GREENBERG TRAURIG, LLP
Nikki E. Dobay (SBN CA 338572)
Todd Pickles (SBN 215629)
Henry Stroud (SBN 342479)
400 Capitol Mall, Suite 2400
Sacramento, California 95814
Telephone (916) 442-1111
Facsimile: (916) 442-1709
Nikki.Dobay@gtlaw.com
PicklesT@gtlaw.com
Henry.Stroud@gtlaw.com

Attorneys for Plaintiff NATIONAL TAXPAYERS UNION

[Additional party on following page]

SUPERIOR COURT OF CALIFORNIA

COUNTY OF SACRAMENTO

NATIONAL TAXPAYERS UNION, Plaintiff, v. CALIFORNIA FRANCHISE TAX BOARD, and SELVI STANISLAUS in her official capacity as Executive Director of the Franchise Tax Board; CALIFORNIA ATTORNEY GENERAL, and ROB BONTA in his official capacity as the California Attorney General; and CALIFORNIA DEPARTMENT OF FINANCE, and JOE STEPHENSHAW in his official capacity as Director of the California Department Of Finance; and DOES 1-10, Defendants.	Case No. **COMPLAINT FOR DECLARATORY AND INJUNCTIVE RELIEF** Exempt from Arbitration:

GREENBERG TRAURIG, LLP
Shail Shah (SBN CA 238396)
101 Second Street, Suite 2200
San Francisco, California 94105
Telephone: (415) 655-1300
Facsimile: (415) 707-2010
Shail.Shah@gtlaw.com

Attorney for Plaintiff NATIONAL TAXPAYERS UNION

COMES NOW Plaintiff National Taxpayers Union ("Plaintiff" or "NTU") by and through its counsel, the law firm of Greenberg Traurig, LLP, to bring their claims for relief against Defendants Franchise Tax Board; California Attorney General; and California Department of Finance, and Does 1 through 10 ("Defendants") and to state and allege as follows:

NATURE OF THIS ACTION

1. This case involves the California Senate Bill 167 (Sen. Bill No. 167 (2023-2024 Reg. Sess.)) ("SB 167") section 18 (the "Apportionment Section"), which upon enactment added California Revenue and Taxation Code ("CRTC")[1] section 25128.9 ("Section 25128.9"). SB 167 was signed by California Governor Gavin Newsom on June 27, 2024, and filed by California Secretary of State Dr. Shirley Weber on June 27, 2024.

2. The stated rational for the Apportionment Section was to clarify existing California Corporation Tax Law. Specifically, the Apportionment Section provided that the formula used to source business income to California under sections 25120 through 25139 shall exclude any amounts related to transactions or activities that are excluded from net income.

3. As enacted, Section 25128.9 appears to exclude from the apportionment formula any receipts that are excluded, deducted, exempt, or otherwise not included in net income.

4. Section 25128.9 applies to tax years beginning *before*, on, or after the effective date of SB 167.

5. The California Office of Tax Appeals ("OTA"), an independent and impartial tax appeals tribunal established by the Taxpayer Transparency and Fairness Act of 2017, issued a precedential decision in *Appeal of Southern Minnesota Beet Sugar Cooperative and Subsidiary* (Off. of Tax App. Mar. 17, 2023) 2023-OTA-342P ("*Beet Sugar*")) and a nonprecedential decision in *Appeal of Microsoft Corporation & Subsidiaries* (Off. of Tax App. Jul. 27, 2023) 2024-OTA-130 ("*Microsoft*")). In both *Beet Sugar* and *Microsoft* (collectively hereinafter the "OTA Decisions"), the OTA held that taxpayers may include amounts in the apportionment formula even if those amounts are excluded from net income.

6. The Apportionment Section and Section 25128.9 are contrary to the OTA's holdings in

---

[1] All further statutory references are to the California Revenue and Taxation Code unless otherwise indicated.

Beet Sugar and *Microsoft*, and the retroactive application of Section 25128.9 will violate the Due Process Clauses of the United States Constitution and the California Constitution.

7. In addition to being contrary to California precedent, Section 25128.9 also contradicts California's apportionment provisions under CRTC sections 25120 through 25139. As such, Section 25128.9 is vague in violation of the Due Process Clause of the United States Constitution.

8. Thus, Plaintiff seeks a declaratory ruling, pursuant to California Code of Civil Procedure section 1060, as such and injunctive relief, pursuant to California Code of Civil Procedure section 526, to prevent Defendants from applying Section 25128.9 either in in its entirety in violation of the United States Constitution or, in the alternative, retroactively in violation of the United States and California Constitutions.

THE PARTIES

9. Plaintiff, NTU, is an Internal Revenue Code section 501 subd. (c)(4) nonprofit social welfare organization corporation organized under the laws of Delaware with its principal office in Washington D.C. As an association of taxpayers that pay taxes in many states, including California, NTU has a substantial interest in having California's tax laws applied in a Constitutional manner. Plaintiff has members that do business in and pay California corporate income and/or franchise taxes and those members will be directly impacted by the application of Section 25128.9. Its members will be irreparably harmed by Defendant's retroactive application of Section 25128.9 through the loss of previously filed tax refund claims.

10. Plaintiff has standing to bring this action because some of its members would have independent standing as they have relied on the OTA's decisions in *Beet Sugar* and *Microsoft* when filing corporate income and franchise tax returns in California and/or filing refund claims based on the OTA Decisions. Plaintiff's members will be impacted by the denial of tax refunds due to Plaintiff's members by applying Section 25128.9 retroactively.

11. Defendant Franchise Tax Board ("FTB") is the California agency charged with the administration of income taxes in California.

12. Defendant Selvi Stanlislaus is the Executive Director of the FTB. She is being sued in her official capacity only.

13. Defendant California Attorney General is the California agency charged with defending suits against California state agencies and alleged constitutional violations and enforcing the laws of the State of California.

14. Defendant Rob Bonta is the California Attorney General. He is being sued in his official capacity only.

15. Defendant California Department of Finance ("CDF") is California's chief fiscal policy advisor and was directly involved with the policy debates and passage of SB 167.

16. Defendant Joe Stephenshaw is the Director of the CDF. He is being sued in his official capacity only.

17. The true names and capacities of the Defendants sued as DOES 1 through 20 are unknown to Plaintiff, who is informed and believes they are responsible for the harms alleged below. Plaintiff will seek leave to amend this Complaint once their true names and capacities are ascertained.

18. Defendants are, and were at all relevant times, either California government agencies or California government officials appointed by the Governor of California.

JURISDICTION AND VENUE

At all relevant times,

19. This Court has jurisdiction over the parties to this action, including but not limited to the claims that arise under the Constitutions of the United States and the State of California and relate to the legality of California law.

20. NTU has members doing business in California that will be impacted by the passage of SB 167 and the implementation of Section 25128.9.

21. Defendants are all California agencies directly or indirectly involved with or charged with the direct or indirect implementation of SB 167 and Section 25128.9.

22. Venue is appropriate in this Court because Plaintiff's members include California taxpayers and Defendants are located in the County of Sacramento. Additionally, many of the facts and circumstances that give rise to the causes of action alleged herein occurred in the County of Sacramento.

//

//

HISTORY OF CALIFORNIA TAX PRECEDENT RELIED UPON BY PLAINTIFF'S MEMBERS AND THE REVERSAL OF PRECEDENT BY SB 167

A. The OTA Established Precedent

23. In 2006, the FTB issued Legal Ruling 2006-1, which addresses the apportionment factor treatment of exempt income. Legal Ruling 2006-1 concludes that items of income that are excluded from California net income are also excluded from the California apportionment factor.

24. In March 2023, the OTA in *Beet Sugar* held that the taxpayer, which operated as a cooperative, may include activities that generate deductible cooperative income in the apportionment formula used to determine the taxpayer's California corporate franchise tax lability. The OTA thereby rejected the FTB's application of Legal Ruling 2006-1. The OTA designated *Beet Sugar* as a precedential decision. Attached hereto as **Exhibit 1** is a true and correct copy of *Beet Sugar*.

25. In July 2023, the OTA in *Microsoft* held that the taxpayer, a multinational software company, may include 100 percent of its foreign dividend receipts in its California sales factor denominator despite deducting 75 percent of the foreign dividends from its California net income. The OTA thereby rejected the FTB's application of Legal Ruling 2006-1. The OTA also rejected the FTB's petition for rehearing in *Microsoft*. Attached hereto as **Exhibit 2** is a true and correct copy of *Microsoft.*

B. The CDF Uses A Streamlined Budget Process Without The Opportunity For Stakeholder Comment To Try To Reverse The OTA Decisions

26. In June 2023, SB 167 became incorporated into California's budget process for the fiscal year 2023-2024 and was ultimately passed through a concurrence process on June 13, 2024.

27. SB 167 was signed by California Governor Gavin Newsom on June 27, 2024, and filed by California Secretary of State Dr. Shirley Weber on June 27, 2024.

28. The relevant provisions of SB 167 passed without sufficient notice to California taxpayers, and the budget process through which it was passed lacked the general comment opportunity for stakeholders to engage.

C. The Revision Is Codified in Section 25128.9, Which Has Potential Unlimited Retroactive Application

29. The Apportionment Section is codified in Section 25128.9. Attached hereto as **Exhibit 3**

is a true and correct copy of Section 25128.9.

30. The stated rational for the Apportionment Section was to clarify existing California Corporation Tax Law.

31. Specifically, the Apportionment Section, codified as Section 25128.9, provided that the formula used to source business income to California under sections 25120 through 25139 shall exclude any amounts related to transactions or activities that are excluded from net income.

32. Section 25128.9 is contrary to the OTA Decisions, including but not limited to because Section 25128.9 excludes from the apportionment formula any items of income or loss that are not included in "net income."

33. Section 25128.9 defines "not included in net income" as income from activities that are excluded, deducted, exempt, or otherwise not subject to apportionment.

34. Section 25128.9 excludes "income or loss" not included in "net income" but does not include "loss" in the definition of "not included in net income."

35. Section 25128.9 also codifies FTB Legal Ruling 2006-1 ("Legal Ruling 2006-1").

36. Section 25128.9 applies to tax years beginning *before*, on, or after the effective date of SB 167.

37. On information and belief, Defendants have enforced or intend to enforce Section 25128.9 with respect to returns filed by California taxpayers prior to June 27, 2024, including the members of Plaintiff.

FIRST CAUSE OF ACTION

DECLARATORY AND INJUNCTIVE RELIEF

Section 25128.9 is Vague in Violation of the Due Process Clause of the U.S. Constitution

(U.S. Const., 14th Amend., § 1)

38. Plaintiff incorporates by reference the allegations in Paragraphs 1 through 37, as though stated herein.

39. There is a present controversy between Plaintiff and Defendants with respect to the application and enforceability of Section 25128.9 that requires a judicial declaration in order for the parties to ascertain their rights and obligations.

40. To pass muster under the due process clause of the Fourteenth Amendment made applicable to the State of California, a law must be "sufficiently explicit to inform those who are subject to it what conduct on their part will render them liable to its penalties." (*Connally v. Gen. Constr. Co.* (1926) 269 U.S. 385, 391 [46 S.Ct. 126, 127].)

41. Section 25128.9 inconsistently defines "not included in net income."

42. Plaintiff's members that are California taxpayers are uncertain what items are "not included in net income."

43. This uncertainty makes it impossible for taxpayers to comply with Section 25128.9 because they are uncertain which items, if any, are to be declared and assessed as income and which may be excluded as income in connection with present and future tax returns.

44. This vagueness of Section 25128.9 as alleged above and herein therefore violates the Due Process Clause of the United States Constitution.

45. Further, Plaintiff's members are irreparably harmed due to the uncertainty as to what items "are not included in net income," including, but not limited to, the potential to incur fees and penalties relating to the assessment of taxes under Section 25128.9, which in turn negatively harms the business interests of Plaintiff's members that may be not fully redressable from the FTB.

WHEREFORE, Section 25128.9 is vague and should be declared unconstitutional and therefore is completely void pursuant to the Fourteenth Amendment to the United States Constitution, section 1, and each of the Defendants should be enjoined from enforcing Section 25128.9.

