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California Unitary Reform 1986

Assembly Committee on Revenue and Taxation

CALIFORNIA UNITARY REFORM

1986

Senate Bill 85 (Alquist)
Chapter 660, Statutes of 1986

and

Assembly Bill 2815 (Hannigan)
Chapter 974, Statutes of 1986

Prepared by the Staff of the

ASSEMBLY COMMITTEE ON REVENUE AND TAXATION

THOMAS M. HANNIGAN
Chairman

October 1986

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PREFACE

This report is available to inform interested parties of California's 1986 reform of the State's bank and corporation tax, or the so-called "unitary tax," that occurred with the enactment of Senate Bill 85. It is not intended to cover in detail all the technical provisions of SB 85. It contains only a brief outline of the economic development provisions of SB 85. Those interested in further information regarding the economic development provisions should contact the Assembly Committee on Economic Development and New Technologies.

This report was prepared by the staff of the Assembly Revenue and Taxation Committee, with Caroline N. Cornwell as the primary author.

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INTRODUCTION

This report explains California's new system of taxing banks and corporations which will become effective January 1, 1988. What follows briefly outlines the history of California's unitary method of taxing corporations, explains the changes to this taxing system that occurred with the enactment of Senate Bill No. 85 in 1986, and examines the probable effects SB 85 will have on California state revenues.

When discussing the bank and corporation tax, it is important to keep in mind that the so-called "unitary tax" is not really a tax, but rather a method by which the bank and corporation tax is levied. Under this method, affiliated corporations that operate as a unit are required to report their worldwide business income, a share of which is then apportioned to California for state tax purposes. The apportionment factor is the average of the firm's payroll, property, and sales factors in California. If, for example, a firm has 10% of its property, payroll, and sales in California, then 10% of its worldwide income is apportioned to the state and subject to the state's 9.6% bank and corporation tax rate.

BACKGROUND

Multistate and multinational corporations by definition conduct business and earn profits in more than one taxing jurisdiction. While these corporations may not be particularly concerned with the level of profitability in each jurisdiction (their focus is more likely upon total corporate profit), it is the key question facing tax administrators. For example, how does an administrator determine the profits allocable to California from an electronics firm whose corporate headquarters are located here and whose manufacturing and distributing operations are located in three different states? Are profits a function of manufacturing, distribution, sales, or good management, or some of each? Expand this example to include a multinational corporation with subsidiaries around the world, which manufactures myriad products, and the complexity increases considerably.

Because of this complexity, it is not possible for tax administrators to determine accurately the profits derived directly from a corporation's operations conducted within a particular jurisdiction, such as a state. It should be emphasized that neither the unitary method, nor its alternative, "separate accounting," provides an accurate determination, but only a rough approximation of a state's share of a corporation's income. The intensity of the unitary controversy stems in large part from the fact the state taxation of multijurisdictional income, no matter what the method, is imprecise. California has been at the center of the unitary controversy because so much revenue is at stake here.

CURRENT LAW

Under California's current law -- a system of unitary accounting and worldwide apportionment -- all corporations, whether created or organized in a foreign country or in the United States, are treated similarly through unitary business principles applied by California.

The California franchise or income tax applies only to that portion of a corporation's total net income that is "derived from or attributable to sources within this state."

If a corporation and its worldwide affiliated corporations (subsidiary or parent corporations) have a unity of business operations, they form a combined group which is required to file as one corporation and file a combined report.

When the business conducted both within and without California is unitary, the portion of the business income from that unitary business which is "derived from or attributable to sources within this state" must be determined by a formula of worldwide apportionment. This approach is followed where the unitary business is conducted by a single corporation or by separate corporations under common ownership or control.

In determining whether a single corporation with operations within and without California is engaged in a unitary business or whether a group of separate corporations within and without California is required to determine their income by use of a combined report, the geographic locations of the corporate business activities are immaterial. Foreign sources as well as domestic sources of income are taken into account for purposes of applying an apportionment formula to determine the amount of income derived from California sources.

This means that a foreign corporation not operating in California, which is an affiliate of one operating in California, may be included in the combined report of the business operating in California if the total business is a unitary business.

The theory is that the income of a corporation should not be altered because of the way it chooses to do business -- the tax is the same whether it operates as one big company or as several corporation-owned little ones. It is also not possible to isolate profit centers fairly where a corporation and its owned subsidiaries are doing business with each other.

After the corporations to be included in the unitary group are determined, an apportionment formula consisting of equally weighted property, payroll, and sales factors is then applied in computing the portion of the taxpayer's total income that is derived from or attributable to California sources. That is:

- First, the total property, sales, and payroll of the unitary business are computed;
- Second, California's percentages of the worldwide property, sales, and payroll are determined;
- Third, the percentages for each of these factors are averaged to determine the taxpayer's apportionment factor;
- Fourth, the apportionment factor is multiplied by the total worldwide income of the unitary business to determine California's share of total income;

- Fifth, the 9.6% corporate tax rate is applied to California's share; and
- The result is the unitary business' tax liability. (See Figure 1 for illustration.)

FIGURE 1

EXAMPLE--MYTHICAL CORPORATION--UNITARY FORMULA

I. Total Corporate Assets Worldwide

Sales	$20,000,000
Property	40,000,000
Payroll	10,000,000
Total	$70,000,000

II. California's Percentage of Worldwide Assets

California Total		CA/World (%)
Sales	$1,000,000	5%
Property	4,000,000	10
Payroll	2,000,000	20
Total	$7,000,000	35%

III. Apportionment Factor: Average of Asset Percentages

Sales	5%
Property	10
Payroll	20
Total	35% ÷ 3 = 11.6666%

IV. California's Share of Total Income

Worldwide Income of Corporation	$5,000,000
x Apportionment Factor	11.6666%
= California Taxable Income	$583,300

V. California Tax Liability

California Taxable Income	$ 583,300
x Tax Rate	9.6%
= California Tax Liability	$ 55,997

ARGUMENTS FOR AND AGAINST WORLDWIDE APPORTIONMENT

Opponents of this worldwide apportionment formula offer several arguments for why the unitary tax is a bad system including:

1) Property, sales, and payroll do not produce equal profits in all parts of the world.

2) The unitary system causes excess record keeping.

3) The unitary system discourages relatively less profitable investment in California, because investments in California property will increase the share of the corporation's income subject to California tax. For example, start-up of a factory is at first often relatively less profitable.

4) Third world countries may copy the unitary method of taxing.

5) The unitary system discourages foreign investment, and the employment associated with such investment, from coming to California.

Supporters of worldwide combination argue that:

1) The system is the fairest way to tax the complex and interconnected operations of multistate and multinational corporations, since it is impossible to segregate the income of a multinational corporation.

2) Repeal of worldwide combination would cause a shift of relative tax burden from multinational businesses to small business and agriculture.

3) Part of the revenue savings from repeal of worldwide combination would be offset by higher federal tax. Because state bank and corporation taxes are permitted to be deducted from income in computing federal income tax, lower state taxes due to repeal of worldwide combination will result in a smaller state tax deduction on federal returns and higher federal taxes. Up to 48% of the savings to corporations could be lost to the Federal Government. (48% is the federal corporate tax rate under current law and is likely to decrease with the passage of current federal tax reform legislation.)

4) The alternative to the unitary system, separate accounting, does not work well.

5) The present application of unitary apportionment makes it more difficult for subsidiaries of foreign firms and overseas operations of domestic firms to undercut U.S. products through a price advantage created by manipulation of the tax system. As a result, they argue that the worldwide combination unitary apportionment formula helps prevent the loss of markets and domestic jobs to products made overseas.

6) Repeal of worldwide combination would result in a large revenue loss for the state.

HISTORY OF REFORM OF THE UNITARY METHOD

California instituted this unitary system in the 1930's. However, most states have either never used or have dropped the unitary method of taxing corporations. Three other states -- Alaska, Montana, and North Dakota -- still use this system of figuring corporation tax. As of 1986, California was the only major taxing jurisdiction in the world to use this method.

In the past decade, pressure to reform the unitary worldwide apportionment system has come from the business community, the federal government, and many foreign governments, including the British Parliament, which threatened sanctions against British subsidiaries of U.S. corporations if the U.S. states did not repeal their unitary taxes. The federal government answered this threat in 1984 when President Reagan announced that his Administration would support federal legislation abolishing states' unitary taxes if the states did not do so themselves. Accompanying these pressures were increasingly strong efforts of lobbyists representing foreign multinationals and domestic business interests.

As the main target of these pressures, California began the arduous task of reforming the state's bank and corporation tax. Legislation on this issue had been introduced at each session since the 1977-78 Session. None had passed. In 1984, SB 1437 (Alquist) passed the Senate, but did not come up for a vote in the Assembly. Senator Alquist, however, was successful in the next legislative session. The successful reform was Senate Bill No. 85 by Senator Alquist, which was signed by the Governor September 5, 1986.

With the enactment of SB 85 California's mandatory worldwide apportionment method has finally been abolished. Dubbed the "California Plan," Senator Alquist's bill was introduced in December, 1984, and then subjected to nearly two years of intensive legislative hearings and negotiations. A compromise version was successfully crafted in the closing days of the 1985-86 session and passed both houses by overwhelming margins (27 to 7 in the Senate and 65 to 11 in the Assembly).

The primary goal of Senator Alquist's plan was to ensure that California would maintain its leadership position in the global economy by reforming the unitary tax system. The plan was also crafted to maximize new investment in jobs in California, to provide equitable treatment for domestic based multinational corporations, and to protect the state's general fund from any unacceptable revenue losses.

1986 UNITARY REFORM

SB 85 (Chapter 660, Statutes of 1986) provides as follows:

Water's Edge Election (R&TC Section 25110)

SB 85 allows corporations to elect between current law (see above) and the "water's edge" option. Under the water's edge option, the combined group is only those affiliated corporations defined to be within the water's edge (rather than all affiliated corporations, as with worldwide apportionment).

The water's edge can be thought of literally and defined as the United States, where the United States is the 50 states and the District of Columbia.

Under the water's edge option, corporations considered to be in the combined group include:

1) All corporations eligible to be included in a federal consolidated tax return.

2) Domestic international sales corporations (DISCs) and foreign sales corporation (FSCs).

3) Any corporation incorporated in the United States, excluding U.S. possessions, if more than 50% of its stock is controlled directly or indirectly by the same interests.

4) Any corporation, regardless of where it is incorporated, if the average of its property, sales, and payroll factors in the in the United States is 20% or more.

5) Controlled foreign corporations (CFC) with a subpart F income, but only to the extent of such subpart F income. (See Attachment 1 for definition of subpart F income.) A CFC is a foreign corporation which is more than 50% owned by the U.S. parent.

6) Export trade corporations.

7) 80-20 corporations. (These are corporations which are incorporated in the United States, but which have more than 80 percent of their property, payroll, and sales outside of the United States.) In addition, foreign 80-20s will be treated as deemed subsidiaries based on their income and factors in the United States and then combined with other related affiliates operating in the United States. The Franchise Tax Board is directed to study the equity and tax compliance issues with respect to 80-20s and report to the Legislature in 1987.

Under the new law, branches of foreign banks are to determine their income and factors based on their activities in the United States only.

No corporation will be included in the combined group if current law does not require such an inclusion.

Corporations electing the water's edge option must file a combined report with their affiliates defined to be within the water's edge. This is a smaller combined group than under worldwide apportionment, and it is to this smaller group that the unitary formula (property, sales, and payroll) is applied.

Election Period (R&TC Section 25111)

Corporations make the election to water's edge annually for a ten year period through contract with the Franchise Tax Board.

Election Fee (R&TC Section 25115)

Those electing water's edge apportionment formula must pay an election fee of .03 percent of 1986 property, 1986 payroll, and current sales per year in California.

A corporation may reduce its election fee base by additional investment in California payroll and property after January 1, 1988. A $1.00 reduction in the election fee base will be given for every $1.00 of new investment. However, a minimum election fee of .01 percent of current California property, sales, and payroll must be paid. Intangible property is not included in the property factor base for the purpose of computing the election fee. (Note: AB 2815, which was chaptered after SB 85, corrects an error in SB 85 and provides that the amount of the minimum election fee is .01 percent of current property, sales, and payroll in California.)

The election fee will be used to finance additional infrastructure which new investment, attracted to California by the water's edge option, will make necessary.

Infrastructure and Economic Growth (Government Code Sections 15365, 15397, 16429.30-16429.49)

Two-thirds of the election fee proceeds are to be directed to state infrastructure and economic development, while the remaining one-third will go to local infrastructure and economic development.

The bulk of the funds, which are estimated to be about $38 million per year beginning in 1988-89, will be used, when appropriated by the Legislature, to finance infrastructure projects necessary to facilitate and attract new investment. Examples include sewer and water line extensions, freeway interchanges, and traffic mitigation measures. The remaining funds will be used to support the export expansion programs of the California State World Trade Commission and the Department of Food and Agriculture and a California Small Business Bond Insurance Corporation established by SB 85. The Small Business Bond Corporation will provide credit enhancements, insurance, and bond pooling services to small businesses to help them access bond markets for long term capital borrowing needs.

