Date of Hearing: April 27, 2026

ASSEMBLY COMMITTEE ON REVENUE AND TAXATION
Mike Gipson, Chair

AB 1790 (Connolly) – As Introduced February 10, 2026

2/3 vote. Tax levy. Fiscal committee.

SUBJECT: Corporations Tax Law: water's-edge election: global intangible low-taxed income

SUMMARY: Prohibits, for taxable years beginning on or after January 1, 2028, any taxpayer from making a water's-edge election or filing on a water's-edge basis. Specifically, **this bill**:

1) Contains the following general legislative findings and declarations:

    a) Multinational corporations continue to shift income earned in California out of the country;

    b) The water's-edge election has not been updated to conform with developments in federal corporate tax law aimed at combating such shifting;

    c) Mandatory worldwide combined reporting is the most efficient and fairest way to tax the income of large multinational corporations; and,

    d) To facilitate the transition to worldwide combination, this bill would allow taxpayers that have made a water's-edge election to continue to file on a water's-edge basis for two years if the water's-edge election calculation is modified, as provided. The measure would also allow taxpayers to terminate an existing water's-edge election and file on a worldwide basis sooner if they choose.

2) Contains the following legislative findings and declarations specific to the combined reporting method:

    a) All persons that are part of a unitary business shall be included in the combined report. Determination of a unitary business shall be governed by the unitary business principle, which shall be applied to the greatest extent allowed by the United States Constitution;

    b) A combined return shall include the income and apportionment factors of any "captive insurers" that are part of the unitary business. For purposes of this provision, a "captive insurer" is an insurance company that is both:

        i) Owned or controlled by a member or members of the unitary group; and,

        ii) Used for the insurance of risks of the parent organization and affiliated persons;

    c) All income and factors of a combined group shall have their income and factors combined even if the state has a special apportionment regime for any particular entity if considered separately. A taxpayer may use the special apportionment regime for a

particular entity, with the consent of the Franchise Tax Board (FTB), if the taxpayer demonstrates by clear and convincing evidence that failure to use the special formula will result in an unfair representation of income produced in this state; and,

d) If any member of the unitary business is subject to a net income tax or a tax measured by net income under some other provision of California law, then such tax liability shall be a credit against any tax liability under the Corporation Tax (CT) Law.

3) Provides that, for those taxpayers electing to file on a water's-edge basis for taxable years beginning on or after January 1, 2026, and before January 1, 2028:

   a) The taxpayer must take into account the entire income and apportionment factors of any corporation, other than a bank, regardless of the place where it is incorporated, if its sales factor within the United States is 20% or more. (Currently, water's-edge filers are required to include income and apportionment factors of a corporation if the average of its property, payroll, and sales factors within the United States is 20% or more.);

   b) The taxpayer must take into account the entire income and apportionment factors of any corporation that is a member of the water's-edge group that is incorporated in the United States, or formed under the laws of any state, the District of Columbia, or any territory or possession of the United States; and,

   c) 40% of net controlled foreign corporation (CFC) tested income, as that term is defined in Internal Revenue Code (IRC) Section 951A, shall be included as business income. However, no factors of any CFC, as defined in IRC Section 957, shall be included as a result of including this income.

4) Authorizes any taxpayer that has made a water's-edge election to terminate that election without the consent of the FTB for any taxable year beginning on or after January 1, 2026, and before January 1, 2028.

5) Terminates all water's-edge elections as of the first taxable year beginning on or after January 1, 2028.

6) Prohibits any taxpayer from making a water's-edge election, or filing on a water's-edge basis, for taxable years beginning on or after January 1, 2028.

7) Takes immediate effect as a tax levy.

EXISTING FEDERAL LAW:

1) Provides that corporations organized in the United States are taxed on all of their income, regardless of source, at the flat rate of 21%. (IRC Section 11.)

2) Requires any United States shareholder of a CFC for any taxable year to include in gross income their share of net CFC tested income. This term, in turn, is defined as a United States shareholder's excess (if any) of their aggregate pro rata share of CFC tested income for the taxable year, over the United States shareholder's CFC tested loss for the taxable year. (IRC Section 951A.)

3) Provides that foreign corporations that are engaged in United States trade or business are taxed at the 21% regular rate on the net income effectively connected with the conduct of that trade or business in the United States (unless a lower rate or different treatment applies via application of a tax treaty). (IRC Section 882(a).)

EXISTING STATE LAW:

1) Imposes on corporations doing business in this state, as defined, a tax according to or measured by net income. (Revenue and Taxation Code (R&TC) Section 23151.)

2) Provides that when the income of a taxpayer subject to the CT Law is derived from or attributable to sources both within and without this state, the tax shall be measured by the net income derived from or attributable to sources within this state in accordance with the provisions of the Uniform Division of Income for Tax Purposes Act. (R&TC Section 25101.)

