax havens.

TECHNICAL CONSIDERATIONS

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

1. On page 6, line 5, delete “Broad”, and insert “Board”.
2. This provision would provide that the procedures a taxpayer would follow to petition the FTB would be developed in a form and manner determined by the FTB. In addition, the provision provides that the determination by the FTB may be appealed to the BOE. It is unclear if “the determination” that may be appealed relates to the form and manner developed by the FTB or if the author meant FTB’s decision to deny the petition. If the former, the following amendment is suggested:

On page 6, line 6, delete “determination”, and insert “decision”

POLICY CONCERN

This provision would define “tax haven” as a jurisdiction identified in the GAO published report discussed in the Background section of the previous analysis. This provision provides that jurisdictions identified as tax havens would be added or removed from the tax haven list if a notice is issued by the Secretary of the Treasury of the U.S (Treasury). Accordingly, having the Treasury update a tax haven list developed by the GAO could result in inconsistencies. It is unclear whether the Treasury has its own tax haven list, issues notices identifying or removing tax havens from such list, or supports the GAO’s tax haven list.

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