Administration and Enforcement (R&TC Sections 25110, 25112-25114)

Most corporations will be required to file a California domestic disclosure spreadsheet with the Franchise Tax Board (FTB), whether or not they make a water's edge election. For corporations electing the water's edge option, such election may be disregarded if this requirement is not met. Election may also be disregarded if the return a corporation files "fails to prevent evasion of taxes." That is, if a corporation fails to comply with these provisions of SB 85, it will have to return to the worldwide apportionment formula to figure its taxes.

In addition, SB 85 requires the FTB to conduct "arms-length" audits of corporations electing water's edge unless the IRS is auditing the same taxpayer

on the same issues. This state-level "arms-length" audit is equivalent to the IRC Section 482 audit.

In the case of tax appeals, SB 85 allows the FTB to introduce final court determinations from another state's proceedings which involved the same taxpayer.

Taxation of Dividends (R&TC Section 24411)

Under current law, all dividends which are "business income" are subject to apportionment and taxation by California.

Under SB 85, in any one year a portion of controlled foreign corporation (CFC) dividends paid to the U.S. parent by foreign subsidiaries will be exempt from taxation. The amount which is exempt is equal to 75% of base period CFC dividends. The base period is one of the income years (1984, 1985, or 1986) in which the greatest amount of dividends was received. This provision allows a 75% exclusion for dividends attributable to investment currently in place and gives corporations tax relief on repatriated profits from this investment.

CFC dividends which exceed the base period amount are either fully taxable, fully excludable, or 75% excludable. Those dividends in excess of the base period amount which are attributable to an increase in foreign payroll are fully taxable; those excess dividends attributable to an increase in the U.S. payroll are fully excludable; and those excess dividends attributable to normal growth are subject to the 75% exclusion. (See Attachment 2 for formula to determine amount of excess dividends which are taxable.)

Loophole Closing Provisions (R&TC Sections 24667, 24668)

SB 85 contains two corporate loophole closing provisions that are similar to those in the federal tax reform bill (HR 3838):

1) Limitation on the use of the installment method for reporting income from certain property sales by corporations.

2) Disallowance of the reserve method of deducting bad debts for most corporate taxpayers except financial institutions.

(See Attachment 3 for an explanation of these loophole closing provisions.)

Effective Date (Section 15 of the Act)

The provisions of SB 85 will take effect January 1, 1988.

FISCAL IMPACT ON CALIFORNIA

The 1986 unitary reform is expected to cost the state about $83 million (in constant 1987 dollars) for the first full year it is in effect. This is the net loss reflecting a total loss of $585 million offset by revenue gains from the election fee, loophole closures, and inclusion of DISCs, FSCs, 80-20s, and subpart F income within the water's edge as discussed above. (See Table 1 for

revenue estimates.) The General Fund revenue loss will be approximately $121 million and will be offset by a special fund revenue gain of about $38 million from the election fee revenue (see above).

TABLE 1

FISCAL EFFECT
(in millions in constant 1987 dollars)

SB 85 - Total Loss	$ -585
Water's Edge Features	
FSCs and DISCs Included	+100
Subpart F Income Included	+ 75
80/20s Included	+130
SUBTOTAL	-280
75% Foreign Dividend Exclusion	+ 33
Retain Interest Offset for Foreign Investment Only	+ 15
SUBTOTAL	-232
Federal Conformity (HR 3838)	--
Installment Obligations	+ 59
Reserve for Bad Debt	+ 52
SUBTOTAL	-121
Election Fee	
.02% - State	+ 25
.01% - Local	+ 13
TOTAL	$ - 83

ATTACHMENT 1

SUBPART F INCOME

Purpose

The primary purpose behind the enactment of the subpart F provisions was to counter the unjustifiable use of tax havens as a means to escape paying U.S. taxes.

Definition

A controlled foreign corporation's subpart F income includes:

1) Income derived from the insurance of United States risks.

2) Foreign base company income.

3) Income derived from international boycotts or from illegal payments, such as bribes.

Insurance of United States Risks

Income of a controlled foreign corporation (CFC) from premiums for insurance, reinsurance, or annuity contracts on property in or residents of the United States is included in subpart F income. Also included in subpart F income is income derived from arrangements between a CFC and another foreign corporation in which the foreign corporation holds insurance involving U.S. risks for the CFC and the CFC holds insurance not involving such risks for the foreign corporation. The premiums on such risks must exceed 5% of the total premiums received by the CFC in order to be included in subpart F income.

Foreign Based Company Income

Foreign based company income is the sum of:

1) Foreign personal holding company income;

2) Foreign base company sales income;

3) Foreign base company service income;

4) Foreign base company shipping income;

5) Foreign base company oil-related income.

International Boycotts and Illegal Bribes

Included in subpart F income are the earnings of a CFC to the extent that such earnings are attributable to the operations of that CFC in which there was an agreement to participate in a secondary or tertiary international boycott. In addition, the amount of illegal payments, kickbacks, or other unlawful payments to an official, employee, or agent of a government are taxable as subpart F income.

ATTACHMENT 2

DETERMINING TAX ON DIVIDENDS IN EXCESS OF THE BASE PERIOD

1) Foreign dividends not to exceed base period amount are subject to a 75% exclusion.

2) Foreign dividends in excess of base period amount are subject to three possible treatments:

   a) Those attributable to an increase in the foreign payroll factor are fully taxable.

   b) Those attributable to an increase in the U.S. payroll factor are fully excluded.

   c) Those attributable to neither (a) nor (b), i.e., those attributable to normal growth, are subject to a 75% exclusion.

   Attribution is determined by applying the increase or decrease in the foreign payroll factor to all foreign dividends.

3) The treatment of the dividends above the base period amount will be determined by the relationship of the change in foreign payroll to total foreign dividends.

4) If the foreign payroll factor in the base period is less than the current foreign payroll factor, the amount of taxable dividends for dividends in excess of the base period amount is computed as follows:

   a) The taxpayer's foreign payroll factor in the base period year is subtracted from the taxpayer's foreign payroll factor in the current year.

   b) This difference is divided by the foreign payroll factor in the current year.

   c) The percentage thus determined is multiplied by total foreign dividends.

   d) This amount is subtracted from dividends in excess of the base period amount.

   e) The balance is the amount of partially (75%) excluded dividends.

   f) All other dividends in excess of the base period amount are fully taxable.

5) If the foreign payroll factor in the base period is larger than the current foreign payroll factor, the amount of taxable dividends for dividends in excess of the base period amount is computed as follows:

   a) The taxpayer's foreign payroll factor in the current year is subtracted from the taxpayer's foreign payroll factor in the base period year.

   b) The difference is divided by the foreign payroll factor in the base period year.

   c) The percentage thus determined is multiplied by total foreign dividends. This amount is the amount of fully excluded dividends.

   d) The amount of fully excluded dividends is not to exceed the amount of dividends in excess of the base period amount.

   e) If the amount of fully excluded dividends does exceed the excess of the base period amount, then this difference (fully excluded dividends minus the excess of the base period amount) is added to the base.

ATTACHMENT 3

EXPLANATION OF LOOPHOLE CLOSURES UNDER SB 85

1) Limits Use of Installment Method For Reporting Income From Certain Property Sales By Corporations

Current Law

Under current law, gain from the sale of property generally is recognized (and tax is due) in the year in which the property is sold. However, under current law, gain from certain sales of property where the seller receives deferred payments are reported for tax purposes on the installment method, and thus income is reported incrementally over two or more years in proportion to the ratio of the installment payments to the gross profit.

The purpose for allowing the reporting of income on the installment method for income tax purposes is that the seller may be unable to pay tax currently because no cash may be available until the deferred payments are made.

Types of sales where the installment method is currently permissible include revolving credit plans, under which customers agree to pay a part of the outstanding balance of their accounts during each period of time for which a periodic statement is rendered.

SB 85 Provisions

Under SB 85, the ability of corporate taxpayers to use the installment method of accounting for deferred-payment sales will be limited in three circumstances, as follows:

a) Where Taxpayer Has Outstanding Debt. Use of the installment method for certain sales by corporations which regularly sell real or personal property, and for certain sales of trades or businesses or rental real property, will be limited based on the amount of the outstanding indebtedness of the corporation. The limitation will not apply to sales of crops or livestock held for slaughter. Also, an exception will be provided, under which the limitation will not apply for installment obligations arising from the sale of certain personal property by a manufacturer to a dealer, if certain conditions are met.

According to congressional committee reports, Congress believes that the ability to defer tax under the installment method is inappropriate in the case of gains from the sales of property, where the corporation has been able to receive cash from borrowings related to its installment obligations. Thus, a formula will be provided for

determining what portion of income is ineligible for installment accounting, based on the corporation's borrowings. This is called the "proportionate disallowance rule." Amounts of income not eligible for the installment method will have to be reported in the year the sale took place.

b) Revolving Credit Plans. Corporate taxpayers which sell property on a revolving credit plan will not be permitted to account for such sales on the installment method. Income from those revolving credit plan sales will have to be reported in the year the sale took place.

According to congressional committee reports, Congress believes that sales under a revolving credit plan more closely resemble the provision of a flexible line of credit accompanied by cash sales by the seller, and therefore it is not appropriate that income from these sales be reported under the installment method.

c) Stock and Securities. Corporate taxpayers which sell stock or securities that are traded on an established securities market will not be permitted to use the installment method of accounting. Income from such sales will have to be reported in the year the sale took place.

According to congressional committee reports, Congress believes that publicly traded property is considered to be a sufficiently liquid asset to be treated the same as a payment of cash, and since the taxpayer can easily sell such property for cash in the market, it does not present the same liquidity problem that the installment method is intended to alleviate.

Fiscal Effect

According to the Franchise Tax Board, this change would produce revenue gains of $59 million in 1987-88.

2) Disallows Reserve Method of Deducting Bad Debts For All Corporate Taxpayers Except Financial Institutions

Current Law

Under current law, taxpayers are allowed a deduction from income for those debts arising from a trade or business which become wholly or partially worthless during the taxable year. The amount of the deduction may be determined using either of the following two methods:

a) Specific Charge-Off Method. Under this method, the bad debt deduction is allowed at the time the debt is determined to be uncollectible in whole or in part. The deduction is equal to the uncollectible amount. Wholly worthless amounts are allowed as a bad debt deduction in the year they become worthless. Partially worthless amounts are allowed as

a bad debt deduction at the time they have become worthless and have been charged-off on the taxpayer's books.

b) Reserve Method. Under this method, a deduction is allowed for a "reasonable addition" to a reserve account for bad debts. A reserve account is an account set up by the taxpayer as an allowance against the possibility that some receivables may later prove to be uncollectible. The appropriate amount in a bad debt reserve generally is computed under one of several formulas, generally based on the taxpayer's past experience with bad debts.

SB 85 Provisions

Under SB 85, most corporations will be prohibited from taking deductions for bad debts computed under the reserve method. Instead, they will be required to use the specific charge-off method to compute their deductions for bad debts.

However, financial institutions and certain farm credit institutions and finance companies will not be subject to this change, and can continue to use the reserve method to compute their bad debt deductions.

According to congressional committee reports, Congress believes that the reserve method allows deductions for losses that statistically may or may not occur in the future, and thus is inconsistent with the treatment of other deductions. In addition, Congress believes that the reserve method allows a deduction prior to the year in which the loss actually occurs, in which case the value of the deduction to the taxpayer is overstated.

Congress believes, however, that financial institutions should continue to be allowed to use the reserve method of computing the bad debt deduction because they are required by government regulators to maintain capital sufficient to support the level of lending and other activities they engage in. To prevent unfair competition between financial institutions and certain finance companies which are their competitors, Congress believes a similar exemption should be applied to the latter.

This change will also require wholly worthless and partially worthless debts to be treated similarly, in that the deduction will not be allowed until the debt actually has been charged off on the taxpayer's books.

Fiscal Effect

According to the Franchise Tax Board, this change would result in revenue gains of $52 million in the 1987-88 fiscal year.

ATTACHMENT 4

TEXTS OF SB 85 (CHAPTER 660 OF 1986)
and AB 2815 (CHAPTER 974 OF 1986)

CHAPTER 660

An act to add Chapter 1.9 (commencing with Section 15365), Chapter 6 (commencing with Section 15397), and Chapter 7 (commencing with Section 15398) to Part 6.7 of Division 3 of, and to add Article 12 (commencing with Section 16429.30) to Chapter 2 of Part 2 of Division 4 of, Title 2 of, the Government Code, to amend Sections 24274, 24344, 24348, 24667, and 24668 of, to amend and renumber Section 25110 of, to add Sections 24411 and 24670 to, and to add and repeal Article 1.5 (commencing with Section 25110) of Chapter 17 of Part 11 of Division 2 of, the Revenue and Taxation Code, relating to taxation.

[Approved by Governor September 5, 1986. Filed with Secretary of State September 5, 1986.]

LEGISLATIVE COUNSEL'S DIGEST

SB 85, Alquist. Bank and corporation taxes: unitary businesses.

(1) Existing law provides for the organization of corporations for specific purposes.

This bill would provide for the establishment of a nonprofit public benefit corporation to be known as the Small Business Bond Insurance Corporation. This bill would provide for the membership, compensation, duties, and powers of the corporation's board of directors.