SECOND CAUSE OF ACTION

DECLARATORY AND INJUNCTIVE RELIEF

The Retroactive Application of Section 25128.9 Violates the Due Process Clause of the U.S. Constitution

(U.S. Const., 14th Amend., § 1)

46. Plaintiff incorporates by reference the allegations set forth in Paragraphs 1 through 45 as though stated herein.

47. There is a present controversy between Plaintiff and Defendants with respect to the retroactive application and enforceability of Section 25128.9 under the United States Constitution with

respect to returns filed with the FTB before June 27, 2024, that requires a judicial declaration in order for the parties to ascertain their rights and obligations.

48. The Fourteenth Amendment provides: "No State shall… deprive any person of life, liberty, or property, without due process of law." (U.S. Const., 14th Amend., § 1.) The Due Process Clause of the Fourteenth Amendment limits how long a tax statute may be retroactive. (*See e.g.*, *United States v. Carlton* (1994) 512 U.S. 26, 31 [114 S.Ct. 2018, 2022].)

49. Under *Carlton*, the Court held a retroactive tax statute is constitutional under the Due Process Clause if it is 1) "justified by a rational legislative purpose[,]" and 2) enacted "promptly and establishe[s] only a modest period of retroactivity." (*Id.* at pp. 31-32.)

50. Supreme Court precedent limits a tax statute's retroactivity period from "that portion of the current calendar year preceding the date of enactment[]" and up to, at most, two years preceding the statute's enactment. (*Ibid.; see e.g., id.* at p. 33 (holding a retroactive period of "slightly greater than one year[]" was permissible); *United States v. Darusmont* (1981) 449 U.S. 292, 294-95, 301 [101 S.Ct. 549, 551, 553] (per curiam) (holding an act passed on October 4, 1976, but retroactive to tax years after December 31, 1975, was permissible); *Welch v. Henry* (1938) 305 U.S. 134, 146, 150-51 [59 S.Ct. 121, 125, 131] (holding a two-year retroactivity period was permissible because the legislature was unable to act prior to this time); *United States v. Hudson* (1937) 299 U.S. 498, 501 [57 S.Ct. 309, 310] (holding a retroactive period of thirty-five days was permissible).)

51. Thus, under Supreme Court precedent, although a tax statute may have a limited retroactive period, it cannot have an unlimited period of retroactivity. (*See e.g.*, *Carlton*, 512 U.S. at pp. 37-38 (O'Connor, J., concurring).)

52. Therefore, a tax statute which does not have a limited period of retroactivity is unconstitutional under the Due Process Clause.

53. Here, Section 25128.9 states the following regarding retroactivity, "[t]his section shall apply to taxable years beginning *before*, on, or after the effective date of the act adding this section." (CRTC §25128.9(c) (emphasis added).)

54. Section 25128.9(c)'s application of the statute to the "taxable years beginning before[] . . . the effective date" creates an unlimited period of retroactivity.

55. Section 25128.9's unlimited retroactivity period is contrary to the limited retroactivity period of zero to two years established by the Supreme Court in *Carlton*, *Darusmont*, *Welch*, and *Hudson*.

56. Accordingly, Section 25128.9's unlimited retroactivity period violates the Due Process Clause of the Fourteenth Amendment.

57. Further, Plaintiff's members will be irreparably harmed by the retroactive application of Section 25128.9, including but not limited to the potential to incur fees and penalties and the costs of audits and appeals relating to the assessment of taxes under Section 25128.9 for returns or refund claims filed before June 27, 2024 based on the OTA Decisions, the imposition of which would further impose collateral business harm to Plaintiff's members that may be not fully redressable from the FTB.

WHEREFORE, the retroactive application of Section 25128.9 is and should be declared unconstitutional pursuant to the Fourteenth Amendment to the United States Constitution, section 1, and each of the Defendants should be enjoined from enforcing Section 25128.9 retroactively, including as to any returns or refund claims filed before June 27, 2024.

THIRD CAUSE OF ACTION

DECLARATORY AND INJUNCTIVE RELIEF

The Retroactive Application of Section 25128.9 Violates the Due Process Clause of the California Constitution

(Cal. Const., Art. I, § 7)

58. Plaintiff incorporates by reference the allegations set forth in Paragraphs 1 through 57 as though stated herein.

59. There is a present controversy between Plaintiff and Defendants with respect to the retroactive application and enforceability of Section 25128.9 under the California Constitution with respect to returns filed with the FTB before June 27, 2024, that requires a judicial declaration in order for the parties to ascertain their rights and obligations.

60. The Due Process Clause of the California Constitution prohibits Defendants from depriving any person of property without due process of law. (Cal. Const., Art. I, § 7)

61. Despite the language in Section 25128.9 stating the statute is declaratory of existing law,

Section 25128.9 substantively changes California law because "it imposes new, additional or different liabilities based on past conduct." (*Brenton v. Metabolife International, Inc.* (2004) 116 Cal.App.4th 679, 688 [10 Cal.Rptr.3d 702].) More particularly, Section 25128.9 reverses the OTA Decisions, on which California taxpayers, including Plaintiff's members, relied in filing their returns and refund claims prior to June 27, 2024.

62. In *City of Modesto v. National Med., Inc.* (2005) 128 Cal.App.4th 518 [27 Cal.Rptr.3d 215], the California Court of Appeal, citing the two part test in *United States v. Carlton* (1994) 512 U.S. 26 [114 S.Ct. 2018], held that in order for retroactive legislation to comply with the Due Process Clause of the California Constitution, "the legislative purpose cannot be either illegitimate or arbitrary…[and] the legislative body must act promptly and establish only a modest period of retroactivity." (*City of Modesto*, 128 Cal.App.4th at p. 528 (citing *Carlton*, 512 U.S. at p. 32).)

63. If legislation fails either prong of the test in *City of Modesto*, it violates the Due Process Clause of the California Constitution.

64. *City of Modesto* held that a period of retroactivity that is longer than one year "would raise serious constitutional issues." (*City of Modesto*, *supra*, 128 Cal.App.4th at p. 529 (citing *Carlton*, *supra*, 512 U.S. at p. 38 (conc. opn. of O'Connor, J.).)

65. Apportionment Section and Section 25128.9 is illegitimate and arbitrary because it directly contradicts established California tax decisions, including the OTA Decisions, and is intended to be applied retroactively to reduce refund claims of California taxpayers, including Plaintiff's members, filed prior to June 27, 2024.

66. The effective date of Section 25128.9 provides that it applies to tax years beginning _*before*_, on, or after the effective date of SB 167.

67. SB 167 was passed without sufficient notice to California taxpayers and the budget process lacked a meaningful comment opportunity for impacted stakeholders.

68. The plain language of the Section 25128.9 effective date provides that it applies retroactively for an indefinite period of time.

69. Plaintiff's members are California taxpayers that filed California corporate income and/or franchise tax returns prior to the enactment of SB 167 and followed the clear law under sections

25120 through 25139 and the OTA Decisions.

70. The retroactive application of Section 25128.9 will subject Plaintiff's members to audits and/or penalties for simply following California law.

71. The indefinite retroactive application of Section 25128.9 to Plaintiff's members violates the second prong of the test in *City of Modesto* and therefore violates the Due Process Clause of the California Constitution.

72. Further, Plaintiff's members will be irreparably harmed by the retroactive application of Section 25128.9, including but not limited to the potential to incur fees and penalties and the costs of audits and appeals relating to the assessment of taxes under Section 25128.9 for returns and refund claims filed before June 27, 2024 based on the OTA Decisions, the imposition of which would further impose collateral business harm to Plaintiff's members that may be not fully redressable from the FTB .

WHEREFORE, the retroactive application of Section 25128.9 is and should be declared unconstitutional pursuant to article I, section 7 of the California Constitution, and each of the Defendants should be enjoined from enforcing Section 25128.9 retroactively, including as to any returns or refund claims filed before June 27, 2024.

PRAYER FOR RELIEF

WHEREFORE, Plaintiff prays for judgment against Defendants, jointly and severally, as follows:

1. As to the First Cause of Action, for a declaration that Section 25128.9 is vague and, as such, unconstitutional pursuant to the Fourteenth Amendment, section 1 of the United States Constitution and therefore is completely void, and temporary, preliminary, and permanent injunctive relief prohibiting the Defendants from enforcing Section 25128.9.

2. As to the Second Cause of Action, a declaration that the retroactive application of Section 25128.9 is unconstitutional pursuant to the Fourteenth Amendment, section 1 of the United States Constitution and temporary, preliminary, and permanent injunctive relief prohibiting Defendants from retroactively applying Section 25128.9;

3. As to the Third Cause of Action, a declaration that the retroactive application of Section 25128.9 is unconstitutional pursuant to article I, section 7 of the California Constitution, and temporary,

preliminary, and permanent injunctive relief prohibiting Defendants from retroactively applying Section 25128.9;

4. For all attorneys' fees incurred in this action by Plaintiffs as provided by law, including but not limited to pursuant to California Code of Civil Procedure section 1021.5;

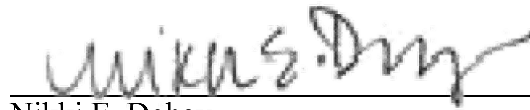
5. For the costs of suit and all other recoverable or allowable costs; and,

6. For all other relief as the Court may deem just and proper.

Respectfully submitted,

Dated: August 14, 2024

GREENBERG TRAURIG, LLP

By: 

Nikki E. Dobay
Shail Shah
Todd Pickles
Henry Stroud

Attorneys for National Taxpayers Union

EXHIBIT 1

DocuSign Envelope ID: 58C107A7-D2F5-4423-9AF0-7BA8260F363D

OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **SOUTHERN MINNESOTA BEET SUGAR COOPERATIVE AND SUBSIDIARY**	) OTA Case No. 19034447

OPINION

Representing the Parties

For Appellants:	Derick J. Brannan, Representative Erin F. Eakes, Representative Ian O'Connell, V.P. of Finance and CFO
For Respondent:	Anthony S. Epolite, Tax Counsel IV Irina Iskander Krasavtseva, Tax Counsel IV
For Office of Tax Appeals:	Grant S. Thompson, Tax Counsel V

K. GAST, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, Southern Minnesota Beet Sugar Cooperative (appellant) and its sole subsidiary Spreckels Sugar Company (Spreckels) (collectively, appellants)[1] appeal actions by respondent Franchise Tax Board (FTB) proposing additional tax of $59,952, $779,503, $1,920,273, and $1,945,119, plus applicable interest, for the 2008, 2009, 2010, and the 2011 tax years, respectively.[2]

Office of Tax Appeals (OTA) Administrative Law Judges Kenneth Gast, Cheryl L. Akin, and Eddy Y.H. Lam held an oral hearing for this matter in Sacramento, California, on January 24, 2023. At the conclusion of the hearing, the record was closed and this matter was submitted for an opinion.

[1] Since the issues largely relate to Southern Minnesota Beet Sugar Cooperative, this Opinion will refer to that entity in the singular as "appellant," even though Spreckels is the other appellant.

[2] Appellants' 2008, 2009, 2010, and 2011 tax years correspond to their fiscal tax years ending August 31, 2009, August 31, 2010, August 31, 2011, and August 31, 2012, respectively.

ISSUES

1. Whether appellant properly included in the combined reporting group's California apportionment percentage its property, payroll, and sales related to business activities that permitted it to deduct certain agricultural cooperative income under R&TC section 24404.
2. Whether appellant may deduct interest expense—incurred to acquire Spreckels, a unitary entity—against its taxable nonmember income.
3. Whether appellant may deduct depreciation expense—incurred from assets used to produce deductible income under R&TC section 24404—against its taxable nonmember income.

FACTUAL FINDINGS

General Background

1. Appellant is an agricultural cooperative corporation headquartered in Minnesota. It is owned by farmer shareholders (its members) and manufactures sugar and sugar by-products from sugar beets produced by its members.
2. During the tax years at issue, most of appellant's income arose from business activities for or with its member shareholders (member income). Under R&TC section 24404, appellant was permitted to deduct the entirety of its member income, which greatly reduced its gross income and resulting net income subject to California tax. Appellant also earned, to a much lesser extent, income that did not qualify for the R&TC section 24404 deduction (taxable nonmember income), which essentially comprised its net income subject to California tax.
3. Prior to the disputed tax years, appellant acquired Spreckels, a for-profit general corporation based in California. Like appellant, Spreckels manufactures refined sugar and other products from sugar beets. But, unlike appellant, Spreckels is not entitled to the R&TC section 24404 deduction. Spreckels earned substantial amounts of net income subject to California tax during the years at issue.
4. Appellant generally funded the Spreckels acquisition with third-party debt. By acquiring Spreckels, appellant obtained additional sugar production and distribution rights that

DocuSign Envelope ID: 58C107A7-D2F5-4423-9AF0-7BA8260F363D

allowed appellant to sell more beet sugar produced by its members, increasing appellant's profitability and deductible member income.