3) Provides that, for taxable years beginning on or after January 1, 2013, all business income of an apportioning trade or business, other than an apportioning trade or business described in R&TC Section 25128(b), shall be apportioned to this state by multiplying the business income by the "sales factor". (R&TC Section 25128.7.)

4) Defines the "sales factor" as a fraction, the numerator of which is the total sales of the taxpayer in this state during the taxable year, and the denominator of which is the total sales of the taxpayer everywhere during the taxable year. (R&TC Section 25134.)

5) Authorizes a qualified taxpayer, as defined, to elect to determine its income derived from or attributable to sources within this state pursuant to a water's-edge election, as provided. A taxpayer making a water's-edge election on or after January 1, 2006, shall take into account that portion of its own income and apportionment factors and the income and apportionment factors of its affiliated entities to the extent provided. (R&TC Section 25110.)

6) Provides that a water's-edge election shall be made on an original, timely filed return for the year of the election. The election will be considered valid if both of the following conditions are satisfied:

   a) The tax is computed in a manner consistent with a water's-edge election; and,

   b) A written notification of election is filed with the return on a form prescribed by the FTB. (R&TC Section 25113.)

7) Provides that a water's-edge election may be terminated without the consent of the FTB after it has been in effect for at least 84 months (i.e., 7 years). (R&TC Section 25113(c)(9).)

FISCAL EFFECT: The FTB notes the following regarding this bill's estimated revenue impact:

Due to the many complexities and differences between worldwide and the water's-edge combined group reporting, estimating the revenue impact from the provisions of this bill is difficult to measure with certainty. However, it is estimated that for taxable years 2026 and 2027, the provisions requiring the water's-edge filers to include 40% of any net [CFC] Tested Income (NCTI) as business income could bring revenue gains up to $1 billion. In addition,

the revision to the foreign affiliated corporation 20% inclusion test, specifically, shifting to the U.S. single sales factor apportionment, could generate up to $350 million in additional revenue. It is estimated that the revenue gains from moving to worldwide from water's-edge filing could be in the range of $700 million to $2.8 billion. Due to limitations in data, these estimates do not account for additional credits and Net Operating Losses (NOLs) that may be used to offset additional tax liabilities.

COMMENTS:

1) The author has provided the following statement in support of this bill:

> For the last 40 years, California has allowed the biggest corporations to choose a tax scheme that ensures they pay as little in taxes as possible. Even though corporate profits have increased to record levels, and the Federal government has reduced their tax rate to historic lows, these multinational companies still stash profits overseas to avoid paying billions in state taxes every year. AB 1790 will even the playing [field] and end the Water's Edge tax loophole to return California to a system that fairly taxes multinational corporations.

2) This bill is co-sponsored by the California School Employees Association, AFL-CIO, which notes:

> Using the water's edge election, large corporations offshore activity and profits to foreign jurisdictions with lower tax rates. As a result, many California-based small businesses pay higher tax rates than their multinational corporate counterparts. The Department of Finance reports that the water's edge loophole cost California $4.5 billion in general fund revenue in 2025-26.
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> These corporations benefit from California's thriving industry, and we believe it is time they pay their fair share, beginning with closing the loopholes that allow them to dodge taxes and rake in record profits. Corporations and billionaires have received numerous tax breaks during Trump's second term at the direct cost of healthcare and nutrition assistance for millions of Americans. Meanwhile, 1 in 3 taxpaying Californians live below the poverty line, struggling to afford rent, bills, and groceries. To rectify this inequity, California must adequately tax these entities to fund social services for Californians like education, healthcare, and nutrition.
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> This additional tax revenue is critical as we work to address California's budget deficit. Closing the water's edge loophole will add billions of dollars yearly, generating reliable annual revenue and helping to mitigate the harm of federal cuts to social services.

3) This bill is supported by the California Alliance for Retired Americans (CARA), which notes:

> The Water's Edge allows multinational corporations [. . .] to cook their books, paying less in corporate taxes on earnings in California than what is their fair share. We know corporate profits of top-rated companies grew 44% from 2013 to 2021, yet federal tax bills dropped by 16%. California corporate tax revenue has been in steady decline throughout that period. Now, add the fact that the federal government reduced taxes

again in 2025 for the richest among us while passing massive cuts in federal funding to State programs critically important to older adults and people with disabilities.

[Multinational corporations] must be forced to bridge this budget gap in California. AB 1790 does just that, bringing $3 to $4 BILLION annually to California. With AB 1790, we close the largest corporate tax break in California, one that cost taxpayers $4.1 billion dollars in 24-25. And part of that centers on the use of the worldwide combined reporting (WWCR) around corporate revenues, a truer, more accurate measure of corporate wealth and success.

