STATE OF CALIFORNIA
Franchise Tax Board

Bill Analysis

Author: Valladares	Sponsor:	Bill Number: SB 1113
	Related Bills: See Legislative History	Amended March 23, 2026

SUBJECT

Gross Income Exclusion for Qualifying Shipping Activities

SUMMARY

This bill would, under the Corporation Tax Law (CTL), provide a gross income exclusion for qualifying shipping activities by an electing corporation or a member of an electing group for which an election is in effect under Subchapter R of Chapter 1 of Subtitle A (Subchapter R) of the Internal Revenue Code (IRC) for taxable years beginning on or after January 1, 2026.

This is the Franchise Tax Board's (FTB) first analysis of the bill.

RECOMMENDATION

No position—The three-member Franchise Tax Board has not formally voted or taken a position on this bill.

SUMMARY OF AMENDMENTS

The March 23, 2026, amendments removed the nonsubstantive change relating to the Revenue and Taxation Code (RTC) under the CTL and replaced them with the provisions discussed in this analysis.

REASON FOR THE BILL

The reason for the bill is to support the supply chain resilience, the maritime workforce, and the United States (U.S.) commercial fleet.

ANALYSIS

This bill, under the CTL, for taxable years beginning on or after January 1, 2026, would exclude from gross income any amount received from qualifying shipping activities by an electing corporation or a member of an electing group for which an election is in effect under Subchapter R of the IRC. This election is used to determine an alternative corporate tax on certain international shipping activities using a per tonnage rate.

The bill would define the following terms:

- "Electing corporation," as defined under IRC section 1355, is any corporation for which an election is in effect under Subchapter R of the IRC, which allows a taxpayer to calculate an alternative tax on shipping activities.
- "Electing group," as defined under IRC section 1355, is a controlled group of which one or more members is an electing corporation.
- "Qualifying Shipping Activities," as defined under IRC section 1356, means core qualifying activities, qualifying secondary activities and qualifying incidental activities. These terms mean the following:
  - "Core qualifying activities" are activities from operating qualifying vessels in the U.S. foreign trade,
  - "Qualifying secondary activities" are activities from (1) active management or operation of vessels other than qualifying vessels in the U.S. foreign trade, (2) the provision of vessel, barge, container, or cargo-related facilities or services to any person, (3) other activities of the electing corporation and other members of its electing group that are an integral part of its business of operating qualifying vessels in U.S. foreign trade and (4) such activities do not exceed 20% of the gross income by the cooperation from core qualifying activities, and
  - "Qualifying incidental activities" are activities from (1) shipping related activities that are incidental to the corporation's core activities, (2) are not qualifying secondary activities, and (3) such activities do not exceed 0.1% of the corporation's gross income by the corporation from core qualifying activities.
- "Qualifying vessel," as defined under IRC section 1355, is a self-propelled U.S. flag vessel used exclusively in the U.S. foreign trade during the period in which the election is in effect under Subchapter R of the IRC.

In addition, any item of loss, deduction (other than an interest expense deduction), or credit, related to any activity, the income of which is excluded from gross income under this section, is disallowed. This bill would also require a corporation to disallow a portion of their interest expense deduction. The interest expense deduction disallowance is based on a ratio of the fair market value of its qualifying vessels, divided by the fair market value of all its assets.

Lastly, if a qualifying vessel is sold or disposed of by an electing corporation in an otherwise taxable transaction, the corporation can elect to defer the recognition of gain if the replacement qualifying vessel is acquired during the specified period under Subchapter R of the IRC. When a company defers tax on the gain from selling a qualifying vessel by buying a replacement qualifying vessel, the tax value (basis) of the new vessel is equal to the cost of the replacement vessel reduced by the amount of gain that wasn't taxed. If the replacement includes multiple vessels, the cost and reduction is split among the vessels based on their relative costs.

Effective/Operative Date

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2026.

Federal/State Law

Federal Law

Current federal tax law allows an electing corporation to elect to use the alternative tax on qualifying shipping activities. The tax is the sum of tax imposed by IRC section 11 and the tax calculated under Subchapter R of the IRC, which is a tax equal to the highest tax rate (21%) multiplied by the notional shipping income for the taxable year. An electing corporation is any corporation for which an election is in effect under Subchapter R of the IRC.