The corporation would have the primary goal of increasing the availability of long-term financing to small businesses in California, and the primary method of accomplishing this goal would be through insurance or guarantees of the payment of bonds issued by or for the benefit of small businesses.

This bill would establish a California Small Business Bond Insurance Corporation Operations Fund in the State Treasury for the receipt of state, federal, and private moneys for the operating expenses of the corporation and would provide, upon appropriation by the Legislature, for the manner in which the moneys in the fund are to be disbursed.

This bill would establish a California Small Business Bond Insurance Reserve Fund in the State Treasury for the receipt of state, federal, and private moneys, returns on investments on these moneys, premiums charged by the corporation, and recoveries and collection on claims paid by the corporation. This bill would provide that the moneys in the fund are to be made available, upon appropriation by the Legislature, for purposes of the small business bond insurance programs conducted by the corporation.

(2) Existing law charges the California State World Trade Commission with encouraging international trade, tourism, and

development.

This bill would create within the commission a California Office of Trade Policy to, among other things, support vigorous enforcement of trade laws against unfair foreign trade practices in United States markets.

This bill would also create within the commission the California Office of Export Promotion to, among other things, strengthen the state's activities in marketing its agricultural, manufacturing, and service industries overseas.

(3) Existing law creates various departments within the Business, Transportation and Housing Agency.

This bill would create within the agency a Development Review Panel, consisting of specified membership, to promote and assist economic development projects where additional development or expansion otherwise is not possible because of a lack of adequate funding for infrastructure. It would specify the powers and duties of this panel. It would provide that all moneys loaned to the panel that are required to be repaid shall be deposited in a specified fund.

(4) This bill would create in the State Treasury a California Unitary Fund, the moneys of which would be used exclusively for infrastructure financing and economic development. It would create the Future Infrastructure State Targeted Account and the Local Project Account for Non-Transient Spending in the California Unitary Fund. It would require the moneys in the California Unitary Fund to remain in the fund until appropriated by the Legislature and upon appropriation would require that moneys in the Future Infrastructure State Targeted Account be made available in specified percentages for specified purposes.

(5) Under the existing Bank and Corporation Tax Law, the income of a unitary business which is subject to taxation is determined by means of an apportionment formula based on income derived from or attributable to sources both within and without the state. That formula generally includes the use of 3 factors: payroll, property, and sales.

This bill would allow a qualified taxpayer, as defined, whose income is subject to the tax imposed under the Bank and Corporation Tax Law to determine its income derived from or attributable to sources within this state pursuant to a water's-edge election, as specified. This bill would require that a water's-edge election be made by contract with the Franchise Tax Board, as specified, for an initial term of 10 years and subject to annual renewal. It would provide for the method of terminating the election by written notice of nonrenewal by the taxpayer.

This bill would require that each contract provide for annual payments to be made by the taxpayer to the Franchise Tax Board for deposit in the California Unitary Fund, which this bill would create. This bill would require that of the amount of annual payments made by qualified taxpayers for deposit in the California Unitary Fund, ⅓ of that amount be deposited in the Local Project Account for Non-Transient Spending and ⅔ of that amount be deposited in the Future Infrastructure State Targeted Account.

This bill would also provide for various new administrative procedures in connection with the water's-edge election and would require the Franchise Tax Board to conduct a specified study relating to certain auditing practices to be reported to the Legislature no later than March 1, 1987.

(6) Under the existing Bank and Corporation Tax Law, a taxpayer is generally entitled to deduct dividends received in computing its income subject to tax if the dividends were declared from income which has been included in the measure of taxes imposed under that law upon the taxpayer declaring the dividends. In the case of a unitary business, dividends received which are treated as nonbusiness income are entirely allocable to this state in computing the taxpayer's income if its commercial domicile is in this state, and dividends received which are treated as business income are subject to allocation and apportionment to this state under the unitary apportionment formula in computing the taxpayer's income.

This bill would permit a qualified taxpayer who elects to determine its income under a water's-edge election to deduct either 100% or 75% of specified portions of its qualifying dividends, as defined, which are received in accordance with specified formulas.

(7) Under the existing Bank and Corporation Tax Law, a taxpayer may take a deduction for debts which become wholly or partially worthless within the income year or for a reasonable addition to a reserve for bad debts. The amount of the deduction may be determined using either the specific charge-off method or the reserve method.

This bill would eliminate the availability of the reserve method of deducting bad debts for all taxpayers, other than savings and loan associations, banks, or financial corporations. It would also provide special transitional rules in connection with these changes.

Under the existing Bank and Corporation Tax Law, a dealer in real and tangible personal property who is liable as an endorser, guarantor, or indemnitor may deduct a reasonable addition to a reserve for bad debts from losses on the guaranteed debts.

This bill would eliminate the availability of the reserve method of deducting those debts for those dealers. It would also provide special transitional rules in connection with these changes.

(8) Under the existing Bank and Corporation Tax Law, gain from certain sales of property in exchange for which the seller receives deferred payments is reported on the installment method, unless the taxpayer elects otherwise.

This bill would limit the availability of the installment method of accounting in specified circumstances, including sales involving certain publicly traded property, sales pursuant to a revolving credit plan, and a portion of certain installment receivables, based on the

amount of the outstanding indebtedness of the taxpayer. It would provide special transitional rules for some of these changes.

(9) This bill would become operative on January 1, 1988, and its tax provisions would be applicable in the computation of taxes for income years commencing on or after January 1, 1988.

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

SECTION 1. Chapter 1.9 (commencing with Section 15365) is added to Part 6.7 of Division 3 of Title 2 of the Government Code, to read:

CHAPTER 1.9. CALIFORNIA EXPORT PROMOTION AND POLICY PROGRAM

Article 1. Trade Policy

15365. There is within the California State World Trade Commission a California Office of Trade Policy.

15365.2. The purposes of the California Office of Trade Policy are the following:

(a) To support vigorous enforcement of trade laws against unfair foreign trade practices in United States markets, in the markets of offending countries, and in third-country markets.

(b) To encourage international negotiations to reduce and eliminate restrictive trade practices abroad, including quotas, tariffs, subsidies, nontariff barriers, and commercial counterfeiting.

(c) To participate in the development of international agreements which affect California's economic interests in cooperation with the Office of the United States Trade Representative.

(d) To respond to industry complaints concerning foreign trade barriers, and help represent their interests before appropriate agencies.

Article 2. Export Promotion

15365.6. There is within the California State World Trade Commission a California Office of Export Promotion.

15365.8. The purpose of the California Office of Export Promotion is to strengthen the state's activities in marketing its agricultural, manufacturing, and service industries overseas. The office shall be responsible for conducting market research; disseminating trade leads; sponsoring trade delegations, missions, marts, seminars, and other appropriate promotional events, and for establishing overseas offices in foreign countries, if appropriate and economically feasible. The office shall consult with the Department of Food and Agriculture on the promotion of agricultural commodities overseas.

SEC. 2. Chapter 6 (commencing with Section 15397) is added to Part 6.7 of Division 3 of Title 2 of the Government Code, to read:

CHAPTER 6. CALIFORNIA DEVELOPMENT REVIEW PANEL

Article 1. Membership

15397. (a) There is within the Business, Transportation and Housing Agency a Development Review Panel consisting of five members as follows:

(1) The Secretary of the Business, Transportation and Housing Agency, who shall serve as chairperson.

(2) The Secretary of the Resources Agency.

(3) The Secretary for Environmental Affairs.

(4) One Member of the Senate, appointed by the Senate Rules Committee.

(5) One Member of the Assembly, appointed by the Speaker of the Assembly.

(b) The Members of the Senate and Assembly shall meet with and, except as otherwise provided by the Constitution, advise the panel to the extent that this participation is not incompatible with their respective positions as Members of the Legislature.

(c) All necessary staffing to carry out the panel's duties and responsibilities shall be provided by the Department of Commerce.

Article 2. Purpose and Powers

15397.3. The purpose of the Development Review Panel shall be to promote and assist economic development projects in the state where additional development or expansion is otherwise not possible due to lack of adequate funding for infrastructure.

15397.5. It is the intent of the Legislature that funds appropriated for the purpose of the Development Review Panel not be used in lieu of or as supplemental funds to any existing state infrastructure financing program, including, but not limited to, the State Transportation Improvement Program or the Clean Water Bond Program.

15397.7. The panel shall meet regularly to review projects submitted to it for funding assistance. To facilitate its activities, the panel shall have the power to do all of the following:

(a) Adopt bylaws for the regulation of its affairs and the conduct of its business, and prepare and promulgate rules and regulations.

(b) Contract for legal, financial, and other services as well as services of appropriate state agencies as may, in its judgment, be necessary for it to evaluate an application for financial assistance.

(c) Make secured loans to any local agency in connection with the financing of public capital improvements projects in accordance

with a loan agreement between the authority and the local agency.

(d) Assign or pledge all or any portion of its interests in mortgages, deeds of trust, indentures of mortgage or trust, or similar instruments, notes, and security interests in property, tangible or intangible, of a local agency to which the authority has made loans, and the revenues therefrom, including payment or income from any interest owed or held by the authority for the benefit of the holders of bonds issued to finance public capital improvements.

(e) Enter into any agreement or contract, execute any instrument, and perform any act or thing necessary, convenient, or desirable to carry out any power expressly given to the panel.

(f) Invest any moneys held in reserve or any moneys not required for immediate use or disbursement in obligations that are authorized by law for the investment of trust funds in the custody of the Treasurer.

(g) Request assistance and information from any department, division, board, commission, or other agency of the state as the panel may need to carry out its duties.

(h) Set such other terms and conditions by resolution pursuant to this section as it deems to be necessary, appropriate, and in the public interest in furtherance of the purposes of this chapter.

Article 3. Duties

15397.9. The panel shall establish criteria for the selection of projects to receive financing assistance. Criteria established by the panel shall include, but not be limited to, the following:

(a) The project must be demonstrated to be infeasible without the assistance of the panel.

(b) The project is needed to attract or otherwise accommodate the location or expansion of a specific industrial enterprise with high employment potential.

(c) A demonstration of community need for economic development.

(d) A demonstration of financial need for state assistance.

(e) Evidence of firm financial commitment on the part of the business or enterprise associated with the project.

(f) The cost per job created or retained is greater than or equal to a threshold established by the panel as part of its evaluation criteria.

(g) Evidence of site control, including any leases, easements, covenants, or encumbrances which may affect the project.

(h) Demonstration of ability to administer the project and state assistance requirements.

(i) Consistency with a city, county, or city and county general plan.

(j) Compliance with the California Environmental Quality Act as set forth in Division 13 (commencing with Section 21000) of the Public Resources Code.

15397.11. (a) Not less that 30 percent of the funds appropriated to the panel in any given fiscal year shall be set aside for projects submitted by rural cities and counties.

(b) For the purposes of this section, "rural city" means a city of less than 50,000 population located in a county of less than 600,000 population.

(c) For the purposes of this section, "rural county" means any unincorporated portion of a county of less than 200,000 population located within a county with a population of less than 600,000.

15397.13. Any city or county, or any city or county acting on behalf of a special district or local agency, may submit an application for financing assistance pursuant to this chapter which includes all of the following:

(a) A resolution in support of the public capital improvement and the financial assistance requested that has been adopted by the legislative body of the local agency.

(b) Financial, legal, and other information which is required by the panel to make a determination of significant public benefits.

(c) An estimate of the maximum amount and type of assistance to be requested.

(d) A description of the public capital improvement or project.

(e) A financing plan for the public capital improvement, including the amount of debt, if any, and the maximum term of maturity of any bond issue, and the identification of revenue sources that will be dedicated to the payment of the principal and interest on the bonds.

(f) A description of the public capital improvement's economic feasibility.

(g) The number of any type of permanent jobs to be either created or retained by the project.

15397.15. Applications for projects not in accordance with the reasonable priorities and criteria that the panel has established need not be accepted or further processed by the panel.

15397.17. The panel shall make a determination on the application within 30 days of receipt of the application, excepting that time required to correct deficiencies in the application.

15397.19. (a) The panel shall contract with local jurisdictions submitting projects accepted by the panel for financing assistance. For the purposes of this section, the panel shall be authorized to provide all of the following types of assistance:

(1) Interest rate assistance on local bonds.

(2) Grants-in-aid for projects.

(3) Secured loans.

(4) Matching funds to increase eligibility for other funds.

(b) Not more than 50 percent of the funds committed by the panel in any given fiscal year may be for direct grants.

(c) Not more than two million dollars ($2,000,000) may be spent

on any one project.

(d) Grants will only be made when other funding options are financially infeasible.

(e) Contracts will be executed within one week of approval of projects. Funds will be transferred within 30 days of execution of the contract.

(f) A report certifying completion of the project will be required of the recipient as will a closeout report certifying number of permanent employment opportunities created by the project.

15397.21. Neither the completion of the project nor the operation of the facility will have the proximate effect of relocation of any substantial operations of the company from one area of the state to another or in the abandonment of any substantial operations of the company within other areas of the state, or, if the completion or operation will have either of the effects, then completion or operation is reasonably necessary to prevent the relocation of any substantial operations of the company from an area within the state to an area outside the state.