Appellants' California Combined Report

5. For each year at issue, appellant and its wholly owned subsidiary, Spreckels, were engaged in a unitary business of manufacturing sugar and sugar by-products and were required to (and did in fact) file a two-member California combined report. (See R&TC, §§ 25101, 25106.5; Cal. Code Regs., tit. 18, § 25106.5 et seq.)
6. In determining the combined reporting group's California source business income, FTB's regulation required appellant and Spreckels to follow a number of sequential steps. As relevant here, they were each required to compute their separate net income before allocation and apportionment. (Cal. Code Regs., tit. 18, § 25106.5(c)(1), (b)(18).) To calculate its separate net income, appellant deducted from its gross income all of its member income (as permitted under R&TC sections 24401 and 24404), as well as interest expense incurred on debt used to acquire Spreckels and depreciation expense from assets used to produce its deductible member income.[3]
7. After aggregating their separate net incomes to derive their total group combined report business income, appellant and Spreckels were essentially required to multiply that combined amount by the group's California apportionment percentage. (Cal. Code Regs., tit. 18, § 25106.5(c)(7)(A) [applicable to appellants' 2011 tax year], (c)(7)(B) [applicable to appellants' other tax years on appeal].) For the tax years at issue, the group's California apportionment percentage was computed using a three-factor formula comprised of the sum of a property factor, a payroll factor, and a double-weighted sales factor, with that sum divided by four.[4] (*Ibid*.)[5] Critically, when computing the group's

---

[3] Because appellant deducted all of its member income, its interest and depreciation expense deductions reduced its taxable nonmember income (and/or Spreckels's separate net income after appellant and Spreckels aggregated their pre-apportioned separate net incomes).

[4] For the 2011 tax year, the combined reporting group did not elect to use a single-sales factor formula (see former R&TC, § 25128.5), and for each disputed tax year, it did not conduct a qualifying agricultural business activity requiring it to use a three-factor (evenly-weighted sales factor) formula (see R&TC, § 25128(b), (c)(1)).

[5] Each of these factors is a fraction, where the numerator is generally the total California property, payroll, and sales of the taxpayer members of the group, and the denominator is the total property, payroll, and sales of the group everywhere. (Cal. Code Regs., tit. 18, § 25106.5(c)(7)(A)1.b.i.-iii & (c)(7)(B)2.a.-c.)

DocuSign Envelope ID: 58C107A7-D2F5-4423-9AF0-7BA8260F363D

California apportionment percentage, appellant included all of its property, payroll, and sales attributable to its deductible member income. Since all of its property and payroll was located outside of California, and a relatively small portion of its sales was located in California for two of the tax years at issue, appellant's inclusion of activities attributable to its member income substantially diluted the group's denominators, thus reducing the group's California apportionment percentages, California source income, and resulting taxes reported as due.[6]

Procedural History

8. FTB examined appellants' tax returns for the disputed years and proposed the following three adjustments.

   a. First, FTB excluded all of appellant's property, payroll, and sales attributable to its deductible member income from the group's California apportionment percentage. FTB reasoned that only activities giving rise to net business income are appropriately included in the apportionment formula. Since, as noted above, all of appellant's property and payroll was located outside of California, and a relatively small portion of its sales was located in California for two of the tax years at issue, this had the effect of removing substantial out-of-state amounts from the group's denominators, resulting in higher California apportionment percentages, California source income, and additional taxes due. By doing so, FTB effectively required the combined reporting group to apportion its business income—which, except for one tax year, consisted mostly of Spreckels's net income—using a California apportionment percentage largely comprised of Spreckels's property, payroll, and sales factors, which were almost exclusively

[6] For the contested tax years, appellant claimed it was protected by Public Law 86-272, a federal statute, from California's franchise tax based on net income. Consequently, Spreckels was essentially attributed, and paid tax on, all of the group's California source (i.e., post-apportioned) combined report business income, including appellant's taxable nonmember income. (See Cal. Code Regs., tit. 18, § 25106.5(c)(7)(A)2. [involving a procedure known as "intrastate apportionment" applicable to appellants' 2011 tax year], (c)(7)(B)4. [applicable to appellants' other tax years on appeal].)

located in California.[7] For each tax year at issue, the group's California apportionment percentages significantly increased from about 29 to 30 percent, as reported, to about 94 to 96 percent, as adjusted by FTB.

b. Second, FTB determined appellant's interest expenses from the Spreckels acquisition could not be deducted from its gross income because it was related to appellant's deductible member income.

c. Third, for the same reason as its interest expense determination, FTB disallowed appellant's depreciation expense deductions.

9. After FTB issued Notices of Action affirming its Notices of Proposed Assessment for each tax year at issue, appellants filed this timely appeal.

DISCUSSION

Issue 1: Whether appellant properly included in the combined reporting group's California apportionment percentage its property, payroll, and sales related to business activities that permitted it to deduct certain agricultural cooperative income under R&TC section 24404.

I. Introduction

FTB's determination of tax is presumed to be correct, and a taxpayer has the burden of proving error. (*Appeal of GEF Operating, Inc.*, 2020-OTA-057P.) Appellant asserts it properly included in the denominator (and numerator, as applicable) of the group's California apportionment percentage its (largely out-of-state) property, payroll, and sales related to its deductible member income. It maintains such income is simply deducted from gross income and cannot be considered "exempt" or "excluded" from the tax base. FTB disagrees, asserting appellant's member income did not generate apportionable business income and therefore the related property, payroll, and sales must be excluded altogether from both the numerator and denominator of the group's apportionment formula. For reasons discussed below, OTA finds in favor of appellant.

[7] FTB determined appellant also generated taxable nonmember income (i.e., income that did not qualify for the R&TC section 24404 deduction), which consisted of dividends, interest, gross rents and royalties, and other income. FTB thus allowed appellant to include in the group's California apportionment percentages (specifically, only the sales factor denominators) sales related to its taxable nonmember income because, unlike its deductible member income, this income was ultimately subject to California tax. Appellant's taxable nonmember sales were significantly smaller than Spreckels's total sales for purposes of computing the group's sales factor denominators. Appellant apparently had no property or payroll related to its taxable nonmember income.

II. Applicable Law – In General

Under California's Corporation Tax Law (CTL), corporations doing business in California are subject to a franchise tax according to or measured by their "net income" (or, if greater, a minimum tax). (R&TC, § 23151(a).) Similarly, in the combined report context, members are first required to compute their "total separate net income" from all sources before allocation and apportionment. (Cal. Code Regs., tit. 18, § 25106.5(c)(1), (b)(18).) R&TC section 24341 provides "'[n]et income' means the gross income, computed under Chapter 6 (commencing with [R&TC] [s]ection 24271), less the deductions allowed under this article [i.e., Article 1] and Article 2 (commencing with [R&TC] [s]ection 24401)." "[G]ross income" means "all income from whatever source derived . . . ." (R&TC, § 24271(a) [incorporating by reference and generally conforming to Internal Revenue Code (IRC) section 61(a)].) Thus, the starting point for determining net income is the taxpayer's gross income from all sources.

Once gross income from all sources is determined, allowable deductions from all sources are applied to calculate net income. (R&TC, § 24341.) These deductions are set forth in Articles 1 and 2 of Chapter 7 of the CTL. (*Ibid*.) Article 1 includes a variety of deductions, such as deductions for trade or business expenses, interest, and depreciation. (R&TC, § 24343 et seq.) Article 2 contains various "special deductions." (See R&TC, § 24401 ["In addition to the deductions provided in Article 1 . . ., there shall be allowed as deductions in computing taxable income the items specified in [Article 2]"].) These include deductions for net operating losses, organizational expenditures, and, as relevant here, a deduction for certain agricultural cooperative income under R&TC section 24404. (R&TC, § 24401 et seq.)

R&TC section 24404 essentially provides that agricultural cooperatives are permitted to deduct "all income resulting from or arising out of such business activities for or with their members carried on by them or their agents; or when done on a nonprofit basis for or with nonmembers."[8] California Code of Regulations, title 18, (Regulation) section 24404 explains that "[c]ooperative associations are not exempt from tax under [the CTL], but are permitted a deduction for all income arising from business done for or with members, and for or with

[8] The term "cooperative" is not defined in the R&TC or its administrative regulations, but one case, interpreting a statute similar to R&TC section 24404, defined it generally as "an enterprise or organization owned by and operated for the benefit of those using its services." (*California State Auto. Assn. v. Franchise Tax Bd.* (1987) 191 Cal.App.3d 1253, 1257 [involving R&TC section 24405, which, like R&TC section 24404, permits a deduction for cooperative income under certain circumstances].)

nonmembers when done on a nonprofit basis." "[A]ll cooperatives are subject to tax on or measured by income derived from business done with nonmembers on a profit basis but not less than the minimum tax." (Cal. Code Regs., tit. 18, § 24404.) Thus, under California's tax scheme, agricultural cooperatives can deduct certain income related to members and certain nonprofit income related to nonmembers (referred to above as "member income"). But they cannot deduct, and therefore are taxable on, their for-profit nonmember income (referred to above as "taxable nonmember income").

After multistate taxpayers compute their net income from all sources, they must allocate and apportion such income under California's version of the Uniform Division of Income for Tax Purposes Act (UDITPA)[9] (R&TC sections 25120 through 25141) to derive their net income attributed to sources within this state.[10] (See R&TC, §§ 25101, 25121; see also Cal. Code Regs., tit. 18, § 25106.5(b)(18), (c)(1)-(7).) "Under the [UDITPA]—adopted by California and certain other states and which seeks to establish uniform rules for the attribution of corporate income—a unitary enterprise's 'business income' is apportioned among the tax jurisdictions according to a formula."[11] (*Appeal of Robert Half International Inc. & Subs*., 2019-OTA-330 (*Robert Half*), citing *Microsoft Corp. v. Franchise Tax Bd.* (2006) 39 Cal.4th 750, 755-756 (*Microsoft*).) For the years at issue, California required appellants' combined report business income to be "apportioned to this state by multiplying the business income by a fraction, the numerator of

---

[9] References to UDITPA in this Opinion refer to the UDITPA as codified by California in 1966 and in effect for the tax years at issue. (See *The Gillette Co. et al. v. Franchise Tax Bd.* (2015) 62 Cal.4th 468, 473.) This act is based upon, and similar to, the model UDITPA drafted by the National Conference of Commissioners on Uniform State Laws. (*Ibid*.) The UDITPA was intended to provide a uniform guide for state laws and practices regarding multistate business taxation and to prevent taxation in multiple jurisdictions based on more than a business's net income. (*Ibid*.)

[10] As background, "[t]he United States Constitution bars taxation of extraterritorial income." (*Microsoft v. Franchise Tax Bd.* (2006) 39 Cal.4th 750, 755, citations omitted.) "However, it permits taxation of 'an apportionable share of the multistate business carried on in part in the taxing [s]tate' and grants states some leeway in separating out their respective shares of this multistate income, not mandating they use any particular formula." (*Ibid*.) One constitutional method of apportionment is the unitary business/formula apportionment method, which the UDITPA is generally based on. (*Id*. at pp. 755-756.) This method "calculates the local tax base by first defining the scope of the 'unitary business' of which the taxed enterprise's activities in the taxing jurisdiction form one part, and then apportioning the total income of that 'unitary business' between the taxing jurisdiction and the rest of the world on the basis of a formula taking into account objective measures of the corporation's activities within and without the jurisdiction." (*Container Corp. v. Franchise Tax Bd.* (1983) 463 U.S. 159, 165.)

[11] The UDITPA divides a unitary enterprise's income into "business income" and "nonbusiness income." Nonbusiness income, which is not apportioned by formula but instead generally allocated directly to a single state, is not at issue here. (See R&TC, §§ 25120(d), 25123-25127.) To avoid confusion, and unless otherwise specified, this Opinion uses the terms "business income" and "net income" interchangeably.