Regular taxpayers like those in CARA demand a fairer tax system that taxes those in the best position to pay. [Multinational corporations] fit that bill. For too long, tax cuts have gone to the rich, and program cuts have devastated retirees and people with disabilities. CARA is hereby asking all your colleagues to join you in taking this major step in reversing that trend.

4) This bill is opposed by the California Taxpayers Association, which makes numerous arguments against this proposal, including the following:

Double-Taxation and Incompatibility With Modern International Tax Agreements. The global tax landscape has shifted significantly in recent years with the introduction of the global minimum tax ("Pillar Two"), which establishes a 15 percent rate to curb profit-shifting. This international framework relies on foreign tax credits to prevent double-taxation – a mechanism that states, including California, do not and cannot possess. Under AB 1790, California would double-tax foreign income that has already been taxed by the country in which it was earned, placing California businesses at a competitive disadvantage against companies domiciled in other states.

Makes California Less Affordable. Without the water's-edge election, companies would face higher overall tax liabilities in California on income earned abroad, increasing their cost of doing business. When taxes increase costs, the burden is passed through to consumers in the form of higher prices for goods and services, especially for products with relatively inelastic demand. Manufactured goods – electronics, vehicles, machinery, and other common products sold in California – are largely produced abroad and priced competitively; adding significant tax costs would reduce that competitiveness and make these goods less affordable for California consumers, at a time when affordability is a major concern for residents of this state.

Severe Administrative and Compliance Burdens. Worldwide combined reporting, mandated by AB 1790, would impose a staggering compliance burden that would force taxpayers into accepting unreasonable treatment. Corporations would be required to analyze hundreds of foreign affiliates to determine "unitary" status under complex and subjective state-specific criteria. Taxpayers would then have to convert foreign financial statements – prepared under different accounting standards (e.g., International Financial Reporting Standards) and currencies – into California taxable income. This data is not compatible or usable for state tax purposes, and the complexity significantly increases the risk of costly and contentious audits. Before California adopted the water's-edge election, taxpayers would have to make "reasonable approximations" that often led to foreign affiliates being included in a combined report and double-taxed. This

incompatibility is the key reason that many taxpayers with a global presence elect to file on a water's-edge basis – for the simplicity of not having to do an analysis that compares apples and oranges. These significant problems could not be solved simply by hiring more lawyers and/or accountants, as they stem from fundamental flaws in the system proposed by AB 1790.

5) The FTB notes the following implementation and technical considerations in its analysis of this bill:

   a) "In Section 25106.5(c), this bill discusses several provisions relating to the combined reporting method as legislative findings and declarations. For clarity as to which provisions would be statutory requirements, the author may wish to move the desired mandatory requirements into the relevant statute section or limit the findings or declarations."

   b) "[R&TC] section 25110(a)(2)(A)(ii) provides that the income and apportionment factors of certain CFCs are included in the water's-edge combined report. In Section 3 of the bill, [R&TC] section 25110(a)(2)(A)(iii) would require the inclusion of 40% of any NCTI. In addition, clause (iii) states that no factors of any CFC would be included in the combined report as a result of including that income, which may contradict clause (ii). For clarity, if the author's intent is to exclude factors of only those CFCs that have NCTI, the author may wish to amend the bill."

   c) "For consistency and clarity, consider amending Section 25110(a)(1)(C) by replacing the phrase, '. . . United States, excluding corporations making an election pursuant to Sections 931 to 936, inclusive, of the Internal Revenue Code.' with '. . . United States, or formed under the laws of any state, the District of Columbia, or any territory or possession of the United States.' and remove subparagraph (E)."

   d) "For consistency of terminology, in section 25110(a)(2)(A)(iii) replace the sentence 'Forty percent of net CFC tested income, as that term is defined in Section 951A of the Internal Revenue Code, is included as business income. No factors of any controlled foreign corporation, as defined in Section 957 of the Internal Revenue Code, shall be included as a result of including that income' with 'Forty percent of net CFC tested income, as that term is defined in Section 951A of the Internal Revenue Code, relating to Net CFC tested income included [in] gross income [of] the United States shareholders, is included as business income. No factors of any controlled foreign corporation, as defined in Section 957 of the Internal Revenue Code, relating to controlled foreign corporations, shall be included as a result of including that income.'"

6) Committee Staff Comments:

   a) *Wading in*: Calculating a company's tax liability can be a relatively straightforward affair in the case of a single corporation doing business solely in California. One simply multiplies the corporate tax rate (generally 8.84%) by the corporation's annual net income. The calculation becomes more complicated, however, when a business engages in commercial activity in more than one state or country. In such cases, it becomes necessary to determine what portion of the business' income is attributable to sources within California and, thus, appropriately subject to state taxation.