15397.23. All moneys loaned or otherwise made available by the panel and that are required to be repaid shall be deposited in the California Unitary Fund (Article 12 (commencing with Section 16429.30) of Chapter 2 of Part 2 of Division 4) and entirely made available for the expenditure for the purposes and uses of the panel, upon appropriation by the Legislature.

SEC. 3. Chapter 7 (commencing with Section 15398) is added to Part 6.7 of Division 3 of Title 2 of the Government Code, to read:

CHAPTER 7. SMALL BUSINESS BOND INSURANCE CORPORATION

15398. There is in state government a nonprofit public benefit corporation which shall be known as the Small Business Bond Insurance Corporation.

15398.1. The primary goal of the corporation is to increase the availability of long-term financing to small businesses in California. The primary method for accomplishing this goal shall be through the provision of insurance or guarantees of the payment of bonds issued by or for the benefit of small businesses which utilize bond financing as a source of long-term capital, including bonds issued pursuant to the California Industrial Development Financing Act (Title 10 (commencing with Section 91500)). Other methods of achieving the primary goal, including bond pooling, may be adopted by the corporation.

15398.2. The corporation shall be a nonprofit public benefit corporation and shall be subject to the Nonprofit Public Benefit Corporation Law (Part 2 (commencing with Section 5110) of Division 2 of Title 1 of the Corporations Code), except as specifically provided in this chapter.

15398.3. (a) The corporation shall be governed by a board of

directors consisting of seven members as follows:

(1) The Secretary of the Business, Transporation and Housing Agency or his or her designee.

(2) The Treasurer or his or her designee.

(3) The Executive Director of the Office of Small Business or his or her designee.

(4) Two members to be appointed by the Governor as follows:

(A) One member with a minimum of three years' experience as an officer or employee of a financial institution.

(B) One member with a minimum of three years' experience as an owner or employee of a small business.

(5) One member to be appointed by the Senate Rules Committee.

(6) One member to be appointed by the Speaker of the Assembly.

(b) The terms of the Governor's initial appointees shall be two years. The terms of subsequent appointees by the Governor and all appointees by the Senate Rules Committee and the Speaker of the Assembly shall be three years. The terms shall expire on December 31. All appointees shall serve at the pleasure of the appointing authority and vacancies shall be filled by the appointing authority.

(c) Initial appointments to the board shall be made within 90 days of the operative date of this chapter.

15398.4. The board shall do all of the following:

(a) Elect a chair and vice chair from among its members. The chair, if present, shall preside at meetings of the board; otherwise the vice chair shall preside.

(b) Adopt bylaws as required to govern the conduct and operation of the board.

(c) File articles of incorporation with the Secretary of State. The articles shall include a statement of purposes that conforms to the goals set forth in this chapter.

(d) Hold regularly scheduled meetings, at least quarterly, to carry out the objectives and responsibilities of the board.

(e) Hire an executive director to provide overall management for the corporation's programs.

(f) Establish the salaries of the executive director and other staff.

(g) Promulgate rules and regulations necessary to the operation of the corporation's programs in an effective and fiscally sound manner.

(h) Adopt criteria establishing eligibility requirements for its programs.

(i) Issue an annual report to the Governor and the Legislature covering the operations and impact of its programs and recommending ways in which the state can improve the financial health of small businesses.

(j) Appoint advisory groups, as it deems necessary, to carry out the powers and duties of the board.

(k) Design, establish, and implement bond insurance, coinsurance, and bond pooling programs necessary to carry out the

goals of this chapter.

15398.5. The executive director shall do all of the following:

(a) Carry out management directives of the board.

(b) Manage and disburse funds and maintain records.

(c) Direct all staff and, hire and dismiss employees.

(d) Submit an annual budget, with the approval of the board, which shall be included in the Governor's proposed budget.

(e) Coordinate the activities and programs of the corporation with those of the Office of Small Business, the State Assistance Fund for Energy, the California Business and Industrial Corporation, the California Export Finance Office, and the California Industrial Development Financing Advisory Commission in order to minimize duplication of effort and improve the effectiveness of the corporation's programs.

15398.6. (a) There is in the State Treasury the California Small Business Bond Insurance Reserve Fund the purpose of which is to receive federal, state, and private moneys, any return on investments of those moneys by the Treasurer, premiums which may be charged by the corporation for insurance or coinsurance programs, and recoveries and collections on claims paid by the corporation. All moneys in the fund, upon appropriation by the Legislature, shall be allocated by the board for the corporation's small business bond insurance programs in accordance with the purposes of this chapter.

(b) Upon appropriation by the Legislature, all moneys in the fund shall be paid out by the Treasurer on warrants drawn by the Controller upon order of the board in furtherance of the purposes of this chapter, including the payment of claims under programs of the board, payments for insurance, coinsurance, and reinsurance, and payments required by state, federal, or private bond insurance programs conducted by the board.

(c) The state shall not be liable or obligated in any way beyond the state money which is allocated and deposited in the fund from state money which is appropriated for that purpose.

(d) The board may request the Treasurer to invest those moneys in the fund which are not immediately encumbered by the corporation's administrative or program costs, in securities issued by the Treasury of the United States government or the government of the State of California. Returns from these investments shall be deposited in the fund and, upon appropriation by the Legislature, shall be used to support loan guarantees, bond insurance, and bond coinsurance as provided in this chapter.

15398.7. (a) There is in the State Treasury the California Small Business Bond Insurance Corporation Operations Fund the purpose of which is to receive state, federal, and private moneys to be used to cover the operating expenses of the corporation.

(b) Upon appropriation by the Legislature, all moneys in the fund shall be paid out by the Treasurer on warrants drawn by the Controller upon order of the board in furtherance of the purposes of this chapter.

(c) The corporation may charge fees for its guarantees, insurance, coinsurance, and other programs and these fees shall be deposited in the fund and, upon appropriation by the Legislature, shall be used to defray the operating expenses of the corporation.

15398.8. If the Legislature has appropriated funds to the California Small Business Bond Insurance Corporation Operations Fund, board members may receive reimbursement, including per diem equal to that received by state employees, for their actual and necessary expenses incurred in the performance of their duties. Board members, who are not employees of the state, may also be paid a stipend, at the discretion of the board, for each day they devote to official board business. The board shall determine the amount of the stipend; however, the stipend shall not exceed one hundred dollars ($100) for any calendar day. Board members may not receive stipends for more than 24 calendar days in any calendar year.

15398.9. (a) The Secretary of the Business, Transportation and Housing Agency or his or her designee shall act as the interim chair of the board of directors and shall continue in that capacity until a permanent chair is elected by the board. The interim chair shall, as soon after the operative date of this chapter as is practical, convene a meeting of the board.

(b) The board may request the Office of Small Business to provide staff support and other necessary assistance in establishing the corporation.

SEC. 4. Article 12 (commencing with Section 16429.30) is added to Chapter 2 of Part 2 of Division 4 of Title 2 of the Government Code, to read:

Article 12. California Unitary Fund

16429.30. There is in the State Treasury the California Unitary Fund, which is hereby created, consisting of all money deposited in the fund pursuant to any provision of law. There is also hereby created the Future Infrastructure State Targeted Account in the California Unitary Fund and the Local Project Account for Non-Transient Spending in the California Unitary Fund. All money in the fund shall be used exclusively for infrastructure financing and economic development.

16429.32. Eighty percent of the money deposited in the Future Infrastructure State Targeted Account shall be available for expenditure for the purposes and uses of the California Development Review Panel upon appropriation by the Legislature.

16429.34. Twenty percent of the money deposited in the Future Infrastructure State Targeted Account shall be available for expenditure only for the following purposes and uses upon appropriation by the Legislature:

(a) Support of the California Export Finance Program Law (Chapter 5 (commencing with Section 15390) of Part 6.7 of Division 3).

(b) Support of the California Export Promotion and Policy Program (Chapter 1.9 (commencing with Section 15365) of Part 6.7 of Division 3).

(c) Support of the California Small Business Bond Insurance Corporation (Chapter 7 (commencing with Section 15398) of Part 6.7 of Division 3).

(d) Support of the Foreign Market Development Export Incentive Program for California Agriculture Act, as established by Chapter 1189 of the Statutes of 1985.

16429.36. Any money deposited in the fund pursuant to Section 15397.23 shall not be subject to apportionment under Sections 16429.32 and 16429.34.

16429.38. All proposed appropriations from the fund shall be summarized in a section of the Governor's Budget for each fiscal year and shall bear the caption "California Unitary Infrastructure and Economic Development Program." The section shall contain a separate description of each program for which an appropriation is made. Appropriations shall be made to the department or entity administering the program and shall be accounted for separately.

16429.40. The Secretary of the Business, Transportation and Housing Agency shall be responsible for annually recommending to the Governor, for inclusion in the Budget Bill, which programs shall be supported by the California Unitary Fund.

16429.49. The moneys in the California Unitary Fund shall remain in the fund until appropriated by the Legislature and upon appropriation shall be used only for those purposes provided in this article.

SEC. 5. Section 24274 of the Revenue and Taxation Code is amended to read:

24274. There shall be included in gross income for the income year the amount of any increase in the suspense account required by subparagraph (B) of paragraph (2) of subdivision (c) of Section 24685 (relating to accrual of vacation pay).

SEC. 6. Section 24344 of the Revenue and Taxation Code is amended to read:

24344. (a) Except as limited by subdivision (b), there shall be allowed as a deduction all interest paid or accrued during the income year on indebtedness of the taxpayer.

(b) If income of the taxpayer which is derived from or attributable to sources within this state is determined pursuant to Section 25101 or 25110, the interest deductible shall be an amount equal to interest income subject to apportionment by formula, plus the amount, if any, by which the balance of interest expense exceeds interest and dividend income (except dividends deductible under the provisions of Section 24402 and dividends subject to the

deductions provided for in Section 24411 to the extent of those deductions) not subject to apportionment by formula. Interest expense not included in the preceding sentence shall be directly offset against interest and dividend income (except dividends deductible under the provisions of Section 24402 and dividends subject to the deductions provided for in Section 24411 to the extent of those deductions) not subject to apportionment by formula.

(c) Notwithstanding subdivision (b), interest expense incurred for purposes of foreign investments may be offset against dividends deductible under Section 24411.

SEC. 7. Section 24348 of the Revenue and Taxation Code is amended to read:

24348. (a) (1) There shall be allowed as a deduction either of the following:

(A) Debts which become worthless within the income year in an amount not in excess of the part charged off within that income year.

(B) In the case of a savings and loan association, bank, or financial corporation, in lieu of any deduction under subparagraph (A), in the discretion of the Franchise Tax Board, a reasonable addition to a reserve for bad debts.

(2) When satisfied that a debt is recoverable in part only the Franchise Tax Board may allow that debt, in an amount not in excess of the part charged off within the income year, as a deduction; provided, however, that if a portion of a debt is claimed and allowed as a deduction in any year no deduction shall be allowed in any subsequent year for any portion of the debt which in any prior year was charged off, regardless of whether claimed as a deduction in that prior year.

(b) (1) The amendments to this section made during the 1985–86 Regular Session by the act adding this subdivision shall apply only to income years beginning after December 31, 1987.

(2) In the case of any taxpayer who maintained a reserve for bad debts for that taxpayer's last income year beginning before January 1, 1988, and who is required by the amendments to this section to change its method of accounting for any income year, all of the following shall apply:

(A) That change shall be treated as initiated by the taxpayer.

(B) That change shall be treated as made with the consent of the Franchise Tax Board.

(C) The net amount of adjustments required by Article 6 (commencing with Section 24721) of Chapter 13, to be taken into account by the taxpayer shall:

(i) In the case of a taxpayer maintaining a reserve under former subdivision (b) (prior to the amendments made during the 1985–86 Regular Session by the act adding this subdivision), be reduced by the balance in the suspense account under paragraph (4) of that subdivision as of the close of such last income year; and

(ii) Be taken into account ratably in each of the first five income

years beginning after December 31, 1987.

SEC. 8. Section 24411 is added to the Revenue and Taxation Code, to read:

24411. (a) For purposes of those taxpayers electing to compute income under Section 25110, 100 percent of the qualifying dividends described in subdivision (c) and 75 percent of the qualifying dividends described in subdivisions (b) and (d). "Qualifying dividends" means those received from corporations regardless of the place it is incorporated if both of the following conditions are satisfied:

(1) The average of the property, payroll, and sales factors within the United States for the corporation is less than 20 percent.

(2) More than 50 percent of the total combined voting power of all classes of stock entitled to vote is owned by the taxpayer.

(b) Qualifying dividends equal to the greatest amount of dividends received in any one of the income years constituting the base period.

(c) The amount of fully excluded dividends, if the taxpayer's greatest foreign payroll factor for any income year in the base period exceeds the taxpayer's foreign payroll factor for the income year, which shall be determined as follows:

(1) The taxpayer's foreign payroll factor in the income year shall be subtracted from the greatest of the taxpayer's foreign payroll factor for any income year in the base period.

(2) The amount determined pursuant to paragraph (1) shall be divided by the greatest of the taxpayer's foreign payroll factor for any income year in the base period.

(3) The percentage determined in paragraph (2) shall be multiplied by the total qualifying foreign dividends. The amount so determined shall be the amount of fully excluded dividends.