DocuSign Envelope ID: 58C107A7-D2F5-4423-9AF0-7BA8260F363D

which is the property factor plus the payroll factor plus twice the sales factor, and the denominator of which is four." (R&TC, § 25128(a); see also Cal. Code Regs., tit. 18, § 25106.5(c)(7)(A)-(B).) Each factor is a fraction where the numerator measures activity or assets within California, and the denominator includes all activities or assets anywhere (including California). (R&TC, §§ 25129, 25132, 25134; see also Cal. Code Regs., tit. 18, § 25106.5(c)(7)(A)1.b.i.-iii & (c)(7)(B) 2.a.-c.)

In general, multiplying business income by the fraction produced by the apportionment formula derives the taxpayer's net income for state purposes (i.e., California source income) to which the tax rate is applied. (See R&TC, §§ 25108(c), 23151(a); see also Cal. Code Regs., tit. 18, § 25106.5(c)(7)(A)1., (B), (f).) Business income may not always result in a positive number (i.e., gross income exceeds the allowable deductions for the tax year). Instead, it could result in a current year net operating loss (i.e., the allowable deductions exceed gross income for the tax year), or theoretically result in neither net income or loss if the business merely breaks even for the year. (See R&TC, §§ 24416, 25108(a), (c); see also Cal. Code Regs., tit. 18, §§ 25121(b), 25106.5(b)(17), (e).)

There is no dispute that under R&TC section 24404, appellant was an agricultural cooperative that generated (and properly deducted) its member income for the tax years at issue. The parties also agree that during these same years, appellants were engaged in a unitary business,[12] were required to determine their portion of net income attributed to California using the UDITPA, and derived business income subject to the standard three-factor (double-weighted sales) apportionment formula. In addition, neither party asserts a deviation from the standard apportionment formula is required to achieve an equitable result. (See R&TC, § 25137.) Rather, their dispute is over how, if at all, R&TC section 24404 impacts the standard apportionment formula under the UDITPA; namely, whether property, payroll, and sales amounts used to generate deductible member income are includible in that formula (i.e., the denominators and, as applicable, numerators of the three fractions).[13]

---

[12] "A unitary business is generally defined as two or more business entities that are commonly owned and integrated in a way that transfers value among the affiliated entities." (*Citicorp North America, Inc., et al. v. Franchise Tax Bd.* (2000) 83 Cal.App.4th 1403, 1411, fn. 5.)

[13] There is also no dispute that if the property, payroll, and sales related to deductible member income are properly included in the apportionment formula, appellant correctly computed its denominators and, as applicable, numerators with respect to such amounts for the tax years at issue.

III. Analysis

1. The UDITPA Does Not Exclude Factors Related to Deductible Member Income Under R&TC Section 24404

"As with any issue of statutory [or regulatory] interpretation, [OTA] begin[s] with the text of the relevant provisions. If the text is unambiguous and provides a clear answer, [OTA] need go no further. If the language supports multiple readings, [OTA] may consult extrinsic sources, including but not limited to the legislative history and administrative interpretations of the language. Where, as here, the Legislature has adopted a uniform act [i.e., the UDITPA], the history behind the creation and adoption of that act is also relevant." (*Microsoft*, *supra*, 39 Cal.4th at p. 758; see also *Butts v. Board of Trustees of California State University* (2014) 225 Cal.App.4th 825, 835 [statutory construction rules also govern interpretation of regulations].)

Nothing in the plain language of the UDITPA, including its accompanying regulations,[14] provides that the factors used to generate deductible member income under R&TC section 24404 are excluded from the apportionment formula. A review of the UDITPA's provisions supports this determination. UDITPA contains various rules for, among other purposes, describing taxpayers subject to its scheme (R&TC, §§ 25121, 25122), defining specific terms, such as business income (R&TC, § 25120(a)), detailing the composition of the formula used to apportion business income (R&TC, § 25128), and explaining how to compute the factors (R&TC, §§ 25129-25136). But none of these provisions, or their underlying regulations, provide that the standard formula is altered to exclude unitary activities that generate deductible member income. In fact, Regulation section 25121(b) clarifies a net loss arising from unitary business activities occurring within and without California must, like positive net income, be apportioned under the UDITPA and its regulations. (See also Cal. Code Regs., tit. 18, § 25106.5(b)(17) [in the combined reporting regulations, the term "income" generally includes "loss"].) Thus, contrary to FTB's position that the apportionment formula only reflects activities giving rise to positive business income, apportionment is still required if such activities produce a net loss.

R&TC sections 24401 and 24404, which allow appellant to deduct member income, are not located in the UDITPA, and they do not address how an agricultural cooperative's business

[14] Many of FTB's regulations under the UDITPA are based on the Multistate Tax Commission's model regulations interpreting the UDITPA. (See *Robert Half*, *supra*.)

DocuSign Envelope ID: 58C107A7-D2F5-4423-9AF0-7BA8260F363D

income is apportioned. Indeed, the only explicit reference to R&TC section 24404 in the UDITPA (both statutes and its regulations) is Regulation section 25128-2. That regulation provides rules for what constitutes a qualified agricultural business activity for purposes of requiring use of a three-factor (evenly-weighted sales factor) formula, as opposed to the standard three-factor (double-weighted sales factor) formula for most businesses for the tax years at issue. (Cal. Code Regs., tit. 18, § 25128-2(f), (g).) Specifically, Regulation section 25128-2(f)(1) provides agricultural cooperatives under R&TC section 24404 are not engaged in qualified agricultural business activities, subsection (f)(2) provides certain sales to non-unitary cooperatives can constitute receipts from a qualified business activity for the non-cooperative seller, and subsection (g) provides patronage dividends under R&TC section 24404 from cooperatives are not included in the non-cooperative producer's (i.e., dividend recipient's) receipts from an agricultural business activity. However, there is no mention that the standard three-factor (double-weighted sales factor) formula (or the evenly-weighted formula for certain agricultural businesses) is somehow altered when applied to agricultural cooperatives permitted to use the R&TC section 24404 deduction.[15]

The UDITPA's statutory provisions defining the property and payroll factors used in the standard apportionment formula do not contain any general exclusion of activities that produce deductible income. R&TC section 25129 provides the property factor reflects "real and tangible personal property owned or rented and used" by the taxpayer, R&TC section 25132 provides the payroll factor reflects "total amount paid . . . by the taxpayer for compensation," and R&TC section 25120(c) defines "compensation" as "wages, salaries, commissions and any other form of remuneration paid to employees for personal services." There is thus no mention that the property and payroll factors must exclude values related to deductible income.

The sales factor likewise contains no such general exclusion. "The sales factor is 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, § 25134.) For the 2008 through 2010 tax years at issue, R&TC section 25120(e) provided the term "sales" meant "all gross receipts of the taxpayer [not

[15] The UDITPA's sole explicit reference by regulation to R&TC section 24404 for one apportionment purpose (the composition of the formula) but not for the purpose here (i.e., what values are included in the formula once its composition is determined) arguably supports appellant's position. (Cal. Code Regs., tit. 18, § 25128-2(f)(1).)

DocuSign Envelope ID: 58C107A7-D2F5-4423-9AF0-7BA8260F363D

allocated as nonbusiness income].” Although the term “gross receipts” was not defined by statute or regulation, in *Microsoft*, the California Supreme Court noted “‘[g]ross’ implies the whole amount received, not just the amount received in excess of the purchase price.” (*Microsoft*, *supra*, 39 Cal.4th at p. 759.) As support, the Court cited a dictionary definition of “gross receipts,” which was defined as the “total amount of money or other consideration received by a business taxpayer for goods sold or services performed in a year, *before deductions*[.]” (*Ibid.*, fn. 7, italics added.) The Court of Appeal also broadly concluded “many transactions that do not generate profit are nevertheless included in ‘sales’ for UDITPA purposes, such as sales to consumers at cost or at a loss that are designed to bring customers into a store or promote the company’s products and thus ultimately generate profit for the company.” (*General Mills v. Franchise Tax Bd.* (2009) 172 Cal.App.4th 1535, 1547, citations omitted (*General Mills*).) Therefore, for the 2008 through 2010 tax years, gross receipts related to deductible member income under R&TC section 24404 are includible in the sales factor.

This sales factor conclusion appears to be the same for the 2011 tax year. The parties do not explicitly address that year, but OTA briefly discusses it because for tax years beginning on or after January 1, 2011, the Legislature, for the first time, added a definition of “gross receipts.” That term is now statutorily defined, in relevant part, as “*the gross amounts realized* (the sum of money and the fair market value of other property or services received) . . . in a transaction that produces business income, in which the income, gain, or loss is recognized . . . under the [IRC], as applicable for purposes of [the CTL]. Amounts realized on the sale or exchange of property *shall not be reduced by the cost of goods sold or the basis of property sold*.” (R&TC, § 25120(f)(2), italics added.) FTB does not appear to argue appellant’s member income itself (prior to the deduction) is not recognized under the IRC, as applicable for purposes of California’s CTL. Therefore, the gross receipts related to such income should count towards to the sales factor for 2011. (See Cal. Code Regs., tit. 18, § 24404 [“Cooperative associations are not exempt from tax [under the CTL] . . . but are permitted a deduction”]; see also R&TC, § 23701a(a) [not exempting from the CTL cooperative organizations described in R&TC section 24404].) Although the statute contains certain enumerated exclusions from the definition of “gross receipts,” none of them relate to deductible member income under R&TC section 24404 or imply such an exclusion was contemplated by the Legislature. (See R&TC, § 25120(f)(2)(A)-(L).)

Similarly, there is nothing in FTB's regulations interpreting the UDITPA that indicate activities related to deductible member income under R&TC section 24404 are excluded from the apportionment formula. Those regulations generally provide that to be included in the apportionment formula, a taxpayer's property, payroll, and sales must be used in, paid in, or derived from transactions and activity in the regular course of the taxpayer's trade or business. (See Cal. Code Regs., tit. 18, §§ 25129, 25132, 25134; see also Cal. Code Regs., tit. 18, § 25106.5(c)(7)(A)1.b.i.-iii & (c)(7)(B)2.a.-c. [involving combined reporting groups and referencing statutory rules for the property, payroll, and sales factors]). The regulations do indicate property and payroll used in connection with the production of nonbusiness income are excluded from the factors, and property previously used in the regular course of the taxpayer's trade or business is excluded from the property factor if that property is permanently withdrawn from the unitary business. (See Cal. Code Regs., tit. 18, §§ 25129(a) & (b), 25132(a).) But there is no suggestion that activities related to deductible member income generated from unitary business activities are likewise excluded.

This is also true for Regulation section 25134, which "provides inclusive rules for the types of gross receipts includible in the sales factor (without distinguishing between the numerator or denominator)." (*Robert Half*, *supra*.) It provides "the term 'sales' means all gross receipts derived by the taxpayer from transactions and activity in the regular course of such trade or business." (Cal. Code Regs., tit. 18, § 25134(a)(1).) It further provides rules for determining sales in various situations, but none of them indicate sales are excluded from the apportionment formula if they do not produce net income for the taxpayer conducting unitary business activities. (See, e.g., Cal. Code Regs., tit. 18, § 25134(a)(1)(A) [sales includes "all gross receipts" from sales of goods or products], (a)(1)(B) [sales includes "the entire reimbursed cost, plus the fee," for cost plus fixed fee contracts], (a)(1)(C) [sales includes "the gross receipts" from the performance of services, including fees, commissions, and similar items], & (a)(1)(F) [sales includes "gross receipts" from the sale of equipment used in the business].) Although it does remove from the sales factor denominator "receipts excluded under Regulation [section] 25137(c)," this provision excludes various types of sales, such as certain substantial and occasional sales, from the sales factor, but none of the exclusions apply here. (Cal. Code Regs., tit. 18, §§ 25134(b), 25137(c).) Accordingly, the property, payroll, and sales factor regulations limit the type of activities includible in the apportionment formula, but the limitation is based on

DocuSign Envelope ID: 58C107A7-D2F5-4423-9AF0-7BA8260F363D

whether the activities are a regular part of the taxpayer's trade or business, not on whether the activities relate to deductible member income or produce positive net income.[16]

To summarize, net income is determined by adding the taxpayer's gross income from all sources and subtracting all allowable deductions from all sources. That computation directly implicates R&TC sections 24401 and 24404, which allow appellant to deduct member income, and is performed *before* allocation and apportionment. R&TC sections 24401 and 24404 are not located in, and do not address how net income is apportioned under, the UDITPA once net income from all sources is determined. There is no language in the UDITPA to support FTB's position that unitary business activities are excluded from the apportionment formula if they relate to deductible income. Although R&TC section 25137 allows for the standard apportionment formula to be altered in some circumstances, FTB does not argue it applies here. Since OTA discerns no, and FTB has not pointed to, any ambiguity in the relevant UDITPA statutes and its regulations, the analysis need go no further. Appellant therefore properly included in the combined reporting group's California apportionment percentage its property, payroll, and sales related to its deductible member income under R&TC section 24404.