Things become even more complicated when one considers that many businesses do not operate as a single corporation. Instead, large business enterprises are often comprised of multiple entities, such as a parent corporation owned by its shareholders, and a host of separately incorporated subsidiaries. These complicated structures may be established to reduce liability or to recognize the operational specialization of specific entities. Historically, these structures have also allowed a certain amount of what the business community might refer to as "tax planning" and what detractors might deem "income shifting", whereby companies seek to shift income to low- or no-tax jurisdictions. California was one of the first states to identify such manipulation and seek to address it via its tax code. As Michael Mazerov notes:

> [California] discovered Hollywood studios selling or licensing movies at artificially low prices to subsidiaries they had established in low- or no-tax states, which then distributed the film reels to movie theaters throughout the country. Little profit showed up on the books of the California studios; most of it showed up on the books of the distribution affiliates. An attorney for the California tax agency determined that the most straightforward way to shut down this manipulation was to require the movie studios to combine their profits with those of the distribution subsidiaries before doing the apportionment calculation, and "combined reporting" was born. Combined reporting was initially applied on an *ad hoc* basis in instances when a corporate income tax auditor concluded that abusive tax avoidance was occurring, but by the mid-1960s it was standard California practice.[1]

b) *Bedrock constitutional principles*: Before examining the various provisions of this bill, which the author contends are needed to further address the problem of income shifting, it may be useful to begin with a brief overview of the basic constitutional principles governing the permissible taxation of businesses operating in more than one jurisdiction. Under both the Due Process and the Commerce Clauses of the United States Constitution, a state may not, when imposing an income-based tax, "tax value earned outside its borders." *ASARCO, Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307, 315 (1982).

   The United States Supreme Court has acknowledged that, when examining an integrated enterprise doing business in more than one state, "arriving at precise territorial allocations of 'value' is often an elusive goal, both in theory and in practice." *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 164 (1983). As such, the Constitution imposes no single formula for apportioning income, and the taxpayer bears the burden of demonstrating by clear and cogent evidence that a state's methodology results in extraterritorial values being taxed. *Id.*

c) *Diving deeper into the unitary business principle*: As noted above, when a business derives income from sources both within and outside California, it is necessary to determine the portion of total income attributable to this state. One method for determining locally taxable income is to employ formal geographical or transactional accounting. The problem with this approach, however, is that formal accounting is subject to manipulation, gaming, and imprecision. It also "often ignores or captures

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[1] Mazerov, M. (2024, June 27). *States Can Fight Corporate Tax Avoidance by Requiring Worldwide Combined Reporting.* Center on Budget and Policy Priorities.

inadequately the many subtle and largely unquantifiable transfers of value that take place among the components of a single enterprise." *Id.* at 164-165.

In recognition of this fact, California has long employed the unitary business principle as a first step in determining how to tax business enterprises operating in more than one jurisdiction. This approach determines the appropriate tax base by first defining the scope of the "unitary business", and then apportioning the total income of that unitary business between California and the other jurisdictions in which the business operates. *Id.* at *165.*

Courts have provided guidance regarding when a given subsidiary or affiliate should be regarded as part of a unitary business with its parent corporation. At the most general level, such an entity will be considered part of the unitary business group when there is functional integration, centralization of management, and economies of scale.[2] *Id.* at 181.

d) *Awash in combined reports*: The business income of all affiliates comprising the unitary group is then reported to California on a "combined report". This "combined report" also includes any nonbusiness income from the unitary group members that is allocated to California. As noted by the FTB's combined reporting guidelines:

> The combined report is a means by which the income of a unitary business is divided among the taxing jurisdictions in which the trade or business is conducted. A combined report is not a "return," but merely the name given to the calculations by which multi-entity unitary businesses apportion income on a geographic basis.[3]

e) *Formula apportionment*: Once the unitary business group is properly identified, California then applies a formula apportioning the business income of that business both within and without the state. Such an apportionment formula must, under both the Due Process and Commerce Clauses, be fair. To determine fairness, courts first examine whether the apportionment formula employed is internally consistent, meaning that "the formula must be such that, if applied by every jurisdiction, it would result in no more than all of the unitary business' income being taxed." *Container Corp. of Am., supra,* at 169. The second and arguably more complex requirement is often referred to as "external consistency". Specifically, the factor or factors used in the apportionment formula "must actually reflect a reasonable sense of how income is generated." *Id.*

California's default rule for apportioning the income of a combined group is often referred to as "single sales factor" apportionment. Put simply, this method looks to the ratio of the business' sales in California to its sales elsewhere.[4]

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[2] For California purposes, "the activities of the taxpayer will be considered a single business if there is evidence to indicate that the segments under consideration are integrated with, dependent upon or contribute to each other and the operations of the taxpayer as a whole." (California Code of Regulations, Title 18, Section 25120(b).)

[3] FTB. "2024 Guidelines for Corporations Filing a Combined Report." FTB Publication 1061.