In general, the notional shipping income of an electing corporation for each qualifying vessel for the taxable year is equal to the product of the daily notional shipping income and the number of days during the taxable year for which the electing corporation operated the vessel as a qualifying vessel in the U.S. foreign trade. The term U.S. foreign trade means the transportation of goods or passengers between a place in the U.S. and a foreign place or between foreign places. In contrast, the term U.S. domestic trade means the transportation of goods or passengers between places in the U.S.

The daily notional shipping income from the operation of a qualifying vessel is 40 cents per 100 tons of so much of the net tonnage of the vessel does not exceed 25,000 net tons and 20 cents per 100 tons of so much of the net tonnage of the vessel as exceeds 25,000 net tons. A qualifying vessel is a self-propelled U.S. flag vessel not less than 6,000 deadweight tons used exclusively in the U.S. foreign trade under the period for which the election is in effect. A U.S. flag vessel is any vessel documented under the laws of the U.S.

A qualifying vessel operator can make an election to use the alternative tax on qualifying shipping activities by making the election in form as prescribed by the Secretary and shall be effective for the taxable year for which is made and for all succeeding taxable years until terminated. The election shall be made timely (including extension) on the on the corporation's tax return filing. A termination can either occur through revocation or by a person ceasing to be a qualifying vessel operator. A qualifying vessel operator means any corporation who operates one or more qualifying vessels and who meets the shipping activity requirements.

In general, a corporation meets the shipping activity requirements for the taxable year if, on average, during the taxable year, at least 25% of the aggregate tonnage of qualifying vessels used by the corporation were owned by such corporation or chartered to such corporation on bareboat charter terms for each of the two preceding taxable years. However, there is a special rule for the first year election which states that a corporation meets the shipping activity requirement for the first taxable year, under IRC section 1354(a), if at least 25% of the aggregate tonnage of qualifying vessels used by the corporation were owned by such corporation or charted to such corporation on bareboat charter terms for the preceding taxable year.

For the purposes of Subchapter R, qualifying shipping activities include core qualifying activities, qualifying secondary activities, and qualifying incidental activities. Core activities include activities in operating the vessels in the U.S. foreign trade. Qualifying secondary activities are secondary activities to the extent that gross income derived by such corporation from such activities does not exceed 20% of the gross income derived from the corporation's core qualifying activities. Qualifying incidental activities means shipping related activities that are incidental to the corporation's core qualifying activities and are not qualifying secondary activities.

In general, gross income of an electing corporation is not included in its income from qualifying shipping activities. Any losses, deductions or credits with respect to any activity to the income excluded from gross income is disallowed, except for interest expense deduction, as specified.

Lastly, the qualifying shipping activities of an electing corporation shall be treated as a separate trade or business activity from all other activities conducted by such corporation. No deductions are allowed against the notional shipping income, and no credit is allowed against the tax imposed under Subchapter R of the IRC. In addition, no deduction is allowed for any net operating loss attributable to the qualifying shipping activities of any person to the extent the loss is carried forward by such a person from a taxable year preceding the first taxable year for which such a person was an electing corporation.

State Law

No comparable provision in state law.

Implementation Considerations

The FTB has identified the following considerations and is available to work with the author's office to resolve these and other considerations that may be identified.

The bill defines an "electing group" by referencing to IRC section 1355, which in turn relies on the "controlled group" definition under IRC sections 52(a) and (b). Although

this federal standard uses a 50% ownership threshold similar to RTC section 25105, minor differences may exist. For California purposes, the bill could instead reference RTC section 25105's "commonly controlled group" definition. However, aligning with the federal standard—consistent with California's approach for the research and development credit—may provide greater simplicity for taxpayers. The author may wish to amend the bill to clarify which definition applies.

Technical Considerations

None noted.

Policy Considerations

This bill does not provide a sunset date, which would generally allow periodic review of the effectiveness of the tax law change. If this is contrary to the author's intent, the author may wish to amend the bill.