2. FTB's Contentions

a. *Chase Brass* Does Not Support FTB's Position

The only case cited by FTB to support its proposed adjustments is *Chase Brass & Copper Co., Inc. v. Franchise Tax Bd.* (1977) 70 Cal.App.3d 457 (*Chase Brass*). *Chase Brass* allowed FTB to exclude from the taxpayer's sales factor internal (i.e., intercompany) sales made to another member of the unitary combined group. FTB notes the court stated "[s]ince no net income is produced by the internal sales, it was not required that they be included in the computation." (*Chase Brass*, *supra*, 70 Cal.App.3d at p. 473.) FTB asserts *Chase Brass* supports its adjustments to the property, payroll, and sales factors because, like a taxpayer's intercompany sales within a unitary combined group, appellant's member activities do not generate net income.

[16] Nothing in FTB's special apportionment regulations under R&TC section 25137 changes this conclusion. (See Cal. Code Regs., tit. 18, § 25137 et seq.) In addition, Regulation section 25106.5 et seq., involving detailed steps to determine California source net income or loss for combined reporting groups such as appellants', does not alter the UDITPA or its regulations in the manner FTB advances here. (See, e.g., Cal. Code Regs., tit. 18, § 25106.5(c)(7)(A)-(B).)

Chase Brass does not support FTB's view and is distinguishable. Income or loss generated from intercompany transactions within a combined reporting group is not the same as gross income generated from outside the group and subsequently deducted. Indeed, the issue of intercompany transactions and their effect on the tax base and apportionment formula are now addressed by at least one statute and a regulation, which were not in effect for the tax years at issue in *Chase Brass*. (See R&TC, § 25106; Cal. Code Regs., tit. 18, § 25106.5-1.) The rules governing intercompany transactions do not apply here, and there are no statutes or regulations requiring taxpayers to exclude from the apportionment formula unitary activities related to deductible member income under R&TC section 24404.

The internal sales at issue in *Chase Brass* also did not have any real impact outside the unitary group. They shifted funds within the unitary group but did not change the overall net income of the group. In contrast, appellant's cooperative activities are an integral part of its unitary business. They have a real economic impact outside the unitary group because they produce sugar and sugar by-products that are sold outside the group. Thus, appellant's use of property, payroll, and sales to generate third-party revenue for the unitary business is materially different from the internal sales at issue in *Chase Brass*.

Additionally, *Chase Brass* reviewed a materially different apportionment statute. The court applied R&TC section 25101 as in effect during the 1950s, which was prior to California's enactment of the UDITPA. During those tax years, the court noted R&TC section 25101 essentially gave FTB "discretion" to choose an apportionment formula that was "fairly calculated" to determine a taxpayer's net income from sources within California, but it did not mandate the use of specific factors. (*Chase Brass*, *supra*, at pp. 466-468.) In contrast, R&TC section 25101 now provides the tax "*shall* be measured by the net income derived from or attributable to sources within [California] in accordance with [the UDITPA]." (Italics added; see also R&TC, § 25121 [net income "shall" be allocated and apportioned under the UDITPA].) Thus, current statutes no longer grant FTB the power to use any "fairly calculated" apportionment formula; rather, they require FTB to apply the UDITPA. (See *Appeal of New York Football Giants, Inc.* (77-SBE-014) 1977 WL 3825.) If FTB seeks to deviate from the standard apportionment formula, then under R&TC section 25137, FTB, not the taxpayer, "has the burden of proving by clear and convincing evidence that (1) the approximation provided by the standard formula is not a fair representation, and (2) its proposed alternative is reasonable."

(*Microsoft*, *supra*, 39 Cal.4th at p. 765.) FTB does not attempt to invoke R&TC section 25137 here.

Lastly, when FTB argues appellant's property, payroll, and sales related to member activities did not produce net income, it makes an error *Chase Brass* warns against: "treating [appellant] as a separate and independent entity with a separate accounting system[,]" when "separate accounting is not permitted for the unitary business of the corporations, and [in fact] the contention [] has been repeatedly rejected [by the California and U.S. Supreme Courts]." (*Chase Brass*, *supra*, at pp. 468-469.) FTB thus improperly focuses on appellant's cooperative activities in isolation when the focus should be in the context of its unitary business with Spreckels and whether appellant's activities contributed to the production of the unitary group's business income. Accordingly, *Chase Brass* does not support FTB's position.

b. FTB Is Not Entitled to Deference Under *Yamaha*

Citing in part to the California Supreme Court's decision in *Yamaha Corp. of America v. State Bd. of Equalization* (1998) 19 Cal.4th 1, 12 (*Yamaha*), FTB notes that while an agency's construction of a statute is reviewed independently, significant weight is given to long-standing agency constructions of a statute. FTB thus appears to seek deference in its interpretation of the apportionment statutes. OTA declines for reasons that follow.

In *Yamaha*, the Court explained the weight and persuasiveness of an agency interpretation may be influenced by factors such as the technical expertise of the agency, the complexity of the matter, whether the agency's interpretation has been consistent, and whether the interpretation has been formally adopted in regulations. (See *Yamaha*, *supra*, 19 Cal.4th at pp. 12-13.) Whether and to what extent an agency's view is entitled to deference is "fundamentally situational" and "turns on a legally informed, commonsense assessment of the[] contextual merit." (*Id.* at pp. 12, 14.) Thus, the weight afforded to the tax agency's judgment depends "'upon *the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control*.'" (*Id.* at pp. 14-15, italics added by *Yamaha*, quoting *Skidmore v. Swift & Co.* (1944) 323 U.S. 134, 140.)

OTA reviews FTB's interpretation with these factors in mind. As to the technical expertise of the agency and complexity of the matter, FTB has extensive expertise in the

complex area of multistate taxation, including expertise in the day-to-day administration of the UDITPA. This factor weighs in favor of a degree of deference to its interpretation.

Regarding whether FTB's interpretation has been formally adopted in regulations, FTB has not provided evidence or argument to show that it has been. As previously discussed, FTB's apportionment regulations generally provide that activities related to property, payroll, and sales must be included in the apportionment formula if they are used or arise in the regular course of the trade or business. They do not provide that such activities are excluded if they do not produce net income.[17] This factor does not weigh in favor of deference.

In evaluating the degree of weight to give FTB's interpretation, OTA also considers the thoroughness evident in FTB's consideration, the validity of its reasoning, and its consistency with earlier and later pronouncements. In this appeal, FTB argues that under *Chase Brass*, its proposed adjustments properly interpret R&TC section 24404 and Regulation section 24404. However, as discussed previously, *Chase Brass* does not support FTB's adjustments. Also, FTB has not adequately explained what specific language in R&TC section 24404 or Regulation section 24404, or other provisions, can be interpreted as setting forth a specific rule that activities that generate deductible member income are excluded from apportionment factors or a general rule that activities that do not produce net income are excluded from apportionment factors. To reiterate, R&TC section 24404 and Regulation section 24404 are not in, and do not reference, the UDITPA.

At the oral hearing, FTB requested that OTA defer to its Legal Ruling 2006-01 (April 28, 2006), which has set forth its position for the past 17 years. In that ruling, FTB addresses the issue of how activities related to income that is partially or completely excluded from the measure of the income or franchise tax should be reflected for apportionment factor purposes. FTB essentially concludes such activities should be excluded from both the numerator and denominator of the property, payroll, and sales factors. FTB asserts its ruling fully supports its contentions here. OTA disagrees for several reasons.

---

[17] FTB's position appears to be that as apportionment factors are used to apportion net income, activities should be excluded from the apportionment factors if they do not generate net income. If this were the case, one might expect the converse to also be true: if activities generate net income, they must be included in the apportionment factor. But OTA does not see such a general rule in FTB's regulations. (See, e.g., Cal. Code Regs., tit. 18, § 25137(c)(1)(A) [excluding from the sales factor certain substantial and occasional sales regardless of whether they produce business income or loss].)

DocuSign Envelope ID: 58C107A7-D2F5-4423-9AF0-7BA8260F363D

Legal Ruling 2006-01 does not squarely address deductible member income under R&TC section 24404. Rather, it addresses two hypothetical factual situations that are distinguishable from the issue here. The first situation involves an organization exempt from California's franchise or income tax that conducts activities generating both exempt and taxable income. FTB concludes only the non-exempt activities that are reflected in the tax base (i.e., the taxable unrelated business income) should be included in the apportionment formula. But appellant is not a tax-exempt entity, as FTB's Regulation section 24404 confirms.

The second situation involves a U.S. corporation that receives a dividend from a unitary foreign (non-U.S.) corporation excluded from the combined group's water's-edge election. The U.S. corporation "eliminate[s]" 75 percent of that dividend income from its tax base under R&TC section 24411. FTB concludes only 25 percent of the dividend is includible in the U.S. corporation's sales factor denominator because the remaining 75 percent was "excluded from the [U.S. corporation's] tax base." But, here, appellant deducted its member income under R&TC section 24404, not R&TC section 24411. Further, in the second situation, FTB adjusts the U.S. corporation's sales factor, but FTB does not address whether that corporation's property and payroll factors are similarly adjusted. In contrast, here, FTB completely eliminated appellant's property and payroll from the group's California apportionment percentage.[18]

Although the two situations addressed in Legal Ruling 2006-01 are not directly applicable, the ruling contains broad language that is similar to FTB's arguments here. Among other things, in the ruling, FTB argues activities that generate excluded income "are simply irrelevant in the UDITPA approach." It further argues "[t]his would be equally true for all activities that do not result in net business income, regardless of whether it is because the activity results in [nonbusiness income] or results in income that is excluded by operation of a statute." In footnote four, the legal ruling broadly asserts this same analysis "would apply regardless of whether the statute uses the term 'exempted,' 'excluded,' 'deducted,['] 'not recognized,' etc." The footnote then disclaims any reliance on statutory language, stating that "[t]he conclusion is based upon the fact that these income amounts are related to activities excluded from net income subject to apportionment, not the language used in the statute to reach this conclusion."

[18] Legal Ruling 2006-01 should also be viewed with caution when considering its application to different factual situations. FTB's website states its legal rulings represent its conclusion "regarding the application of law to the entire statement of facts specified[,]" and taxpayers and others are therefore "cautioned against reaching the same conclusion in other cases unless the facts and circumstances are *the same*." (https://www.ftb.ca.gov/tax-pros/law/legal-rulings/index.html, italics added.)