[4] Conversely, a qualified business that derives more than 50% of its gross business receipts from one or more qualified business activities such as agriculture or extraction, must use a different formula. This formula is comprised of three components measuring the activity of the unitary group in the state: property, payroll, and sales. This method is often referred to as "three-factor" apportionment.

f) *The high-water mark*: By the early 1980s, approximately 15 states had followed California in requiring combined reporting.[5] Twelve states, including California, were applying this method on a worldwide basis, meaning that foreign parents and subsidiaries were included in the combined group.[6] Multinational corporations, however, strenuously resisted worldwide combined reporting. Foreign businesses went so far as to pressure their own governments into threatening economic retaliation against the United States unless individual states moved away from these tax regimes.[7] Mazerov notes:

> That pressure escalated after the U.S. Supreme Court upheld [worldwide combined reporting's] constitutionality in 1983. The following year the Worldwide Unitary Taxation Working Group convened by the Reagan Administration and composed of federal and state officials called on the [worldwide combined reporting] states to retreat to domestic or "water's edge" combined reporting – that is, to no longer include foreign parents and subsidiaries in combined groups. By the late 1980s, only Alaska required [worldwide combined reporting], and only for oil companies. In addition, ten states plus the District of Columbia continue to allow corporations to use [worldwide combined reporting] if they choose.[8]

Largely as a result of this pressure, California abandoned mandatory worldwide combined reporting with the passage of SB 85 (Alquist), Chapter 660, Statutes of 1986, which authorized the water's-edge election at issue in this bill.

g) *The water's-edge election*: Current law allows a unitary group to either file on a worldwide combined reporting basis or to elect the option of calculating California income and activities on a water's-edge basis. A water's-edge election requires that the taxpayer file on a water's-edge basis for a statutory election period of at least 84 months. Generally, water's-edge taxpayers may exclude foreign-organized unitary affiliates that would otherwise be part of the unitary combined report. However, the water's-edge rules do require that the income and apportionment factors of certain specified foreign unitary affiliates be included, either fully or partially, in the apportionable income and apportionment factors of the water's-edge group. Lastly, the water's-edge group is allowed a 75% dividend received deduction for their qualifying dividends received from foreign affiliates. This deduction is often referred to as the "foreign dividend deduction".

h) *Boiling down this bill's provisions*: This bill contains a few main provisions. First and foremost, for taxable years beginning on or after January 1, 2028, this bill would prohibit any taxpayer from either making a water's-edge election or filing on a water's-edge basis. As such, all taxpayers would be moved to mandatory worldwide combined reporting.

Second, for those taxpayers electing to remain water's-edge filers before that option is eliminated, this bill makes a number of modifications designed to shore up the base of income reflected in the taxpayer's combined report. These provisions are briefly summarized here:

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[5] Mazerov, 2024, p. 3
[6] *Id.*
[7] *Id.*
[8] *Id.*

i) *The 20% test*: This bill would require a water's-edge combined report to include the entire income and apportionment factors of any corporation, other than a bank, regardless of its place of incorporation, if its sales factor within the United States is 20% or more. Currently, water's-edge filers are required to include the income and apportionment factors of a corporation only if the average of its property, payroll, and sales factors within the United States is 20% or more.

   As such, Committee staff is informed this bright line test would first compare a corporation's sales within the United States to its global sales. If the corporation's sales in the United States comprise 20% or more of its global sales, the corporation would then be included within the water's-edge combined report. This modification would be operative for taxable years beginning on or after January 1, 2026.

ii) *NCTI conformity*: This bill would also require any taxpayer making a water's-edge election to include as business income 40% of net CFC tested income, as that term is defined in IRC Section 951A. However, no factors of any CFC would be included as a result of including this income.

   Net CFC tested income, often referred to as "NCTI", refers to a federal tax rule effective January 1, 2026, which has replaced the old GILTI regime[9]. Specifically, it requires United States shareholders owning at least 10% of a CFC to pay annual federal tax on their share of the corporation's profits, even if those profits have not been distributed. This provision of federal law is designed to prevent federal taxpayers from avoiding tax by keeping income in low-tax foreign jurisdictions, and essentially ensures a minimum tax is paid on foreign earnings. This regime functions as an annual deemed income inclusion, and seeks to address the issue of corporations "parking" profits offshore indefinitely. Advocates of including NCTI note the following:

   > NCTI includes 60 percent of the profits that U.S.-based multinationals report through their [CFCs] in the U.S. tax base, a mechanism we argue effectively treats this portion as improperly shifted income that should have been booked domestically. This 60 percent inclusion rate reflects empirical reality: Research demonstrates that aggressive profit shifters routinely book 60 percent or more of their profits in tax havens despite generating the underlying economic value domestically. For specific firms that can demonstrate that this default rule overtaxes their genuine foreign earnings, states already provide escape valves through alternative apportionment petitions or worldwide filing elections.[10]

   Advocates note that this bill's lower 40% inclusion rate is being advanced to both simplify compliance and to limit the number of taxpayer disputes and appeals.