(4) The amount determined in paragraph (3) shall not exceed the amount of qualifying dividends in excess of the base dividends determined in subdivision (b).

(5) If the amount of fully excluded dividends determined pursuant to paragraph (3) is less than the amount of qualified dividends in excess of the amount of base dividends determined pursuant to subdivision (b), the difference shall be added to the base dividends determined pursuant to subdivision (b).

(d) The amount of partially excluded dividends, if the taxpayer's greatest foreign payroll factor for any income year in the base period is the same as or less than the taxpayer's foreign payroll factor in the income year, which shall be determined as follows:

(1) The taxpayer's greatest foreign payroll factor for any income year in the base period shall be subtracted from the taxpayer's foreign payroll factor in the income year.

(2) The amount determined pursuant to paragraph (1) shall be divided by the taxpayer's foreign payroll factor in the income year.

(3) The percentage determined in paragraph (2) shall be multiplied by the total qualifying foreign dividends.

(4) The amount determined in paragraph (3) shall be subtracted from the amount of qualifying dividends in excess of the amount of base dividends determined in subdivision (b).

(5) The balance shall be the amount of partially excluded dividends.

(e) The base period shall consist of the income year ending before January 1, 1987, and the two immediately preceding income years.

(f) A taxpayer's foreign payroll factor for an income year shall be a fraction, the numerator of which is the total amount paid outside the United States during the income year by the taxpayer and its affiliates for compensation, and the denominator of which is the total compensation paid everywhere during the income year.

SEC. 9. Section 24667 of the Revenue and Taxation Code is amended to read:

24667. (a) Except as otherwise provided in this section, income from an installment sale shall be taken into account for purposes of this part under the installment method.

(b) For purposes of this section—

(1) The term "installment sale" means a disposition of property where at least one payment is to be received after the close of the income year in which the disposition occurs.

(2) The term "installment sale" does not include—

(A) A disposition of personal property on the installment plan by a person who regularly sells or otherwise disposes of personal property on the installment plan.

(B) A disposition of personal property of a kind which is required to be included in the inventory of the taxpayer if on hand at the close of the income year.

(c) For purposes of this section, the term "installment method" means a method under which the income recognized for any income year from a disposition is that proportion of the payments received in that year which the gross profit (realized or to be realized when payment is completed) bears to the total contract price.

(d) (1) Subdivision (a) shall not apply to any disposition if the taxpayer elects to have subdivision (a) not apply to such disposition.

(2) Except as otherwise provided, an election under paragraph (1) with respect to a disposition may be made only on or before the due date prescribed by law (including extensions) for filing the taxpayer's return of the tax imposed by this part for the income year in which the disposition occurs. Such an election shall be made in the manner prescribed by the Franchise Tax Board.

(3) An election under paragraph (1) with respect to any disposition may be revoked only with the consent of the Franchise Tax Board.

(e) (1) If—

(A) Any person disposes of property to a related person (hereinafter in this subdivision referred to as the "first disposition"),

and

(B) Before the person making the first disposition receives all payments with respect to such disposition, the related person disposes of the property (hereinafter in this subdivision referred to as the "second disposition"),

then, for purposes of this section, the amount realized with respect to such second disposition shall be treated as received at the time of the second disposition by the person making the first disposition.

(2) (A) Except in the case of marketable securities, paragraph (1) shall apply only if the date of the second disposition is not more than two years after the date of the first disposition.

(B) The running of the two-year period set forth in subparagraph (A) shall be suspended with respect to any property for any period during which the related person's risk of loss with respect to the property is substantially diminished by—

(i) The holding of a put with respect to such property (or similar property),

(ii) The holding by another person of a right to acquire the property, or

(iii) A short sale or any other transaction.

(3) The amount treated for any income year as received by the person making the first disposition by reason of paragraph (1) shall not exceed the excess of—

(A) The lesser of—

(i) The total amount realized with respect to any second disposition of the property occurring before the close of the income year, or

(ii) The total contract price for the first disposition, over

(B) The sum of—

(i) The aggregate amount of payments received with respect to the first disposition before the close of such year, plus

(ii) The aggregate amount treated as received with respect to the first disposition for prior income years by reason of this subdivision.

(4) For purposes of this subdivision, if the second disposition is not a sale or exchange, an amount equal to the fair market value of the property disposed of shall be substituted for the amount realized.

(5) If paragraph (1) applies for any income year, payments received in subsequent income years by the person making the first disposition shall not be treated as the receipt of payments with respect to the first disposition to the extent that the aggregate of such payments does not exceed the amount treated as received by reason of paragraph (1).

(6) For purposes of this subdivision—

(A) Any sale or exchange of stock to the issuing corporation shall not be treated as a first disposition.

(B) A compulsory or involuntary conversion (within the meaning of Section 24944) and any transfer thereafter shall not be treated as a second disposition if the first disposition occurred before the threat or imminence of the conversion.

(C) Any transfer after the earlier of—

(i) The death of the person making the first disposition, or

(ii) The death of the person acquiring the property in the first disposition, and any transfer thereafter shall not be treated as a second disposition.

(7) This subdivision shall not apply to a second disposition (and any transfer thereafter) if it is established to the satisfaction of the Franchise Tax Board that neither the first disposition nor the second disposition had as one of its principal purposes the avoidance of bank and corporation tax.

(8) The period for assessing a deficiency with respect to a first disposition (to the extent such deficiency is attributable to the application of this subdivision) shall not expire before the day which is two years after the date on which the person making the first disposition furnishes (in such manner as the Franchise Tax Board may prescribe) a notice that there was a second disposition of the property to which this subdivision may have applied. Such deficiency may be assessed notwithstanding the provisions of any law or rule of law which would otherwise prevent such assessment.

(f) For purposes of this section—

(1) Except for purposes of subdivisions (g) and (h), the term "related person" means a person whose stock would be attributed under Section 24497 (other than subdivision (d) thereof) to the person first disposing of the property.

(2) The term "marketable securities" means any security for which, as of the date of the disposition, there was a market on an established securities market or otherwise.

(3) Except as provided in paragraph (4), the term "payment" does not include the receipt of evidences of indebtedness of the person acquiring the property (whether or not payment of such indebtedness is guaranteed by another person).

(4) Receipt of a bond or other evidence of indebtedness which—

(A) Is payable on demand, or

(B) Is issued by a corporation or a government or political subdivision thereof and is readily tradable,

shall be treated as receipt of payment.

(5) For purposes of paragraph (4), the term "readily tradable" means a bond or other evidence of indebtedness which is issued—

(A) With interest coupons attached or in registered form (other than one in registered form which the taxpayer establishes will not be readily tradable in an established securities market), or

(B) In any other form designed to render such bond or other evidence of indebtedness readily tradable in an established securities market.

(6) In the case of any exchange described in subdivision (b) of Section 24941—

(A) The total contract price shall be reduced to take into account

the amount of any property permitted to be received in such exchange without recognition of gain,

(B) The gross profit from such exchange shall be reduced to take into account any amount not recognized by reason of subdivision (b) of Section 24941, and

(C) The term "payment," when used in any provision of this section other than paragraph (1) of subdivision (b), shall not include any property permitted to be received in such exchange without recognition of gain.

Similar rules shall apply in the case of an exchange which is described in Section 24535 and is not treated as a dividend.

(7) The term "depreciable property" means property of a character which (in the hands of the transferee) is subject to the allowance for depreciation provided in Section 24349.

(g) (1) In the case of an installment sale of depreciable property between related persons within the meaning of subdivision (b) of Section 1239 of the Internal Revenue Code, subdivision (a) shall not apply, and, for purposes of this part, all payments to be received shall be deemed received in the year of the disposition.

(2) Paragraph (1) shall not apply if it is established to the satisfaction of the Franchise Tax Board that the disposition did not have as one of its principal purposes the avoidance of bank and corporation tax.

(h) (1) (A) If, in connection with a liquidation to which Section 24512 applies, in a transaction to which Section 24501 applies the shareholder receives (in exchange for the shareholder's stock) an installment obligation acquired in respect of a sale or exchange by the corporation during the 12-month period set forth in subdivision (b) of Section 24512, then, for purposes of this section, the receipt of payments under such obligation (but not the receipt of such obligation) by the shareholder shall be treated as the receipt of payment for the stock.

(B) Subparagraph (A) shall not apply to an installment obligation described in paragraph (2) of subdivision (a) of Section 24513 unless such obligation is also described in paragraph (2) of subdivision (b) of Section 24513.

(C) If the obligor of any installment obligation and the shareholder are married to each other or are related persons (within the meaning of subdivision (b) of Section 1239 of the Internal Revenue Code), to the extent such installment obligation is attributable to the disposition by the corporation of depreciable property—

(i) Subparagraph (A) shall not apply to such obligation, and

(ii) For purposes of this part, all payments to be received by the shareholder shall be deemed received in the year the shareholder receives the obligation.

(D) For purposes of subparagraph (A) of paragraph (1) of subdivision (e), disposition of property by the corporation shall be

treated also as disposition of such property by the shareholder.

(E) For purposes of subparagraph (A), in any case to which subdivision (c) of Section 24514 applies, an obligation acquired in respect of a sale or exchange by the selling corporation shall be treated as so acquired by the corporation distributing the obligation to the shareholder.

(2) If—

(A) Paragraph (1) applies with respect to any installment obligation received by a shareholder from a corporation, and

(B) By reason of the liquidation such shareholder receives property in more than one income year, then, on completion of the liquidation, basis previously allocated to property so received shall be reallocated for all such income years so that the shareholder's basis in the stock of the corporation is properly allocated among all property received by such shareholder in such liquidation.

(i) (1) In the case of any installment sale of property to which subdivision (a) applies, both of the following shall apply:

(A) Notwithstanding any other provision of this part, any recapture income shall be recognized in the year of the disposition.

(B) Any gain in excess of the recapture income shall be taken into account under the installment method.

(2) For purposes of paragraph (1), "recapture income" means, with respect to any installment sale, the amount by which the lower of—

(A) The recomputed basis of the property, or

(B) (i) In the case of a sale, exchange, or involuntary conversion, the amount realized, or

(ii) In the case of any other disposition, the fair market value of the property, exceeds the adjusted basis of the property.

(3) This subdivision shall not apply to any installment sale of property which is irrigation equipment which is used to irrigate farmland.

(4) For purposes of this subdivision, "recomputed basis" means the adjusted basis of the property recomputed by adding thereto both of the following:

(A) All depreciation adjustments attributable to periods after December 31, 1962.

(B) Any amount deducted under Section 24356.3 (relating to expensing of certain business assets).

(j) (1) This section shall not apply to any installment obligation arising out of a sale of either of the following:

(A) Stock or securities which are traded on an established securities market.

(B) To the extent provided in regulations, property (other than stock or securities) of a kind regularly traded on an established market under regulations.

(2) This subdivision shall not apply to any sale of crops or livestock held for slaughter.

(3) The Franchise Tax Board may disallow the use of the installment method in whole or in part for transactions in which the rules of this subdivision otherwise would be avoided through the use of related parties or other intermediaries.

(k) (1) The Franchise Tax Board may prescribe such regulations as may be necessary or appropriate to carry out the provisions of this section.

(2) The regulations prescribed under paragraph (1) shall include regulations providing for ratable basis recovery in transactions where the gross profit or the total contract price (or both) cannot be readily ascertained.

(l) The amendments to this section made during the 1985–86 Regular Session by the act adding this subdivision shall apply only to dispositions made after December 31, 1987.

SEC. 10. Section 24668 of the Revenue and Taxation Code is amended to read:

24668. (a) (1) Under rules prescribed by the Franchise Tax Board, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any income year that proportion of the installment payments actually received in that year which the gross profit, realized or to be realized when payment is completed, bears to the total contract price.

(2) For purposes of paragraph (1), the total contract price of all sales of personal property on the installment plan includes the amount of carrying charges or interest which is determined with respect to such sales and is added on the books of account of the seller to the established cash selling price of such property.

(b) If the carrying charges or interest with respect to sales of personal property, the income from which is returned under paragraph (1) of subdivision (a), is not included in the total contract price, payments received with respect to such sales shall be treated as applying first against such carrying charges or interest.

(c) (1) This section shall not apply to any of the following:

(A) Any disposition of personal property under a revolving credit plan.

(B) Any installment obligation arising out of a sale of either of the following:

(i) Stock or securities which are traded on an established securities market.

(ii) To the extent provided in regulations, property (other than stock or securities) of a kind regularly traded on an established market under regulations.

(2) This subdivision shall not apply to any sale of crops or livestock held for slaughter.

(3) The Franchise Tax Board may disallow the use of the installment method in whole or in part for transactions in which the rules of this section otherwise would be avoided through the use of related parties or other intermediaries.

(d) (1) The amendments to this section made during the 1985–86 Regular Session by the act adding this subdivision shall apply only to dispositions made after December 31, 1987.

(2) In the case of any taxpayer who made sales under a revolving credit plan and was on the installment method under Section 24668 for that taxpayer's last income year beginning before January 1, 1988, and who is required by the amendments to this section made during the 1985–86 Regular Session by the act adding this subdivision to change its method of accounting all of the following apply:

(A) That change shall be treated as initiated by the taxpayer.