DocuSign Envelope ID: 58C107A7-D2F5-4423-9AF0-7BA8260F363D

As OTA is evaluating the consistency of FTB's position, the ruling's broad statements appear to be consistent with FTB's arguments here. But when also evaluating the thoroughness evident in FTB's consideration and the validity of its reasoning, OTA finds member income "deducted" under R&TC section 24404 should not be equated with income that has been "exempted," "excluded," or "not recognized." These terms and others are terms of art that have specific meaning in the context and structure of the R&TC. (See *Beamer v. Franchise Tax Bd.* (1977) 19 Cal.3d 467, 478-479.) They also can have unique meaning for purposes of the UDITPA. (See *Microsoft*, *supra*, 39 Cal.4th at pp. 759-760 [gross receipts differs from gross income in that the latter subtracts the cost of goods sold, and "sales" for sales factor purposes encompasses more than just gross income]; *General Motors v. Franchise Tax Bd.* (2006) 39 Cal.4th 773, 787-788 (*General Motors*) [for tax purposes, return of loan principal is not a gross receipt under the UDITPA]; R&TC, § 25120(f)(2) [for tax years 2011 and forward, the definition of gross receipts is tied to the IRC, as applicable for purposes of the CTL].)[19]

Critically, items that are "exempted," "excluded," or "not recognized" generally do not enter into gross income (or gross receipts) to begin with and are not included in net income. This appears to support FTB's position the related activities should not be included in the apportionment formula. (See R&TC, § 23701 et seq. [involving organizations exempt from all taxes imposed under the CTL]; R&TC, § 24301 ["In computing the tax imposed under [the CTL], 'gross income' does not include any of the items specified in [Article 2 of Chapter 6]"]; R&TC, § 24320 et seq. [involving other exclusions from gross income under Article 3 of Chapter 6]; Treas. Reg. § 1.61-6(b)[20] ["Certain realized gains or losses on the sale or exchange of property are not 'recognized,' that is, are not included in or deducted from gross income at the time the transaction occurs [such as IRC sections 351, 721, and 1031]"].) However, the deduction for certain agricultural cooperative income is not found in the R&TC provisions dealing with exempt entities (R&TC, § 23701 et seq.), gross income (Article 1 of Chapter 6 of

[19] When interpreting the UDITPA, California courts "strive to achieve uniformity with sister states when possible." (*General Motors*, *supra*, 39 Cal.4th at p. 788; see also R&TC, § 25138 [the UDITPA "shall be so construed as to effectuate its general purpose to make uniform the law of those states which enact it"].) At least one other state that follows the UDITPA has issued a recent opinion acknowledging these principles. (*Oracle Corp. and Subs. v. Dept. of Revenue* (2021) TC 5340, 2021 WL 9848297 at p. *10 [the Oregon Tax Court, Regular Division, concluded there is a link between "gross receipts" for income tax accounting purposes and for apportionment purposes].)

[20] Since, under R&TC section 24271(a), California generally conforms to IRC section 61, it likewise conforms to this federal Treasury Regulation. (R&TC, § 23051.5(d).)

DocuSign Envelope ID: 58C107A7-D2F5-4423-9AF0-7BA8260F363D

the CTL), exclusions from gross income (Articles 2 and 3 of Chapter 6 of the CTL), or nonrecognition transactions (e.g., IRC sections 351, 721, and 1031). Rather, it is found in Article 2 of Chapter 7 of the CTL as an item that is specifically deducted from gross income, which at that point has already been computed and includes gross member income itself. Under the CTL, member income is thus first considered gross income and then deducted under R&TC section 24404 to determine net income subject to tax. Indeed, if member income were not gross income, there would arguably be no need for the R&TC section 24404 deduction.

At the oral hearing, FTB also argued that in 2016, the California Legislature endorsed Legal Ruling 2006-01 when it enacted Senate Bill No. 2. (Stats. 2015-2016, 2nd Ex. Sess., ch. 2, § 1.) In that bill, the Legislature stated "[i]t is the intent of the Legislature that [FTB] Legal Ruling 2006-01 . . . regarding the treatment of apportionment factors attributable to income exempt from income tax shall apply to apportionment factors attributable to the income of qualified health care service plans excluded by Section 24330 of the [R&TC], as added by . . . this act." (*Ibid.*) However, R&TC section 24330, which has since been repealed by its own terms, specifically operated to exclude certain gross income of a qualified health care service plan. (Former R&TC, § 24330.) It was found in Article 3 of Chapter 6 of the CTL, which contains other exclusions from gross income and, as discussed above, should not be considered the same as a deduction from gross income. If anything, the Legislature's statement—"income exempt from income"—appears to endorse Legal Ruling 2006-01's conclusion related to organizations exempt from the CTL, but should not be broadly interpreted as applying to the deductible member income at issue here.

One might argue the R&TC section 24404 deduction effectively "eliminates" member income from gross income and is similar to an exclusion or exemption of income from the tax base such that the related activities should likewise be excluded from the apportionment formula. (See generally *Anaheim Union Water Co. v. Franchise Tax Bd.* (1972) 26 Cal.App.3d 95, 103- 104 [noting R&TC section 24425 prevents taxpayers from deducting expenses related to "gross income" not included in the measure of tax and is applicable to member income deductible under R&TC section 24405].) However, there is no authority in the UDITPA or its regulations that indicates activities related to the deduction under R&TC section 24404 are excluded from the apportionment formula. (Cf. R&TC, § 25106 [intercompany unitary dividends are "eliminated from the income of the recipient" and generally are not considered "in

DocuSign Envelope ID: 58C107A7-D2F5-4423-9AF0-7BA8260F363D

any other manner" in determining the tax]; Cal. Code Regs., tit. 18, § 25106.5-1(f) [several examples eliminate intercompany unitary dividends from the sales factor].)

Indeed, the purpose of cooperative income deductions "rests on the theory that such earnings are not profits, but rather savings produced for patrons through a pooled effort." (*Woodland Production Credit Assn. v. Franchise Tax Bd.* (1964) 225 Cal.App.2d 293, 298 [involving R&TC section 24405].) The savings "constitute in theory a downward adjustment in the price of the product the cooperative sells or the service it furnishes to its patrons; or in an upward adjustment in the price of the product it markets for them." (*Id.* at p. 299.) Thus, even though these savings may not generate profit for appellant's unitary group, such transactions can nevertheless be included in "sales" under the UDITPA, and this should be equally true of the property and payroll factors. (See *General Mills*, *supra*, 172 Cal.App.4th at p. 1547 [sales from hedging futures includible in the sales factor because they are made for the ultimate purpose of obtaining gains or profit, even if there is no profit motive from the future trades alone]; see also *Microsoft*, *supra*, 39 Cal.4th at p. 760 [looking to the economic reality of the taxed transaction].)[21]

Lastly, in its brief and in Legal Ruling 2006-01, FTB refers to a quote from Professor William Pierce, the principal drafter of the model act reflected in California's UDITPA, to bolster its position. In the quote, Professor Pierce states the following: "[T]he uniform act assumes that the existing state legislation has defined the base of tax and that the only remaining problem is the amount of the base that should be assigned to the particular taxing jurisdiction. Thus, the statute does not deal with the problem of ascertaining the items used in computing income or the allowable items of expense." (Pierce, *The Uniform Division of Income for State Tax Purposes* (1957) 35 Taxes 747, italics omitted (*Pierce*).)

But Professor Pierce's statement does not support FTB's position because it does not suggest deductions that reduce the tax base also require alterations to the apportionment formula. Rather, if any inference can be drawn from the statement, it is the computation of net income, including the application of deductions such as R&TC section 24404, is determined *before and separate from* the UDITPA. Indeed, Professor Pierce's discussion of the apportionment

[21] *Microsoft* and *General Motors* were companion cases issued by the California Supreme Court on August 17, 2006. *General Mills* was issued by the California Court of Appeal on April 15, 2009. Therefore, these cases were issued after FTB issued Legal Ruling 2006-01 on April 28, 2006, they are not addressed in that ruling, they provide important guidance on what is a gross receipt includible in the sales factor, and they have bearing on the issues in this appeal.

formula's composition tends to support that activities related to appellant's cooperative business should be included in the group's apportionment formula since they contribute to the overall production of the group's (including Spreckels's) business income. (See *Pierce*, *supra*; see also *Appeal of Merrill, Lynch, Pierce, Fenner & Smith, Inc.* (89-SBE-017) 1989 WL 95886 [the property, payroll, and sales factors reflect capital, labor, and consumer markets, respectively, that contribute to the production of business income]; Hellerstein, Hellerstein, & Appleby, State Taxation (3d ed. 2001) Division of the Tax Base, ¶ 8.06.)

In short, FTB's expertise in multistate taxation counsels in favor of a degree of deference to its interpretation. However, FTB's position does not persuasively explain how the relevant statutes or regulations might be interpreted in the manner it proposes, which would result in excluding unitary business activities that contribute to the production of apportionable business income from the apportionment formula without support in the UDITPA and its regulations and without a showing of distortion.[22] In these circumstances, OTA gives due deference and careful consideration to FTB's position, but in the end, OTA must apply its own independent judgment. Accordingly, OTA reverses FTB's decision on this issue.

<u>Issue 2: Whether appellant may deduct interest expense—incurred to acquire Spreckels, a unitary entity—against its taxable nonmember income.</u>

Income tax deductions are a matter of legislative grace, and a taxpayer that claims a deduction has the burden of proving by competent evidence it is entitled to that deduction. (*Appeal of Vardell*, 2020-OTA-190P.) In computing a taxpayer's net income (here, appellant's pre-apportioned net income), certain specified items are nondeductible. (R&TC, § 24421.) One such nondeductible item is set forth in R&TC section 24425(a), which provides, in full, that "[n]o deduction shall be allowed for any amount otherwise allowable as a deduction which is allocable to one or more classes of income not included in the measure of the tax imposed by

[22] FTB's position would effectively remove a corporation from a unitary group if the corporation's activities did not produce net income. For example, this could occur when a unitary corporation produces a net loss for the year or utilizes a net operating loss carryover to fully offset its post-apportioned taxable income. In this respect, the consequence of FTB's interpretation would appear to be in tension with the general unitary business principle that taxation of a unitary business should be determined by examining all the activities of that business as a whole, rather than by viewing the business activities of one corporate member of the unitary group in isolation. (See, e.g., *Butler Bros. v. McColgan* (1941) 315 U.S. 501, 508-509; *Mobil Oil Corp. v. Comr. of Taxes of Vermont* (1980) 445 U.S. 425, 438.) In addition, depreciation on fixed assets and payroll expenses are deductible in determining unitary business income, but the related property and payroll values are, of course, included in the apportionment formula, as long as they are used or paid in the regular course of the trade or business. (See Cal. Code Regs., tit. 18, §§ 25129, 25132.)

DocuSign Envelope ID: 58C107A7-D2F5-4423-9AF0-7BA8260F363D

[the CTL], regardless of whether that income was received or accrued during the taxable year." This rule "applies whenever income is eliminated from tax under any authority or for any purpose, thus preventing a taxpayer from receiving a double benefit in deducting interest expenses incurred in the production of nontaxable income." (*Apple, Inc. v. Franchise Tax Bd.* (2011) 199 Cal.App.4th 1, 23, citation and quotation marks omitted (*Apple*).)

There is no dispute R&TC section 24425(a) operates, among other purposes, to deny deductions related to income deductible under R&TC section 24404. (See *Appeal of Imperial Hay Growers' Association* (70-SBE-031) 1970 WL 2464.) The question here is whether appellant's interest expense deductions are in fact allocable to its deductible member income. Appellant argues its interest expense is directly traceable to debt used to acquire an asset (i.e., Spreckels) that generated taxable income. FTB counters the acquisition allowed appellant to generate more deductible member income under R&TC section 24404.

To support their respective positions, both parties cite to the Board of Equalization's (BOE's) precedential decision in *Appeal of Zenith National Insurance Corp.* (98-SBE-001) 1998 WL 15204 (*Zenith*). The issue there was whether interest expense incurred in connection with the issuance of corporate debentures should be allocated to taxable or nontaxable income for purposes of determining the deductibility of that expense under R&TC section 24425. (*Zenith*, *supra*.) The taxpayer received nontaxable dividends from an insurance subsidiary over several tax years. (*Ibid.*) During those same years, the taxpayer incurred interest expense in connection with the issuance of corporate debentures used to develop a portfolio of preferred stock paying taxable dividends. (*Ibid.*) The taxpayer deducted all of its debenture-related interest expense, but on audit, FTB used a formula to reallocate the interest expense deductions between the taxpayer's income from taxable preferred stock dividends and its income from nontaxable insurance dividends. (*Ibid.*)

In deciding the case, BOE discussed the proper analysis for these issues. (*Zenith*, *supra*; see also *Apple*, *supra*, 199 Cal.App.4th at pp. 22-26 [applying the *Zenith* analysis].) It held "[i]n the absence of direct evidence linking indebtedness with a particular purchase, [BOE] will determine whether the totality of the facts and circumstances establish a sufficiently direct relationship between the borrowing and the investment to allow for a direct allocation between those two items." (*Zenith*, *supra*, citing IRS Rev. Proc. 72-18, 1972-1 C.B. 740.) BOE further held "[u]nless the taxpayer can establish its dominant purpose and a sufficiently direct

relationship between the expense and the income, [FTB's] allocation formula will provide the best means to allocate interest expense between taxable and nontaxable activities." (*Ibid.*) BOE then concluded "*due to the factual nature of the inquiries presented by this analysis*, it is also clear that the taxpayer must carry the general burden of proving its *dominant purpose* for incurring and/or continuing the subject obligations (and the related interest expense), as well as the burden of demonstrating *the actual use* of the subject funds, by tracing or some other method." (*Ibid.*, italics added.)