Because the foregoing provisions would likely result in many water's-edge filers having substantial additional income included in their combined reports, this bill would authorize

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[9] GILTI referred to global intangible low-taxed income.
[10] Shanske, Darien & David Gamage, *NCTI Is the New GILTI, and States Should Still Conform,* 117 Tax Notes State (Sept. 22, 2025).

a taxpayer to terminate any water's-edge election without FTB's consent for any taxable year beginning on or after January 1, 2026, and before January 1, 2028.

This bill also seeks to strengthen and clarify California's application of the unitary business principle by stipulating that all entities that are part of a unitary business must be included in the combined report. Additionally, this bill specifies that the determination of a unitary business shall be governed by the unitary business principle outlined above, which this bill specifies must be applied to the greatest extent allowed by the United States Constitution.

Finally, this bill would require that any combined return must include the income and apportionment factors of any "captive insurers" that are a part of the unitary business. A "captive insurer", in turn, is defined as an insurance company that is owned or controlled by one or more members of the unitary group, and that is used for the insurance of risk of the parent organization or its affiliates. Moreover, this bill provides that if any member of the unitary business is subject to a net income tax or a tax measured by net income under some other provision of California law, then such tax liability shall be a credit against tax liability. It appears to Committee staff, however, that this credit would not be available to insurance companies, given that they are taxed on the basis of gross premiums instead of net income.

In support of the provisions outlined above, the author's office notes:

> Corporate taxes have not kept up with corporate profits. According to the Institute on Taxation and Economic Policy, corporate income tax revenue has been in steady decline for decades, while after-tax corporate profits continue to climb to historic numbers. The most consistently profitable companies in the Fortune 500 and S&P 500 saw profits grow by 44 percent from 2013 to 2021, while their federal tax bills dropped by 16 percent.
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> Returning California's corporate tax system to worldwide combined reporting (WWCR), and removing the Water's Edge loophole, will generate new revenue by ensuring [multi-national corporations] are paying their fair share. California's use of WWCR was upheld by the U.S. Supreme Court and worked well to combat income stripping by [multi-national corporations]. Corporations that profit in California will be taxed based on real economic gains instead of the manipulated amount they are currently allowed to choose.

i) *The arguments in favor*: Advocates of eliminating the current water's-edge election make a number of arguments rooted both in tax policy and the need to shore up the state's fiscal resources. First, advocates note that California's water's-edge election represents the largest corporate tax expenditure. They specifically point to the Department of Finance's estimate that the current election results in foregone revenues of over $4 billion a year. To this end, advocates contend that eliminating the election would raise critical government resources primarily from the largest – and potentially most tax aggressive – multinational corporations. This, advocates argue, is vital in the face of the antagonistic and haphazard policies being advanced by the current federal government, and the threatened loss of vital services they represent for many vulnerable Californians.

Advocates also argue that eliminating the water's-edge election would be an effective mechanism for shoring up the corporate tax base by reducing income shifting. As noted previously, income shifting refers to tax planning techniques whereby corporations seek to move income from the jurisdiction in which it was earned to a lower tax jurisdiction. To help conceptualize this practice, Professor Shanske provides the following example:

> A big widget company sells 1 million widgets in California. The company's profit margin is $100 per widget and so it should pay tax in California on $100mn in profits. However, the company incorporates a subsidiary in a low-tax jurisdiction, say Ireland, and places its valuable intellectual property in that jurisdiction. The foreign subsidiary charges the US-based company a high licensing rate for use of its intellectual property, say $90 per widget. Because of this new expense, which amounts to one hand paying the other, the US-based Widget corporation reports $10 million in profits in the United States.

Advocates point to estimates showing that such income shifting activities result in $300 billion in profits being removed from the United States tax base annually. In reference to Professor Shanske's example noted above, if California were to move to mandatory worldwide combined reporting, the profits of the Irish subsidiary would be combined with the domestic parent corporation, and no income would be lost.

Finally, proponents argue that eliminating California's current water's-edge regime would not harm California's competitiveness. They point to the fact that California's corporate tax is based on where a business sells its products. As such, a corporation would not be able to reduce its tax liability in response to mandatory worldwide combined reporting by moving its facilities or workforce out of California. It could only do so by intentionally choosing to make fewer profitable sales in this state. To this end, even some fierce critics of eliminating the water's-edge election concede that such a policy change would not directly result in fewer individuals being employed in California.

j) *The arguments in opposition*: Critics of eliminating California's current water's-edge election also make a number of arguments, largely grounded in administrative convenience, litigation risk, and global competitiveness. First, critics contend that this bill would jeopardize our relationship with foreign trading partners. They point to the immense pressure, and threats of retaliatory measures, brought to bear by many of our nation's largest trading partners in the 1980s. They also argue that this bill risks foreign countries pulling back on their direct United States investments.