(B) That change shall be treated as having been made with the consent of the Franchise Tax Board.

(C) The period for taking into account adjustments under Article 6 (commencing with Section 24721) by reason of that change shall not exceed five years.

SEC. 11. Section 24670 is added to the Revenue and Taxation Code, to read:

24670. (a) For purposes of Section 24667 and 24668, if a taxpayer has allocable installment indebtedness for any income year, that indebtedness—

(1) Shall be allocated on a pro rata basis to any applicable installment obligation of the taxpayer which meets both of the following requirements:

(A) Arises in that income year.

(B) Is outstanding as of the close of that income year.

(2) Shall be treated as a payment received on that obligation as of the close of that income year.

(b) For purposes of this section:

(1) "Allocable installment indebtedness" means, with respect to any income year:

(A) The installment percentage of the taxpayer's average quarterly indebtedness for that income year, reduced (but not below zero) by --

(B) The aggregate amount treated as allocable installment indebtedness with respect to applicable installment obligations which --

(i) Are outstanding as of the close of that income year, but

(ii) Did not arise during that income year.

(2) "Installment percentage" means the percentage (not in excess of 100 percent) determined by dividing:

(A) The face amount of all applicable installment obligations of the taxpayer outstanding as of the close of the income year, by --

(B) The sum of both of the following:

(i) The aggregate adjusted basis of all assets not described in clause (ii) held as of the close of the income year.

(ii) The face amount of all installment obligations outstanding as of that time.

For purposes of clause (i) of subparagraph (B), a taxpayer may elect to compute the aggregate adjusted basis of all assets using the deduction for depreciation which is used in computing earnings and profits under Section 24491.1.

(3) For purposes of this subdivision:

(A) There shall not be taken into account under subparagraph (B) of paragraph (2) any property used in the trade or business of farming (within the meaning of Section 2032A(e)(4) or (5) of the Internal Revenue Code) or any installment obligation arising from the sale of that property.

(B) There shall not be taken into account in computing the taxpayer's average quarterly indebtedness under subparagraph (A) of paragraph (1) any indebtedness secured by any property described in subparagraph (A).

(c) (1) If any amount is treated as received under subdivision (a) (after application of paragraph (2) of subdivision (d)) with respect to any applicable installment obligation, subsequent payments received on that obligation shall not be taken into account for purposes of Sections 24667 and 24668 to the extent that the aggregate of those subsequent payments does not exceed the aggregate amount treated as received under subdivision (a).

(2) For purposes of applying subparagraph (B) of paragraph (1) of subdivision (b) for the income year in which any payment to which paragraph (1) of this subdivision applies was received, and for any subsequent income year, the allocable installment indebtedness with respect to the applicable installment obligation shall be reduced (but not below zero) by the amount of that payment not taken into account by reason of paragraph (1).

(d) (1) The amount treated as received under subdivision (a) with respect to any applicable installment obligation for any income year shall not exceed the excess (if any) of:

(A) The total contract price, over

(B) Any portion of the total contract price received under the contract before the close of that income year:

(i) Including amounts so treated under subdivision (a) for all preceding income years, but

(ii) Not including amounts not taken into account by reason of subdivision (c).

(2) If after application of paragraph (1), the allocable installment indebtedness for any income year exceeds the amount which may be allocated to applicable installment obligations arising in, and outstanding as of the close of, that income year, that excess shall, subject to the limitations of paragraph (1), be allocated to applicable installment obligations outstanding as of the close of that income year which arose in preceding income years, beginning with applicable installment obligations arising in the earliest preceding income year and shall be treated as a payment under paragraph (2) of subdivision (a).

(e) (1) "Applicable installment obligation" means any obligation which meets both of the following requirements:

(A) Arises from the disposition after December 31, 1987, of any of the following:

(i) Personal property under the installment method by a person who regularly sells or otherwise disposes of personal property on the installment plan.

(ii) Real property under the installment method which is held by the taxpayer for sale to customers in the ordinary course of the taxpayer's trade or business.

(iii) Real property under the installment method which is property used in the taxpayer's trade or business or property held for the production of rental income, but only if the sales price of that property exceeds one hundred fifty thousand dollars ($150,000). All sales and exchanges which are part of the same transaction (or a series of related transactions) shall be treated as one sale or exchange.

(B) Is held by the seller or a member of the same affiliated group as the seller.

(2) For purposes of this section, all members of-

(A) An affiliated group (within the meaning of Section 1504(a) of the Internal Revenue Code, but without regard to Section 1504(b) of the Internal Revenue Code), or

(B) A group under common control (within the meaning of Section 52(b) of the Internal Revenue Code), shall be treated as one taxpayer. The Franchise Tax Board may prescribe regulations for the treatment under this section of transactions between members of these groups.

(3) The Franchise Tax Board may provide that all (or any portion of) applicable installment obligations of a taxpayer may be treated as one obligation.

(4) (A) If a taxpayer elects the application of this paragraph, this section shall not apply to any installment obligation which meets both of the following requirements:

(i) Arises from a sale in the ordinary course of the taxpayer's trade or business to an individual of either of the following:

(I) A timeshare right to use or a timeshare ownership interest in residential real property for not more than six weeks, or a right to use specified campgrounds for recreational purposes.

(II) Any residential lot but only if the taxpayer (or any related person) is not to make any improvements with respect to that lot.

(ii) Is not guaranteed by any person other than an individual.

(B) If subparagraph (A) applies to any installment obligation, interest shall be paid on the portion of any tax for any income year (determined without regard to any deduction allowable for that interest) which is attributable to the receipt of payments on that obligation in that year (other than payments received in the income year of the sale). That interest shall be computed for the period from

the date of the sale to the date on which the payment is received using the federal short-term rate under Section 1274 of the Internal Revenue Code (compounded semiannually) in effect at the time of the sale and adjusted annually to the federal short-term rate in effect on each anniversary of the sale.

(C) Any interest payable under this paragraph with respect to a payment shall be treated as an addition to tax for the income year in which the payment is received, except that the amount of that interest shall be taken into account in computing the amount of any deduction allowable to the taxpayer for interest paid or accrued during that income year.

(5) Except as otherwise provided, a shareholder who (after application of Section 318 of the Internal Revenue Code) owns stock in a corporation meeting the requirements of Section 1504(a)(2) of the Internal Revenue Code shall be treated as a member of the affiliated group.

(6) The Franchise Tax Board may disallow the use of the installment method in whole or in part for transactions in which the rules of this subdivision otherwise would be avoided through the use of related parties or other intermediaries.

(f) (1) Except as otherwise provided, this section shall apply to income years beginning after December 31, 1987, with respect to dispositions after December 31, 1987.

(2) (A) This section shall not apply to any installment obligation arising from the disposition of tangible personal property by a manufacturer (or any taxpayer owned or controlled by the same interest, as defined by Section 25102) to a dealer if all of the following requirements are met:

(i) The dealer is obligated to pay on that obligation only when the dealer resells (or rents) the property.

(ii) The manufacturer has the right to repurchase the property at a fixed (or ascertainable) price after no later than the 9-month period beginning with the date of the sale.

(iii) The disposition is in an income year with respect to which the requirements of subparagraph (B) are met.

(B) The requirements of this subparagraph are met with respect to any income year if for that income year and the preceding income year the aggregate face amount of installment obligations described in subparagraph (A) is at least 50 percent of the total sales to dealers giving rise to those obligations, except that if the taxpayer met the requirements of this subparagraph for the preceding income year, then the taxpayer shall be treated as failing to meet the requirements of this subparagraph only in the second consecutive income year in which the 50-percent test is not met.

(C) An obligation issued before the date of the enactment of this section shall be treated as described in subparagraph (A) if, within 60 days after that date, the taxpayer modifies the terms of the obligation to conform to the requirements of subparagraph (A).

(D) In applying this section, any obligations described in subparagraph (A) shall not be treated as applicable installment obligations (within the meaning of subparagraph (A) of paragraph (1) of subdivision (e)).

(E) This paragraph shall apply only if the taxpayer meets the requirements of subparagraphs (A) and (B) for its first income year beginning after the date of enactment of this section.

(3) In applying this section to any installment obligation of a corporation incorporated on January 13, 1928, the following indebtedness shall not be taken into account in determining the allocable installment indebtedness of that corporation under this section:

(A) Twelve and five-eighths percent subordinated debentures, with a total face amount of one hundred seventy-five million dollars ($175,000,000) issued pursuant to a trust indenture dated as of September 1, 1985.

(B) A revolving credit term loan in the maximum amount of one hundred thirty million dollars ($130,000,000) made pursuant to a revolving credit and security agreement dated as of September 6, 1985, payable in various stages with final payment due on August 31, 1992.

This paragraph shall also apply to indebtedness which replaces indebtedness described in this paragraph if that indebtedness does not exceed the amount and maturity of the indebtedness it replaces.

SEC. 12. Section 25110 of the Revenue and Taxation Code is amended and renumbered to read:

25108. (a) For corporations whose income is subject to the provisions of Section 25101 or 25101.15, the net operating loss determined in accordance with Section 172 of the Internal Revenue Code, as modified by Section 24416, for a particular income year (taxable year of corporations subject to the tax imposed by Chapter 3) shall be the corporation's "net loss for state purposes" as defined in subdivision (c).

(b) The net operating loss deduction allowed by Section 24416 for an income year (taxable year of corporations subject to the tax imposed by Chapter 3) shall be deducted from "net income for state purposes" (as defined in subdivision (c)) for that income year (taxable year of corporations subject to the tax imposed by Chapter 3).

(c) "Net income (loss) for state purposes" means the sum of the net income or loss of that corporation apportionable to this state and the income or loss allocable to this state as nonbusiness income, as provided by Chapter 17 (commencing with Section 25101).

SEC. 6. Article 1.5 (commencing with Section 25110) is added to Chapter 17 of Part 11 of Division 2 of the Revenue and Taxation Code, to read:

Article 1.5. Water's-Edge Election

25110. (a) Notwithstanding Section 25101, a qualified taxpayer, as defined in paragraph (2) of subdivision (b) which 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 which makes a water's-edge election shall take into account the income and apportionment factors of the following affiliated entities only:

(1) Affiliated banks or corporations which are eligible to be included in a federal consolidated return as described in Sections 1501 to 1505, inclusive, of the Internal Revenue Code.

(2) Domestic international sales corporations, as described in Sections 991 through 994 of the Internal Revenue Code and foreign sales corporations as described in Sections 921 through 927 of the Internal Revenue Code.

(3) Any corporation, 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.

(4) Banks and corporations which are incorporated in the United States, excluding corporations described in Sections 931 to 936, inclusive, of the Internal Revenue Code, of which more than 50 percent of their stock is controlled directly or indirectly by the same interests, which are not included in paragraph (1).

(5) A bank or corporation which is not described in paragraphs (1) to (4), inclusive, or paragraph (6), but only to the extent of its income derived from or attributable to sources within the United States and its factors assignable to a location within the United States in accordance with paragraph (3). Income of such a bank or corporation derived from or attributable to sources within the United States shall be limited to and determined from the books of account maintained by the bank or corporation with respect to its activities conducted within the United States as determined by federal income tax law.

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

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

(B) The income and factors of a bank which is not described in paragraphs (1) to (4), inclusive, and (6) and which is an electing taxpayer under this subdivision shall be taken into account in determining its income only to the extent set forth in paragraph (5).

(8) Any affiliated bank or corporation which is a "controlled foreign corporation", as defined in Section 957 of the Internal Revenue Code, if all or part of the income of that affiliate is defined

in Section 952 of Subpart F of the Internal Revenue Code ("Subpart F income"). The income and apportionment factors of any affiliate to be included under this paragraph shall be determined by multiplying the income and apportionment factors of that affiliate without application of this paragraph by a fraction (not to exceed one), the numerator of which is the "Subpart F income" of that bank or corporation and the denominator of which is the "earnings and profits" of that bank or corporation, as defined in Section 964 of the Internal Revenue Code.

(b) For purposes of this section:

(1) An "affiliated bank or corporation," for purposes of this article, means a bank or corporation which is part of one or more chains of banks or corporations connected through stock ownership with a common parent if both of the following exist:

(A) Over 50 percent of the voting stock of the bank or corporation is directly or indirectly owned or controlled by one or more of the other banks or corporations.

(B) The common parent owns directly or indirectly over 50 percent of the voting stock of at least one of the other banks or corporations.

(2) A "qualified taxpayer" means a bank or corporation which does both of the following:

(A) Files with the state tax return on which the water's-edge election is made a consent to the taking of depositions from key domestic corporate individuals and to the acceptance of subpoenas duces tecum requiring reasonable production of documents to the Franchise Tax Board as provided in Section 26423 or by the State Board of Equalization or by the courts of this state. The consent shall remain in effect so long as the water's-edge election is in effect and shall be limited to providing that information necessary to review or to adjust income or deductions in a manner authorized under Sections 482, 861, Subpart F of Part III of Subchapter N, or similar provisions of the Internal Revenue Code, together with the regulations adopted pursuant thereto, and for the conduct of an investigation with respect to any unitary business in which the taxpayer may be involved.