On the facts before it, BOE found that for three of the four tax years, the taxpayer established a dominant purpose sufficient to allow for a direct allocation of its interest expense. (*Zenith*, *supra*.) However, for the last year, BOE concluded the taxpayer failed to keep its original dominant purpose and required the use of FTB's allocation formula. (*Ibid.*) That formula consisted of a ratio of the taxpayer's insurance-related income (income excluded from California's bank and corporation tax) to its gross income (all income whether excluded or not). (*Ibid.*)

Applying this analysis here, OTA first notes the term "dominant" is not defined in *Zenith* or the authorities it cites, but one dictionary definition states the term means "exercising the most power, control, or influence."[23] Therefore, "dominant purpose" appears to mean the most important purpose if there is more than one purpose. Here, appellant argues since FTB agrees the interest expense is directly traceable to debt used to purchase Spreckels, that expense is deductible because it relates to a class of income included in the measure of tax (i.e., Spreckels's net income that was taxed by California). FTB contends the dominant purpose of appellant's acquisition debt was to allow it to sell more sugar and increase its deductible member income. As support, FTB provides an audit information request sent to appellant relating to the Spreckels acquisition and its impact on appellant's sugar distribution rights.[24] Appellant responded, in part, "the purchase of Spreckels along with its unused allocations immediately allowed [appellant] to sell more sugar." Appellant further responded that due to the acquisition, it "estimated that it would reap an annual benefit of approximately $9 [million] by being able to sell all of its refined sugar at market prices."

[23] https://www.ahdictionary.com/word/search.html?q=dominant. *Microsoft* cited, in part, to a version of the American Heritage Dictionary when defining "gross receipts." (*Microsoft*, *supra*, 39 Cal.4th at p. 759, fn. 7.)

[24] It is unclear if the purpose of FTB's information request specifically related to this interest expense issue and/or whether it was related to the unitary audit of appellant and Spreckels.

DocuSign Envelope ID: 58C107A7-D2F5-4423-9AF0-7BA8260F363D

Although both parties present a credible reason why appellant incurred and/or continued the debt used to acquire Spreckels, OTA finds neither has established appellant's *dominant purpose*. On the one hand, appellant incurred the debt to acquire a unitary asset (i.e., Spreckels) that did in fact generate significant net income for the combined group that was subject to tax during the disputed years.[25] (See *Zenith*, *supra* [direct evidence of a purpose to purchase assets producing taxable or nontaxable income exists where the proceeds of indebtedness are used for, and are directly traceable to, the purchase]; *Appeal of Mission Equities Corp.* (75-SBE-002) 1975 WL 3263 ["the question is what income did the expenses in controversy help to produce"].) On the other hand, appellant admitted Spreckels helped appellant sell more sugar and therefore generate more deductible member income. (See *Zenith*, *supra* [BOE referenced taxpayer's declarations, as well as its president's live testimony, to discern its dominant purpose].)

Since OTA is unable to discern appellant's dominant purpose, and the acquisition produced both taxable and nontaxable income for the combined group, *Zenith* instructs an allocation formula must be employed. (*Zenith*, *supra* [allocation formula used when dominant purpose not shown].) However, appellant, which carries the general burden of proof, has not shown what allocation formula should be used. In its briefing, appellant indicates, without further explanation or support, its interest expense should be allocated between Spreckels's taxable income and the increased benefit appellant enjoyed as a result of the acquisition (i.e., $9 million).[26] At the oral hearing, appellant then suggested a different formula—one taking into account other factors, such as gross revenue or income—might be more appropriate, but did not provide anything more specific. Because appellant did not clearly set forth a reasonable allocation formula supported by evidence, it is not entitled to deduct its interest expense at issue.[27]

---

[25] At the oral hearing, FTB argued the interest expense should not be allocated to taxable income because appellant did not show the Spreckels acquisition increased the amount of *Spreckels's* taxable income. However, FTB's argument seems misplaced because the acquisition did in fact increase the *combined reporting group's* taxable income, whereas prior to the acquisition, Spreckels's taxable income was not included in a combined report filed with appellant.

[26] It is unclear if the $9 million is a gross or net amount (before application of the deduction permitted by R&TC section 24404).

[27] OTA notes it does not have sufficient evidence in the record to allow it to compute an allocation formula (e.g., using appellant's gross or net income before application of R&TC section 24404 for the tax years at issue versus Spreckels's gross or net income for those same years).

DocuSign Envelope ID: 58C107A7-D2F5-4423-9AF0-7BA8260F363D

Issue 3: Whether appellant may deduct depreciation expense—incurred from assets used to produce deductible income under R&TC section 24404—against its taxable nonmember income.

This final issue also involves R&TC section 24425(a), which generally prevents taxpayers from deducting expenses that enable them to earn income that is not included in the measure of tax. There is no dispute R&TC section 24425(a) denies depreciation deductions related to deductible income. (See *Appeal of Redwood Mutual Water Co.* (80-SBE-84) 1980 WL 5016 (*Redwood*).) There is also no dispute, and indeed appellant concedes, R&TC section 24425(a) disallows its claimed depreciation because it is wholly allocable to assets used to produce deductible member income under R&TC section 24404. Appellant nonetheless contends it is still entitled to deduct depreciation.

Appellant argues "depreciation represents a loss to the going concern," and it should be allowed "to deduct a loss for the declining value of its assets on an annual basis in order to allow [its combined reporting group] to properly reflect its income for tax purposes." Quoting *U.S. v. Ludey* (1927) 247 U.S. 295, 301, appellant asserts the theory underlying depreciation is that by using property and subjecting it to wear and tear, the taxpayer makes a "gradual sale" of the property. Appellant believes it is "inconsistent" to deny depreciation deductions when cooperative property is used to generate deductible income, yet if that property is sold, treat the sale proceeds as a taxable event (because such sales to third parties do not give rise to deductible income). On this ground, it argues FTB should, under R&TC section 24651, make an adjustment to reflect the annual loss suffered by its for-profit activities due to the "gradual sale" of a piece of property.

R&TC section 24651, however, provides no assistance to appellant. It generally requires income to be computed under the method of accounting the taxpayer regularly uses to compute its income in keeping its books. (R&TC, § 24651(a).) R&TC section 24651(b) provides that, if no method of accounting has been regularly used by the taxpayer, or the method used "does not clearly reflect income," income shall be computed "under such method as, in the opinion of [FTB], does clearly reflect income." Appellant has not shown its method of accounting failed to clearly reflect income, or it proposed an alternative computation that "in the opinion of [FTB]" clearly does so.

Appellant does not explain, or provide support for, why R&TC section 24425's denial of its depreciation deductions does not clearly reflect its income on a yearly basis. Simultaneously

DocuSign Envelope ID: 58C107A7-D2F5-4423-9AF0-7BA8260F363D

deducting depreciation expenses as well as deducting the income those assets produce arguably also leads to yearly income distortion. The result appellant advocates would essentially allow cooperatives to use otherwise nondeductible expenses to offset taxable income those expenses did not produce, which can only exacerbate the problem. (See *Anaheim Union*, *supra*, 26 Cal.App.3d 95 at p. 106 [it would be an "absurd result" to allow cooperatives "to offset their expenses incurred in producing [deductible] income [] against their nonmember profit business," and "there is nothing to indicate the Legislature intended to confer double benefits"].) In addition, as appellant acknowledges, cooperative businesses ultimately benefit from an upward basis adjustment in the amount of the disallowed depreciation deductions, which may reduce (or entirely eliminate) taxable gain when the property is sold. (See *Redwood*, *supra*.) Accordingly, appellant is not entitled to deduct its depreciation expense at issue.

HOLDINGS

1. Appellant properly included in the combined reporting group's California apportionment percentage its property, payroll, and sales related to business activities that permitted it to deduct certain agricultural cooperative income under R&TC section 24404.
2. Appellant may not deduct interest expense—incurred to acquire Spreckels, a unitary entity—against its taxable nonmember income.
3. Appellant may not deduct depreciation expense—incurred from assets used to produce deductible income under R&TC section 24404—against its taxable nonmember income.

DISPOSITION

FTB's actions, proposing to exclude from the combined reporting group's California apportionment percentage appellant's property, payroll, and sales related to business activities that permitted it to deduct certain agricultural cooperative income under R&TC section 24404, are reversed. In all other respects, FTB's actions are sustained.

DocuSigned by:
Kenneth Gast
3AF5C32BB93B456...

Kenneth Gast
Administrative Law Judge

We concur:

DocuSigned by:
Cheryl L. Akin
1A8C8F38740B4D5...

Cheryl L. Akin
Administrative Law Judge

DocuSigned by:
Eddy Y.H. Lam
1EAB8BDA3324477...

Eddy Y.H. Lam
Administrative Law Judge

Date Issued: 3/17/2023

EXHIBIT 2

DocuSign Envelope ID: 783E88BC-3614-4606-BF34-4BA4F51C6E51

2024-OTA-130
Nonprecedential

OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **MICROSOFT CORPORATION & SUBSIDIARIES**	OTA Case No. 21037336

OPINION

Representing the Parties:

For Appellant:	Michael Kelley, State Tax Director Stephanie Parks, State Tax Counsel
For Respondent:	Laurie McElhatton, Tax Counsel V Delinda Tamagni, Assistant Chief Counsel
For Office of Tax Appeals:	Nguyen Dang, Tax Counsel III

J. LAMBERT, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19324, Microsoft Corporation & Subsidiaries (appellant) appeals an action by respondent Franchise Tax Board (FTB) denying appellant's claim for refund of $93,901,901 for the fiscal year ending June 30, 2018.

Office of Tax Appeals (OTA) Administrative Law Judges Josh Lambert, Sheriene Anne Ridenour, and John O. Johnson held an oral hearing for this matter in Sacramento, California, on April 18, 2023. At the conclusion of the hearing, the record was closed, and this matter was submitted for an opinion.

ISSUES

1. Whether qualifying dividends deducted from income pursuant to R&TC section 24411 are includable in appellant's sales factor.
2. Whether the gross receipts from the qualifying dividends should be excluded from the sales factor as a substantial and occasional sale, pursuant to California Code of Regulations, title 18, (Regulation) section 25137(c)(1)(A).

3. Whether FTB has shown that the use of an alternative apportionment method is warranted, pursuant to R&TC section 25137.

FACTUAL FINDINGS

1. Appellant is a Washington corporation with its principal place of business located in Washington.
2. Appellant and its subsidiaries operate a worldwide unitary business that includes developing, manufacturing, licensing, and selling Microsoft-branded software and other products and services.
3. Appellant elected to file a water's-edge combined report for the tax year at issue. As a result, appellant and certain affiliated entities filed a California Corporation Franchise or Income Tax Return – Water's-Edge Filers (Form 100W) for the fiscal year ending June 30, 2018.[1] Affiliated entities are included in the water's-edge combined report to the extent provided under R&TC section 25110(a) (water's-edge group), which generally provides that domestic entities are included in the water's-edge group and that unitary foreign affiliates are excluded from the group, subject to certain foreign inclusion rules.
4. Appellant was also unitary with controlled foreign corporations (CFCs) that were excluded from appellant's water's-edge group and the Form 100W. The CFCs sell Microsoft-branded software and other products and services outside the United States (U.S.) and are responsible for most of appellant's foreign sales and foreign earnings.
5. Appellant received repatriated dividends from the CFCs outside the water's-edge group.[2] On its return, appellant reported $109,001,169,787 of total previously taxed income (PTI) from the dividends,[3] less $1,235,021 for PTI exchange gain/loss under Internal Revenue Code (IRC) section 986(c), plus taxable dividends distributed from non-previously taxed

[1] The record does not include appellant's federal or California tax returns. The amounts stated in the factual findings were included in appellant's claim for refund and schedules provided by the parties. The parties were provided the opportunity to correct or object to the amounts and did not raise any objections or disputes.

[2] Generally, repatriation is when foreign earnings of a CFC are distributed through dividends to domestic shareholders. (See, e.g., *Rodriguez v. Commissioner* (2013) 722 F.3d 306, 310.)