Critics of mandatory worldwide combined reporting argue that such a regime would make California a global outlier, and would result in the double-taxation of income already taxed abroad. They also argue that there is no guarantee such a regime would result in the increased revenues projected by many advocates of eliminating the current water's-edge election. To this end, the California Taxpayers Association notes:

> If California were to require taxpayers to file a mandatory worldwide combined report, California would effectively get "a smaller slice of a bigger pie." Worldwide reporting brings all affiliates into the combined group and imports the losses of less profitable foreign subsidiaries, which could reduce California tax liability.

Finally, critics of this bill argue that a move to mandatory worldwide combined reporting would impose significant administrative and compliance burdens on certain taxpayers. They contend that corporations would be required to analyze potentially hundreds of foreign affiliates to determine which should properly be included in the unitary business enterprise. They also argue that taxpayers would be required to convert foreign financial statements into California taxable income. This, they suggest, would significantly increase their audit risk due to the many vagaries involved.

k) *A final note*: California's water's-edge election is many things, including the negotiated result of significant pressure applied by both the Reagan Administration and this country's main trading partners. To its detractors, it represents suboptimal tax policy that allows large, highly profitable multinational corporations to shift income from the domestic tax base to low-tax foreign jurisdictions. To its supporters, it is viewed as a mechanism to avoid double-taxation that also affords multinational companies the administrative convenience of merely tracking and reporting domestic sales. In some cases, this may be done to reduce corporate tax liability. In others, it may be done because the attendant compliance burden of worldwide combined reporting is viewed as too high. This bill, at its core, presents the question of whether it is time to revisit a compromise California struck in the 1980s.

l) *Suggested technical amendments*: Committee staff suggests adoption of the following technical and clarifying amendments:

   i) On page 5, in line 9, after "United States," insert "or formed under the laws of any state, the District of Columbia, or any territory or possession of the United States." and delete lines 10 and 11;

   ii) On page 5, delete lines 14 through 17;

   iii) On page 6, in line 2, after "Internal Revenue Code," insert "relating to Net CFC tested income included in gross income of United States shareholders,";

   iv) On page 6, in line 5, after "Code," insert "relating to controlled foreign corporations,"; and,

   v) On page 13, in line 15, delete "the".

m) *Prior legislation*:

   i) AB 71 (Luz Rivas), of the 2021-22 Legislative Session, would have, beginning January 1, 2022, required a taxpayer making a water's-edge election to take into account 50% of the global intangible low-taxed income and 40% of the repatriation income of its affiliated corporations, as defined. AB 71 died on the Assembly inactive file.

   ii) SB 567 (Lara), of the 2017-18 Legislative Session, as originally introduced, would have removed the water's-edge election for taxable years beginning on or after January 1, 2017, and would have specified that existing electors would be unable to elect to file using the water's-edge method for taxable years beginning on or after

January 1, 2023. These provisions were subsequently amended out of the bill, and SB 567 died on the Senate inactive file.

iii) AB 32 (Charles Calderon), of the 2007-08 Third Extraordinary Session, would have repealed the statutory provisions allowing corporations to make a water's-edge election. AB 32 died at the Assembly Desk.

iv) AB 2829 (Ridley-Thomas), of the 2005-06 Legislative Session, would have required a corporation that makes a water's-edge election to include the income and apportionment factors of an affiliated foreign incorporated entity that is treated as an inverted domestic corporation, as defined. AB 2829 died on the Assembly third reading file.

v) AB 441 (Chu), of the 2005-06 Legislative Session, would have required a corporation that makes a water's-edge election to include the income and apportionment factors of its affiliated foreign incorporated entity that is treated as an inverted domestic corporation, as defined. AB 441 failed passage on the Assembly Floor and eventually died on the Assembly inactive file.

vi) AB 34 (Ruskin), of the 2005-06 Legislative Session, would have required a corporation that makes a water's-edge election to take into account the income and apportionment factors of a corporation that is incorporated, headquartered, or located in a tax haven country, as defined. AB 34 died pursuant to Article IV, Section 10(c) of the California Constitution.