The bill, as drafted, would exclude qualified shipping income in California but would not impose the alternative tonnage tax that is collected federally. FTB does not administer these types of taxes. Enacting California legislation that would exclude this shipping income could mean these corporations may not pay income or franchise tax in California on this income. If this is contrary to the author's intent, the author may wish to amend the bill.

LEGISLATIVE HISTORY

No legislation similar to this bill has been identified.

PROGRAM BACKGROUND

None noted.

OTHER STATES' INFORMATION

None noted.

FISCAL IMPACT

FTB's costs to implement this bill have yet to be determined. As the bill moves through the legislative process, costs will be determined.

ECONOMIC IMPACT

Revenue Estimate

This bill has the following two provisions that have revenue impacts:

Qualified Shipping Activities - Gross Income Exclusion and Denial of Losses, Deductions and Credits

Estimating the revenue impact of the gross income exclusion for qualified shipping activities and the related gain from the disallowance of losses, deductions and credits cannot be predicted. To determine the magnitude of the revenue impact the number of entities that file in California for which an election is in effect under Subchapter R of Chapter 1 of Subtitle A of the IRC, the value of qualified shipping activities, and the apportionment factors for each of these taxpayers would need to be known. Because it is difficult to predict these factors, the revenue impact is unknown. However, it is assumed that for every $1 billion in net income excluded from qualified shipping activities, the estimated impact to the General Fund could be a loss of up to $50 million annually.

Revenue Discussion

The revenue impact from the gross income exclusion for qualified shipping activities and the related gain from the disallowance of losses, deductions and credits can vary greatly depending on the value of qualified shipping activities and the apportionment factors.

This estimate assumes that a portion of the amount of net income excluded would be California sales, and as a result, would reduce the overall California apportionment factor accordingly. The provisions are assumed to result in a reduction to both the California sales factor numerator and everywhere sales denominator and result in an overall decrease to the apportionment factor. Thus, increasing the revenue loss.

For example, if a taxpayer under current law has an apportionment factor of 40% and under this current proposal, 50% of their excluded qualified shipping activity income is determined to be California sales, reducing both the numerator and denominator for the value of the excluded sales would reduce the overall apportionment factor to 25%. The impact of this reduction is roughly a 70% annual revenue loss.

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill or for the net final payment method of accrual.

Election to Not Recognize the Gain from the Disposition of a Qualifying Vessel where the Electing Corporation Acquires a Replacement Qualifying Vessel

Estimating the revenue impact of unrecognized gains from the disposition of a qualifying vessel where the electing corporation acquires a replacement qualifying vessel cannot be predicted. To determine the magnitude of the revenue impact of the number of entities that file in California for which an election is in effect under Subchapter R of Chapter 1 of Subtitle A of the IRC, the value of qualified vessels bought and sold, and the apportionment factors for each of these taxpayers would need to be known. Because it is difficult to predict these factors, the revenue impact is unknown. However, it is assumed that for every $200 million in unrecognized gains from the disposition of a qualifying vessel, the estimated impact to the General Fund could be a loss of up to $10 million annually.

Revenue Discussion

The revenue impact from the unrecognized gains from the disposition of a qualifying vessel where the electing corporation acquires a replacement qualifying vessel can vary greatly depending on the value of the vessels and the electing corporations' current apportionment factors.

This estimate assumes that a portion of the amount of unrecognized gains would be California Sales, and as a result, would reduce the overall California apportionment factor accordingly. The provisions are assumed to result in a reduction to both the California sales factor numerator and denominator from the unrecognized gains and result in an overall decrease to the apportionment factor. Thus, increasing the revenue loss.

For example, if a taxpayer under current law has an apportionment factor of 40% and under this current proposal, 10% of their unrecognized gains from the sale of a qualifying vessel is determined to be California sales, reducing both the numerator and denominator for the value of the excluded sales would reduce the overall apportionment factor to 38%. The impact of this reduction is roughly a 15% annual revenue loss.

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill or for the net final payment method of accrual.

LEGAL IMPACT

None noted.

EQUITY IMPACT

None noted.

APPOINTMENTS

None noted.

SUPPORT/OPPOSITION

To be determined.

ARGUMENTS

To be determined.

LEGISLATIVE CONTACT

FTBLegislativeServices@ftb.ca.gov