(B) Agrees that for purposes of this article, dividends received by any bank or corporation whose income and apportionment factors are taken into account pursuant to subdivision (a) from either of the following shall be deemed to be functionally related dividends subject to Section 24111 and shall be presumed to be business income:

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

(ii) Any bank or corporation which is either a significant source of supply for the unitary business or a significant purchaser of the

ificant part of its

output or obtains a significant part of its raw materials or input from the unitary business. "Significant," as used in this subparagraph, means an amount of 15 percent or more of either input or output.

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

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

Sales shall be considered to be made to a state only if the bank or corporation making the sale may otherwise be subject to a tax on or measured by net income under the Constitution or laws of the United States, and shall not include sales made to a bank or corporation whose income and apportionment factors are taken into account pursuant to this subdivision.

(4) The Franchise Tax Board, for purposes of administering the provisions of Sections 25110 and 25115, shall examine the returns filed by taxpayers subject to these provisions. Where this examination reveals potential noncompliance, a detailed examination shall be made notwithstanding the potential net revenue benefit to the state unless the taxpayer is being examined by the Internal Revenue Service for the same year or years on the same issues.

In any case of two or more organizations, trades, or businesses (whether or not organized in the United States and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Franchise Tax Board may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among these organizations, trades, or businesses, if the board determines that the distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of these organizations, trades, or businesses.

In making distributions, apportionments, and allocations under this section, the Franchise Tax Board shall generally follow the rules, regulations, and procedures of the Internal Revenue Service in making audits under Section 482 of the Internal Revenue Code. Any of these rules, regulations, and procedures adopted by the Franchise Tax Board shall not be subject to review by the Office of Administrative Law.

If the Internal Revenue Service has conducted a detailed audit under Section 482 of the Internal Revenue Code and has made adjustments pursuant to that section, it shall be presumed that no further adjustments are necessary for this state's purposes. If the Internal Revenue Service has conducted a detailed audit under this section and has made or proposed no adjustments to the transaction

examined, it shall be presumed that no adjustment is necessary for this state's purposes. These presumptions shall be overcome if the Franchise Tax Board or the taxpayer demonstrates that an adjustment or a failure to make an adjustment was erroneous, if it demonstrates that the results of such an adjustment would produce a minimal tax change for federal purposes because of correlative or offsetting adjustments or for other reasons, or if substantially the same federal tax result was obtained under other sections of the Internal Revenue Code. No inference shall be drawn from an Internal Revenue Service failure to audit international transactions under Section 482 of the Internal Revenue Code and it shall not be presumed that any such transactions were correctly reported.

(5) "The United States" means the 50 states of the United States and the District of Columbia.

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

(d) A water's-edge election may be disregarded by the Franchise Tax Board only if any of the following occurs:

(1) A bank or corporation fails to comply substantially with Section 25114 or any federal law requiring the filing of domestic spreadsheets.

(2) After a reasonable adjustment of transfer prices, royalty rates, the allocation of common expenses, and similar adjustments, the return filed pursuant to this section fails to prevent the evasion of taxes.

(3) An otherwise qualified taxpayer fails to do any of the following:

(A) Retain and make available upon request the documents and information, including any questionnaires completed and submitted to the Internal Revenue Service or qualified states, which are necessary to audit issues involving attribution of income to the United States or foreign jurisdictions under Sections 482, 861, 863, 902, 904, and Subpart F of Part III of Subchapter N, or similar sections of the Internal Revenue Code.

(B) Identify, upon request, principal officers or employees who have substantial knowledge of and access to documents and records which discuss pricing policies, profit centers, cost centers, and the methods of allocating income and expense among these centers. The information shall include the employees' titles and addresses.

(C) Retain and make available upon request all documents and correspondence ordinarily available to a bank or corporation included in the water's-edge election which are submitted to or obtained from the Internal Revenue Service, foreign countries or their territories or possessions, and competent authority pertaining to ruling requests, rulings, settlement resolutions, and competing claims involving jurisdictional assignment and sourcing of income that affect the assignment of income to the United States. The

documents shall include all ruling requests and rulings on reorganizations involving foreign incorporation of branches, all ruling requests and rulings on changing a bank or corporation's jurisdictional incorporation, and all documents which are ordinarily available to a bank or corporation included in the water's-edge election which pertain to the determination of foreign tax liability, including examination reports issued by foreign taxing administrations. If the documents have been translated, the translations shall be furnished.

(D) Prepare and make available upon request for each bank or corporation included in the disclosure spreadsheet referred to in subdivision (a) of Section 25114 in which the taxpayer is included, a list of each state of the United States, including the District of Columbia, territories or possessions, and each foreign country in which it has payroll, property, or sales. The sales shall be determined by destination whether or not the taxpayer is taxable in the destination jurisdiction.

(E) Retain and make available upon request forms filed with the Internal Revenue Service to comply with Sections 6038, 6038A, and 6041 of the Internal Revenue Code.

(F) Prepare and make available upon request, for each bank or corporation organized or created under the laws of the United States or a political subdivision thereof, of which 50 percent or more of its voting stock is directly or indirectly owned or controlled, the information which would be included in the forms described in subparagraph (E) if those forms were required for United States corporations.

(G) Retain and make available upon request all state tax returns filed by each bank or corporation included under subdivision (a) in each state, including the District of Columbia.

(H) Comply with reasonable requests for discovery directed at obtaining information necessary to determine or verify its net income, apportionment factors, or the geographic source of that income pursuant to the Internal Revenue Code.

(I) For purposes of this subdivision, information for any year shall be retained for that period of time in which the taxpayer's income or franchise tax liability to this state may be subject to adjustment, including all periods in which additional income or franchise taxes may be assessed or during which an appeal is pending before the State Board of Equalization or a lawsuit is pending in the courts of this state or the United States with respect to California franchise or income tax.

(4) A failure to satisfy any of the requirements of paragraph (3) shall mean a willful failure to retain and make available documents that are material to a determination by the Franchise Tax Board of a qualified taxpayer's tax under this part.

25111. (a) A water's-edge election shall be made by contract with the Franchise Tax Board in the original return for a year and

shall be effective only if every affiliated bank or corporation subject to tax under this part consents to the election. Consent by the common parent of an affiliated group shall constitute consent of all members of the group. The form and manner of making the water's-edge election shall be prescribed by the Franchise Tax Board. Each contract making a water's-edge election shall be for an initial term of 10 years, except as provided in subdivision (b). Each contract shall provide that on the anniversary date of the contract or any other annual date specified by the contract a year shall be added automatically to the initial term unless notice of nonrenewal is given as provided in subdivision (d). Each contract shall be conditioned by an agreement to pay the amount specified in Section 25115. Except as provided in subdivision (b), the Franchise Tax Board shall enter into a contract as provided by this section with any qualified taxpayer which wishes to make a water's-edge election. An affiliated bank or corporation which becomes subject to tax under this part subsequent to the water's-edge election shall be deemed to have consented to the election. No water's-edge election shall be made for an income year beginning prior to the operative date of this article.

(b) A water's-edge election may be disregarded by the Franchise Tax Board as provided in subdivision (d) of Section 25110 and may be changed by a taxpayer prior to the end of the 10-year period only with the permission of the Franchise Tax Board.

(c) In disregarding an election or in granting a change of election, the Franchise Tax Board shall impose any conditions which are necessary to prevent the avoidance of tax or clearly reflect income for the period the election was, or was purported to be, in effect. These conditions may include a requirement that income, including dividends paid from income earned while a water's-edge election was in effect, which would have been included in determining the income of the taxpayer from sources within and without this state pursuant to Section 25101 but for the water's-edge election shall be included in income in the year in which the election is changed or disregarded.

(d) If the taxpayer desires in any year not to renew the contract, the taxpayer shall serve written notice of nonrenewal of the contract upon the board in advance of the annual renewal date of the contract. Unless that written notice is served by the taxpayer at least 90 days prior to the renewal date, the contract shall be considered renewed as provided in subdivision (a).

If the taxpayer serves notice of intent in any year not to renew the contract, the existing contract shall remain in effect for the balance of the period remaining since the original execution or the last renewal of the contract, as the case may be.

25112. (a) If a taxpayer electing under Section 25110 fails to supply any required information, in addition to being subject to disqualification by the Franchise Tax Board pursuant to Section 25110 and to any penalties otherwise provided by this part, the

taxpayer shall pay a penalty of one thousand dollars ($1,000) for each income year with respect to which the failure occurs.

(b) If the failure continues for more than 90 days after the date on which the Franchise Tax Board mails notice of that failure to the taxpayer, the taxpayer shall pay a penalty (in addition to the amount required under subdivision (a)) of one thousand dollars ($1,000) for each 30-day period (or fraction thereof) during which the failure continues after the expiration of the 90-day period. The increase in any penalty under this subdivision shall not exceed twenty-four thousand dollars ($24,000).

(c) If the taxpayer fails to comply substantially with any formal document request arising out of the examination of the tax treatment of any item (hereinafter in this section referred to as the "examined item") before the 90th day after the date of the mailing of the request, any court having jurisdiction of a civil proceeding in which the tax treatment of the examined item is an issue shall, upon motion by the Franchise Tax Board, prohibit the introduction by the taxpayer of any documentation covered by that request.

(d) For purposes of this section, the time in which information is to be furnished (and the beginning of the 90-day period after notice by the Franchise Tax Board) shall be treated as beginning not earlier than the last day on which reasonable cause existed for failure to furnish the information.

(e) This section shall not apply with respect to any requested documentation if the taxpayer establishes that the failure to provide the documentation, as requested by the Franchise Tax Board, is due to reasonable cause. For purposes of subdivision (c), the fact that a foreign jurisdiction would impose a civil or criminal penalty on the taxpayer (or any other person) for disclosing the requested documentation is not reasonable cause.

(f) For purposes of this section, the term "formal document request" means any request (made after the normal request procedures have failed to produce the requested documentation) for the production of documentation which is mailed by registered or certified mail to the taxpayer at its last known address and which sets forth all of the following:

(1) The time and place for the production of the documentation.

(2) A statement of the reason the documentation previously produced (if any) is not sufficient.

(3) A description of the documentation being sought.

(4) The consequences to the taxpayer of the failure to produce the documentation described in this section.

(g) Notwithstanding any other law or rule of law, any taxpayer to whom a formal document request is mailed may begin a proceeding to quash that request not later than the 90th day after the date the request was mailed. In any such proceeding, the Franchise Tax Board may seek to compel compliance with the request.

(h) The superior courts of the State of California for the Counties

of Los Angeles, Sacramento, and San Diego, and for the City and County of San Francisco shall have jurisdiction to hear any proceeding brought under subdivision (g). An order denying the petition shall be deemed a final order which may be appealed.

The running of the 90-day period referred to in subdivision (b) shall be suspended during any period during which a proceeding brought under subdivision (g) is pending.

(i) For purposes of this section, "documentation" means any documentation which may be relevant or material to the tax treatment of the examined item.

(j) The Franchise Tax Board, and any court having jurisdiction over a proceeding under subdivision (g), may extend the 90-day period referred to in subdivision (b).

(k) If any bank or corporation takes any action as provided in subdivision (g), the running of any period of limitations under Sections 25663 to 25663d, inclusive (relating to the assessment and collection of tax), or under Section 25964 (relating to criminal prosecutions) with respect to that bank or corporation shall be suspended for the period during which the proceedings under subdivision (g) and appeals thereto are pending.

25113. (a) In any administrative or judicial proceeding, the Franchise Tax Board may introduce into evidence the record of any final court determination in another state involving the same taxpayer or a unitary business of which the taxpayer is alleged to be a member.

(b) Tax information pertaining to the examination of multinational operations, including underlying data, obtained from the Internal Revenue Service or a foreign government shall be admissible into evidence in an administrative or judicial proceeding involving a taxpayer's liability under this part without being contestable as to its relevancy.

25114. Any bank or corporation required to file a United States tax return or which could be included in a consolidated federal tax return shall file with the Franchise Tax Board within three months after the bank or corporation files its federal income tax return a domestic disclosure spreadsheet if it and its related corporation's payroll, property, or sales in a foreign country exceeds one million dollars ($1,000,000) or if it and its related corporation's total assets exceed two hundred fifty million dollars ($250,000,000), or such higher levels as may be subsequently established by regulation. For purposes of this paragraph, two corporations are related if more than 50 percent of the voting stock of one company is directly or indirectly owned or controlled by the other or if more than 50 percent of the voting stock of both is directly or indirectly owned or controlled by the same interest. The spreadsheet shall provide for full disclosure as to the income reported to each state, the state tax liability, and the method used for apportioning or allocating income to the states, and any other information as provided for by regulations as may be

necessary to determine properly the amount of taxes due to each state and to identify the corporate parent and those of its affiliates of which more than 20 percent of the voting stock is directly or indirectly owned or controlled by the parent. The spreadsheet shall be reviewed for completeness by the Franchise Tax Board and if it is not properly completed shall not be accepted and shall be subject to penalties.

25115. (a) Each contract described in Section 25111 shall provide that a taxpayer making a water's-edge election pursuant to this article shall pay an annual amount to the Franchise Tax Board for deposit in the California Unitary Fund created pursuant to Section 16429.30 of the Government Code. One-third of the amount shall be deposited in the Local Project Account for Non-Transient Spending in the California Unitary Fund, and two-thirds of the amount shall be deposited in the Future Infrastructure State Targeted Account in the California Unitary Fund.