REGISTERED SUPPORT / OPPOSITION:

Support

American Federation of State, County and Municipal Employees, AFL-CIO (Co-Sponsor)
California School Employees Association, AFL-CIO (Co-Sponsor)
End Child Poverty in California (Co-Sponsor)
AAPI Force
AAPIs for Civic Empowerment
Alliance of Californians for Community Empowerment
Apen Action
Arc and United Cerebral Palsy California Collaboration
Asian Pacific Environmental Network
Bike LA
California Alliance for Retired Americans
California Climate Voters
California Domestic Workers Coalition
California Environmental Voters
California Faculty Association
California Federation of Labor Unions
California Green New Deal Coalition
California Immigrant Policy Center
California Labor for Climate Jobs
California Latinas for Reproductive Justice
California National Organization for Women

California Nurses Association
California Nurses for Environmental Health & Justice
California Professional Firefighters
California State Council of Service Employees International Union
California Tax Reform Association
California Teachers Association
California Work and Family Coalition
CEH
CEJA Action
Center for Biological Diversity
Center for Community Action and Environmental Justice
Center on Race, Poverty & the Environment
CFT – a Union of Educators & Classified Professionals
Child Care Law Center
Clean Earth 4 Kids
Climate Action California
Climate Center
Climate Health Now
Climate Reality Project, Los Angeles Chapter
Coalition of California State Tribes
Communities for a Better Environment
Communities United for Restorative Youth Justice
Community Legal Services in East Palo Alto
Courage California
CPCA Advocates
Culver City Democratic Club
Early Edge California
Earth Ethics, Inc.
East Bay Community Law Center
Economic Security California Action
End Child Poverty California
Engineers and Scientists of California Local 20, IFPTE
Equal Rights Advocates
Families Advocating for Chemical & Toxics Safety
Food and Water Watch
Fossil Free California
Friends Committee on Legislation of California
Golden State Opportunity
Greenpeace USA
Hand in Hand: The Domestic Employers Network
Labor Coalition
Little Manila Rising
Los Angeles Unified School District
National Alliance to End Homelessness
National Council of Jewish Women Los Angeles
NRDC
Oil Change International
Oil and Gas Action Network
Parent Voices

PICO California
Prosper California Coalition
PSR-LA
PSR-SF Bay Chapter
Resource Renewal Institute
Rise Economy
San Francisco Baykeeper
Santa Cruz Climate Action Network
Sierra Club California
Small Business Majority
Socal 350
Southeast Asia Resource Action Center
State Building and Construction Trades Council
Sunflower Alliance
System Change Not Climate Change
United Domestic Workers/AFSCME Local 3930
Western Center on Law & Poverty
Women's Foundation California
350 Bay Area Action
350 Conejo
350 Humboldt
350 Sacramento
350 Santa Barbara

Opposition

American Canyon Chamber of Commerce
American Car Rental Association
American Rental Car Association
Anaheim Chamber of Commerce
Asian Business Association
Association of California Life and Health Insurance Companies
Bay Area Council
Biocom
Biotechnology Innovation Organization
Brea Chamber of Commerce
California Bankers Association
California Building Industry Association
California Business Roundtable
California Chamber of Commerce
California Fuels and Convenience Alliance
California Hispanic Chambers of Commerce
California Independent Petroleum Association
California Life Sciences
California Manufacturers & Technology Association
California Retailers Association
California Taxpayers Association
California Trucking Association
CAWA

Cellular Telecommunications Industry Association
Cellular Telecommunications and Internet Association
Chino Valley Chamber of Commerce
Colusa County Chamber of Commerce
Consulate General of Japan in San Francisco
Contra Costa County Taxpayers Association
Council on State Taxation
Family Business Association of California
Fontana Chamber of Commerce
Garden Grove Chamber of Commerce
Global Business Alliance
Government of Canada
Government of Germany
Government of Iceland
Government of Ireland
Government of Japan
Government of Ukraine
Government of the United Kingdom
Government of the Republic of Korea
Greater High Desert Chamber of Commerce
Greater Irvine Chamber of Commerce
Greater San Fernando Valley Chamber of Commerce
Hispanic Chambers of Commerce of San Francisco
Hollywood Chamber of Commerce
Information Technology Industry Council
Institute of International Bankers
Japan Business Association of Southern California
Japanese Chamber of Commerce of Northern California
Latin American and Caribbean Business Chamber of Commerce
Lincoln Area Chamber of Commerce
Long Beach Area Chamber of Commerce
Los Angeles Area Chamber of Commerce
Menifee Valley Chamber of Commerce
Mission Viejo Chamber of Commerce
Napa Chamber of Commerce
National Federation of Independent Business
Orange County Business Council
Rancho Cordova Area Chamber of Commerce
Redondo Beach Chamber of Commerce
San Juan Capistrano Chamber of Commerce
San Marcos Chamber of Commerce
Securities Industry and Financial Markets Association
Silicon Valley Leadership Group
Sino-American Certified Public Accountants Association
Solano County Taxpayers Association
South Bay Association of Chambers of Commerce
Southwest California Legislative Council
Taiwanese American Chamber of Commerce of Greater Los Angeles
Torrance Area Chamber of Commerce

Ventura County Taxpayers Association
Western States Petroleum Association
Wilmington Chamber of Commerce
World Trade Center Los Angeles
Yorba Linda Chamber of Commerce

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