(b) The amount shall be equal to thirty-thousandths of 1 percent of the sum of the taxpayer's property, payroll, and sales in this state, as defined in this chapter, with the following adjustments:

(1) Intangibles shall not be included in the property factor.

(2) The property and payroll factors shall be with respect to the income year ending during calendar year 1986.

(3) The sum of the property, payroll, and sales shall be reduced by the cumulative amount expended since January 1, 1988, for investment in new plants or facilities in this state, as defined in subdivision (c), and shall further be reduced by the amount expended for new employees in this state as defined in subdivision (e).

(c) A new plant or facility is property described in Section 70, provided that it is not a replacement, in whole or in part, for an existing plant or facility in this state. A plant or facility shall be deemed a replacement if the taxpayer, or an affiliated bank or corporation, as defined in paragraph (1) of subdivision (b) of Section 25110, closes, takes out of service, sells, or leases to an unrelated party, in either the three immediately preceding or the three immediately succeeding years from the time the new plant or facility is operational, a plant or facility with a cost basis equal to 25 percent or more of the cost basis of the new plant or facility.

(d) The number of new employees in this state for any income year shall be determined by comparing the total number of work years in this state for the income year to the greater of (1) the average of the total number of work years in this state for the income years ending in 1985, 1986, and 1987, or (2) the total number of work years in this state for the income year ending in 1987. A "work year" means, in the case of workers who are paid an hourly wage, 2,000 paid hours, and in the case of salaried employees, a total of 12 paid months.

(e) The amount expended for new employees shall be equal to the product of the number of new employees determined pursuant

to subdivision (d) and the average wages paid for each work year in this state for the income year.

(f) Each contract shall provide that the amount described in this section shall not be subject to any statutory changes, for the period the contract is in effect, without the consent of the taxpayer. Any statutory change shall be applicable for any renewal year beginning 10 years after that statutory change.

(g) Amounts determined pursuant to this section shall be collected in the same manner as the taxes imposed by this part and shall be subject to interest and penalties as provided in this part.

(h) In no event shall the amount determined pursuant to this section be less than ten-thousandths of the sum of the taxpayer's property, payroll, and sales in this state for the current year.

(i) The annual amount otherwise determined pursuant to this section and payable under a contract described in Section 25111 shall not be imposed for an income year in which a taxpayer incurs no tax liability under Sections 25101 and 25110.

SEC. 14. The Franchise Tax Board shall study its current auditing practices and those of the Internal Revenue Service for so-called 80-20 corporations, and the equity of the treatment of those corporations pursuant to this act. The Franchise Tax Board shall present a report to the Legislature no later than March 1, 1987, which identifies additional authority needed, if any, to adequately audit so-called 80-20 corporations if those corporations were outside the water's edge and which sets forth its findings with respect to the equity treatment.

SEC. 15. This act shall become operative on January 1, 1988. The provisions of this act shall be applicable in the computation of taxes for income years commencing on or after January 1, 1988.

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Assembly Bill No. 2815

CHAPTER 974

An act to amend Sections 17206, 17220, 24345, 24520, 25115, 25553.5, 25563.1, and 25563.2 of, to repeal Section 25563.3 of, and to repeal Article 2.5 (commencing with Section 25441) of Chapter 19 of Part 11 of Division 2 of, the Revenue and Taxation Code, relating to taxation.

[Approved by Governor September 20, 1986. Filed with Secretary of State September 22, 1986.]

LEGISLATIVE COUNSEL'S DIGEST

AB 2815, Hannigan. Income taxes: bank and corporation taxes.

Under the existing Personal Income Tax Law and the Bank and Corporation Tax Law, various statutes make reference to other sections in the Revenue and Taxation Code and the Internal Revenue Code.

This bill would correct various erroneous or obsolete section references in those laws.

Existing law provides for the deduction of state and local sales and use taxes. However, the existing Personal Income Tax Law and Bank and Corporation Tax Law provides that no deduction shall be allowed for sales or use tax paid or incurred in connection with the purchase of qualified property by a qualified business in certain depressed areas and enterprise zones for which a tax credit is claimed.

This bill would make technical nonsubstantive changes to that disallowance of a deduction.

The existing Bank and Corporation Tax Law contains special provisions concerning the declaration of estimated taxes for income years beginning before January 1, 1972. It also contains a special provision excluding from the estimated tax the tax on preference income with respect only to income years beginning after December 31, 1971, and before January 1, 1973.

This bill would repeal those provisions.

Existing provisions of SB 85 of the 1985–86 Regular Session require qualified taxpayers who elect to determine their income derived from or attributable to sources within this state for bank and corporation tax purposes pursuant to a water's-edge election to make an annual contract payment to the Franchise Tax Board as a condition of making that election. SB 85 provides that in no event shall the annual contract payment of a qualified taxpayer be less than ten-thousandths of the sum of its property, payroll, and sales in this state for the current year.

This bill would revise the annual minimum payment amount from ten-thousandths of the sum of the above three factors to

ten-thousandths of 1% of the sum of the above three factors. The operation of this revision would be conditional upon SB 85 becoming operative, in which case the revision would become operative on January 1, 1988.

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

SECTION 1. Section 17206 of the Revenue and Taxation Code is amended to read:

17206. (a) Section 165(h)(2) of the Internal Revenue Code, relating to limitation of losses, shall not be applicable to losses occurring before January 1, 1984.

(b) For purposes of computing the deduction allowed under Section 165(c)(3) of the Internal Revenue Code, the term "adjusted gross income," as used in Section 165(h)(2) of the Internal Revenue Code, shall refer to adjusted gross income as shown on the federal tax return for the same taxable year.

SEC. 2. Section 17220 of the Revenue and Taxation Code is amended to read:

17220. No deduction shall be allowed for any of the following:

(a) State, local, and foreign income, war profits, and excess profits taxes.

(b) Sales or use tax paid or incurred in connection with the purchase of qualified property for which a tax credit is claimed pursuant to Section 17052.13.

SEC. 3. Section 24345 of the Revenue and Taxation Code is amended to read:

24345. There shall be allowed as a deduction—

(a) Taxes or licenses paid or accrued during the income year except:

(1) Taxes paid to the state under this part.

(2) Taxes on or according to or measured by income or profits paid or accrued within the income year imposed by the authority of any of the following:

(A) The Government of the United States or any foreign country.

(B) Any state, territory, county, school district, municipality, or other taxing subdivision of any state or territory.

(3) Taxes assessed against local benefits of a kind tending to increase the value of the property assessed, but this does not exclude the allowance as a deduction of so much of the taxes assessed against local benefits as is properly allocable to maintenance or interest charges. Nor does this exclude the allowance of any irrigation or other water district taxes or assessments which are levied for the payment of the principal of any improvement or other bonds for which a general assessment on all lands within the district is levied as distinguished from a special assessment levied on part of the area within the district.

(4) Federal stamp taxes (not described in paragraph (2) or (3) of subdivision (a)) but this subdivision shall not prevent such taxes from being deducted under Section 24343 (relating to trade or business expenses).

(5) Sales or use tax paid or incurred in connection with the purchase of qualified property for which a tax credit is claimed pursuant to Section 23612.

(b) (1) In this subdivision, "retail sales tax" means a tax imposed by any state, territory, district, or possession of the United States, or any political subdivision thereof, upon persons engaged in:

(A) Selling tangible personal property at retail, which is measured by the gross sales price or the gross receipts from the sale or which is a stated sum per unit of the property sold.

(B) Furnishing services at retail, which is measured by the gross receipts for furnishing the services.

(2) If the amount of a retail sales tax is separately stated, to the extent that the amount so stated is paid by the purchaser (otherwise than in connection with the purchaser's trade or business) the amount shall be allowed as a deduction in computing the net income of the purchaser as if the amount were a tax imposed upon and paid by the purchaser.

SEC. 4. Section 24520 of the Revenue and Taxation Code is amended to read:

24520. (a) For purposes of this chapter, a distribution shall be treated as in complete liquidation of a corporation if the distribution is one of a series of distributions in redemption of all of the stock of the corporation pursuant to a plan.

(b) The Franchise Tax Board shall prescribe such regulations as may be necessary to ensure that the purpose of subsections (a) and (b) of Section 222 of the Tax Equity and Fiscal Responsibility Act of 1982 (which repeal the special tax treatment for partial liquidations) may not be circumvented through the use of Sections 24512, 24513, 24514, 24516, 24521, 24532, and 24533, or any other provision of law or regulations.

SEC. 5. Section 25115 of the Revenue and Taxation Code, as added by Senate Bill 85 of the 1985–86 Regular Session, is amended to read:

25115. (a) Each contract described in Section 25111 shall provide that a taxpayer making a water's-edge election pursuant to this article shall pay an annual amount to the Franchise Tax Board for deposit in the California Unitary Fund created pursuant to Section 16429.30 of the Government Code. One-third of the amount shall be deposited in the Local Project Account for Non-Transient Spending in the California Unitary Fund, and two-thirds of the amount shall be deposited in the Future Infrastructure State Targeted Account in the California Unitary Fund.

(b) The amount shall be equal to thirty-thousandths of 1 percent of the sum of the taxpayer's property, payroll, and sales in this state, as defined in this chapter, with the following adjustments:

(1) Intangibles shall not be included in the property factor.

(2) The property and payroll factors shall be with respect to the income year ending during calendar year 1986.

(3) The sum of the property, payroll, and sales shall be reduced by the cumulative amount expended since January 1, 1988, for investment in new plants or facilities in this state, as defined in subdivision (c), and shall further be reduced by the amount expended for new employees in this state as defined in subdivision (e).

(c) A new plant or facility is property described in Section 70, provided that it is not a replacement, in whole or in part, for an existing plant or facility in this state. A plant or facility shall be deemed a replacement if the taxpayer, or an affiliated bank or corporation, as defined in paragraph (1) of subdivision (b) of Section 25110, closes, takes out of service, sells, or leases to an unrelated party, in either the three immediately preceding or the three immediately succeeding years from the time the new plant or facility is operational, a plant or facility with a cost basis equal to 25 percent or more of the cost basis of the new plant or facility.

(d) The number of new employees in this state for any income year shall be determined by comparing the total number of work years in this state for the income year to the greater of (1) the average of the total number of work years in this state for the income years ending in 1985, 1986, and 1987, or (2) the total number of work years in this state for the income year ending in 1987. A "work year" means, in the case of workers who are paid an hourly wage, 2,000 paid hours, and in the case of salaried employees, a total of 12 paid months.

(e) The amount expended for new employees shall be equal to the product of the number of new employees determined pursuant to subdivision (d) and the average wages paid for each work year in this state for the income year.

(f) Each contract shall provide that the amount described in this section shall not be subject to any statutory changes, for the period the contract is in effect, without the consent of the taxpayer. Any statutory change shall be applicable for any renewal year beginning 10 years after that statutory change.

(g) Amounts determined pursuant to this section shall be collected in the same manner as the taxes imposed by this part and shall be subject to interest and penalties as provided in this part.

(h) In no event shall the amount determined pursuant to this section be less than ten-thousandths of 1 percent of the sum of the taxpayer's property, payroll, and sales in this state for the current year.

(i) The annual amount otherwise determined pursuant to this section and payable under a contract described in Section 25111 shall not be imposed for an income year in which a taxpayer incurs no tax liability under Sections 25101 and 25110.

SEC. 6. Section 25553.5 of the Revenue and Taxation Code is amended to read:

25553.5. The amount of tax payable by taxpayers subject to the tax imposed by Article 3 (commencing with Section 23181) of Chapter 2 as set forth in a notice mailed to such taxpayers pursuant to Section 23186.1 shall be due and payable on or before the 15th day following the mailing of the notice by the Franchise Tax Board.

SEC. 7. Section 25563.1 of the Revenue and Taxation Code is amended to read:

25563.1. If, after paying any installment of estimated tax required by subdivision (b) of Section 25563, the taxpayer makes a new estimate, the amount of each remaining installment (if any) shall be the amount which would have been payable if the new estimate had been made when the first estimate for the income year was made, increased or decreased (as the case may be) by the amount computed by dividing—

(1) The difference between—

(A) The amount of estimated tax required to be paid before the date on which the new estimate is made, and

(B) The amount of estimated tax which would have been required to be paid before such date if the new estimate had been made when the first estimate was made, by

(2) The number of installments remaining to be paid on or after the date on which the new estimate is made.

SEC. 8. Section 25563.2 of the Revenue and Taxation Code is amended to read:

25563.2. At the election of the taxpayer, any installment of the estimated tax required by subdivision (b) of Section 25563, may be paid before the date prescribed for its payment.

SEC. 9. Article 2.5 (commencing with Section 25441) of Chapter 19 of Part 11 of Division 2 of the Revenue and Taxation Code is repealed.

SEC. 10. Section 25563.3 of the Revenue and Taxation Code is repealed.

SEC. 11. Section 5 of this act shall become operative only if Senate Bill 85 of the 1985–86 Regular Session becomes operative, in which case Section 5 shall become operative on January 1, 1988.

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