[3] FTB's schedules state that total dividend income, which includes the $109,001,169,787 for the current year, represents dividend income before state adjustments.

earnings and profits (E&P) of $38,087,839,[4] resulting in total taxable dividend income of $109,038,022,605. After a $219,183,364 reduction for intercompany dividends pursuant to R&TC section 25106, appellant reported dividends of $108,818,839,241 (gross dividends) that qualified for the dividends received deduction (qualifying dividend deduction) under R&TC section 24411.[5]

6. Appellant reported a 75 percent qualifying dividend deduction of $81,614,129,431, which is 75 percent of the qualifying dividends of $108,818,839,241. Appellant reported net foreign dividends of $27,387,040,356 (net dividends).[6]

7. Appellant only included the net dividends of $27,387,040,356 in its reported total/gross sales of $122,086,437,834. After accounting for adjustments, including cost of goods sold (COGS) and deductions, pre-apportioned net income was reported as $44,387,432,997.[7]

8. In computing the single-sales factor apportionment percentage for the Form 100W, appellant included net dividends of $27,387,040,356[8] in the sales factor denominator. This resulted in a sales factor of 5.63 percent using sales in California (numerator) of

[4] As to the adjustment for $1,235,021, IRC section 986(c) provides that foreign currency gain or loss with respect to distributions of previously taxed earnings and profits attributable to movements in exchange rates between the times of deemed and actual distribution shall be recognized and treated as ordinary income or loss from the same source as the associated income inclusion. As to the adjustment for $38,087,839, this appears to be for distributions from non-previously taxed E&P, pursuant to IRC section 959(c)(3). (See IRS Notice 2019-01.)

[5] FTB's schedules state that the amounts were derived from appellant's response to an information document request, and that it did not examine the amounts. FTB's schedules state that the calculation of total taxable dividend income of $109,038,022,605 is based on amounts from appellant's workpapers. FTB's schedules state that qualifying dividends of $108,818,839,241 pursuant to R&TC section 24411 are from appellant's Form 100W, Schedule H, Dividend Income Deduction for Water's-Edge Filers. FTB asserts that, should appellant prevail on Issue 1, the amount includable as gross receipts would be $108,818,839,241. Appellant does not provide any argument or evidence to show otherwise. Therefore, OTA treats the qualifying dividends totaling $108,818,839,241 as the amount at issue.

[6] The net dividends of $27,387,040,356 appear to be calculated by subtracting $81,614,129,431 ($108,818,839,241 * 75 percent) from $109,001,169,787. Therefore, there appears to be an error in appellant's computation of the net dividends as it should have subtracted $81,614,129,431 from the total qualifying dividends of $108,818,839,241, which accounts for adjustments including the elimination of intercompany dividends of $219,183,364, pursuant to R&TC section 25106.

[7] This net income amount is provided in appellant's schedules from its claim for refund.

[8] FTB's schedules state that appellant's original filing reported net dividends of $27,387,040,350 for a sales factor denominator of $122,086,437,828. However, appellant's claim for refund and FTB's schedules state that appellant's workpapers calculate net dividend income to be $27,387,040,356.

$6,874,544,868 and sales everywhere (denominator) of $122,086,437,834. Appellant paid the reported tax due on the return.

9. Appellant filed a claim for refund for $93,901,901 with FTB, asserting that the foreign dividends should be included in the sales factor denominator without a reduction for the qualifying dividend deduction. In computing its revised California apportionment percentage, appellant included the total PTI dividends of $109,001,169,787 in the sales factor denominator. This resulted in a sales factor of 3.37 percent using sales in California of $6,874,544,868 and sales everywhere of $203,700,567,265.[9]

10. Appellant's sales factor percentages from the prior three years were 5.29 percent, 5.68 percent, and 6.68 percent for fiscal years ending June 30, 2015; June 30, 2016; and June 30, 2017; respectively. For the prior three years, appellant reported total dividend income of $2.9 billion, $4.2 billion, and $4.4 billion for fiscal years ending June 30, 2015; June 30, 2016; and June 30, 2017; respectively. Appellant reported dividend income that included repatriated dividends of $1.3 billion, $609 million, and $1.9 billion for fiscal years ending June 30, 2015; June 30, 2016; and June 30, 2017; respectively.[10] For the current fiscal year, appellant reported $3.3 billion in dividend income from other than the repatriated dividends at issue.

11. FTB denied appellant's claim for refund, and this timely appeal followed.

DISCUSSION

Issue 1: Whether qualifying dividends deducted from income pursuant to R&TC section 24411 are includable in appellant's sales factor.

Background

A taxpayer bears the burden of proving entitlement to a refund claim. (*Appeal of Jali, LLC*, 2019-OTA-204P.) A multistate corporation that is engaged in a unitary business generally

[9] FTB's schedules state that appellant's claim for refund used a sales factor denominator of $203,518,236,719, which includes adjustments to dividends for PTI exchange loss under IRC section 986(c), taxable dividends distributed from non-previously taxed E&P, and intercompany dividends pursuant to R&TC section 25106, totaling $182,330,546. See factual finding number 5 for additional details regarding these adjustments. However, appellant's claim for refund uses $203,700,567,265, which does not include those adjustments to appellant's total taxable dividends.

[10] For the three prior years, FTB's schedules provide total dividend income before state adjustments, and include amounts accounting for "Repatriated Dividends." FTB's schedules also state that the total dividend income amounts include, among other items, "dividends from foreign corporations and other dividends."

must determine its California tax liability based upon a worldwide combined report that includes the income and apportionment factors of all members of the unitary group, wherever located. (R&TC, §§ 25101, 25120-25137.) "A unitary business is generally defined as two or more business entities that are commonly owned and integrated in a way that transfers value among the affiliated entities." (*Citicorp North America, Inc., et al. v. Franchise Tax Bd.* (2000) 83 Cal.App.4th 1403, 1411, fn. 5.) Qualifying taxpayers that constitute a unitary business can elect to file a water's-edge combined report that generally includes the income and apportionment factors of California and U.S. based entities and partially included CFCs, in order to determine income derived from or attributable to California sources. (R&TC, §§ 25110(a), 25113; see *Fujitsu IT Holdings, Inc. v. Franchise Tax Bd.* (2004) 120 Cal.App.4th 459, 469 (*Fujitsu*).) A CFC, generally, is a corporation that is organized in a foreign country and is more than 50 percent owned by U.S. shareholders. (IRC, § 957(a).)

The water's-edge election limits the combined report to include only the entities of the unitary business to the extent defined under R&TC section 25110(a).[11] (R&TC, § 25110; Cal. Code Regs., tit. 18, § 25110(d)(1).) A CFC with "Subpart F income," as defined in IRC section 952, is partially included to the extent determined by multiplying the CFC's income and apportionment factors by an "inclusion ratio." (R&TC, § 25110(a)(2)(A)(ii); Cal. Code Regs., tit. 18, § 25110(d)(2)(E).) Subpart F income gets its name from Subpart F of the IRC, as defined in IRC section 952, and includes certain forms of passive income earned by CFCs. (*Fujitsu*, *supra*, 120 Cal.App.4th at p. 469.)

Subpart F of the IRC was enacted to deter U.S. taxpayers from using related foreign companies to accumulate earnings offshore. (*Apple, Inc. v. Franchise Tax Bd.* (2011) 199 Cal.App.4th 1, 8 (*Apple*); see also *Fujitsu*, *supra*, 120 Cal.App.4th at p. 469.) Under the Subpart F rules, a U.S. entity is generally required to include in current taxable income a portion of the U.S. entity's share of the CFC's current income (Subpart F income), even if there has been no actual distribution. (*Apple*, *supra*, 199 Cal.App.4th at p. 8, fn. 5; IRC, § 951.) California does not conform to Subpart F (IRC sections 951 to 965) relating to CFCs, except to the extent

---

[11] In general, this includes domestic international sales corporations; any corporation (other than a bank), regardless of the place where it is incorporated if the average of its property, payroll, and sales factors within the U.S. is 20 percent or more; corporations that are incorporated in the U.S.; and export trade corporations. (R&TC, § 25110(a)(1)(A)-(D).) Also included are the income and apportionment factors of any corporation not described above, to the extent of its income derived from or attributable to sources within the U.S. and its factors assignable to a location within the U.S. (R&TC, § 25110(a)(2)(A)(i).)

applicable to the water's-edge combined report. (R&TC, § 25110(a)(2)(B); Cal. Code Regs., tit. 18, § 25110(d)(2)(E).)

In 2017, Congress passed the federal Tax Cuts and Jobs Act (TCJA). (P.L. 115-97, 131 Stat. 2054 (2017).) The rules enacted by the TCJA "encourage repatriation of foreign income…." (*Silver v. Internal Revenue Service* (2021) 531 F.Supp.3d 346, 351 (*Silver*); see also H.R. Rep. 115-409, at p. 370 (2017) [the TCJA "will remove tax-driven incentives to keep funds offshore…."].)[12] For instance, "[u]nder the rules enacted by the TCJA, to encourage repatriation of foreign income, 'domestic corporations are in most circumstances entitled to a 100-percent deduction for any dividends received from their foreign subsidiaries [IRC section 245A], which eliminates any U.S. tax liability on the dividend.' " (*Silver*, *supra*, 531 F.Supp.3d at p. 351; IRC, § 245A.)

"To prevent a windfall, 'whereby a domestic corporation could distribute its historical pre-[TCJA] earnings tax free to the [U.S.], the [TCJA] included [IRC] section 965….' " (*Silver*, *supra*, 531 F.Supp.3d at p. 351; see also H.R. Rep. 115-409, *supra*, at p. 375.) Under IRC section 965, previously untaxed foreign earnings of deferred foreign income corporations, such as CFCs, from post-1986 E&P were deemed to be "repatriated" and subject to a one-time federal transition tax, regardless of whether the income was distributed.[13] (See IRC, § 965; see also *Silver*, *supra*, 531 F.Supp.3d at p. 351.)[14] For the tax year at issue in this appeal, appellant was subject to the federal transition tax for deemed dividends attributable to accumulated foreign E&P from its CFCs, pursuant to IRC section 965.

Unless otherwise specifically provided, the IRC as of January 1, 2015, is applicable for purposes of the California Corporation Tax Law (CTL) for the tax year at issue. (R&TC, §§ 23051.5(a)(1), 17024.5(a)(1)(P).) Notwithstanding R&TC section 23051.5(a)(1), when a

---

[12] Modified on denial of reconsideration as to statutory standing of one plaintiff in *Silver v. Internal Revenue Service* (2021) 569 F.Supp.3d 5.)

[13] While the transition tax applies to historical earnings, the TCJA also added IRC section 951A "in order to subject intangible income earned by a CFC to U.S. tax on a current basis…." and which acts as a "base protection measure…." (T.D. 9866; 84 FR 29288-01, at p. 29324, citing S. Comm. on the Budget, Reconciliation Recommendations Pursuant to H. Con. Res. 71, S. Print No. 115-20, at p. 365 (2017).)

[14] Pursuant to IRC section 965(a), in the case of the last taxable year of a deferred foreign income corporation which begins before January 1, 2018, the Subpart F income of such foreign corporation (as otherwise determined for such taxable year under IRC section 952) shall be increased by the greater of the accumulated post-1986 deferred foreign income of such corporation determined as of November 2, 2017, or December 31, 2017.

water's-edge provision refers to provisions of the IRC that do not otherwise apply for purposes of Part 10.2 of the R&TC (Administration of Franchise and Income Tax Laws) or the CTL, the applicable version of the IRC is the version in effect for federal purposes for the taxable period, except as otherwise specifically provided in the water's-edge provisions. (R&TC, § 25116.) California selectively conforms to the TCJA pursuant to Assembly Bill 91 (2019).[15] However, for instance, California does not conform to IRC sections 965 or 245A, and California's water's-edge provisions do not specifically refer to those statutes.[16]

Under California's water's-edge provisions, members of the water's-edge combined group compute their "total separate net income" which is the total net income from all sources of a member of a combined reporting group from its separate books of account as determined under the R&TC, before allocation and apportionment. (Cal. Code Regs., tit. 18, § 25106.5(c)(1), (b)(18).) Total separate net income shall be determined by the R&TC, subject to modifications, such as intercompany transactions. (Cal. Code Regs., tit. 18, §§ 25106.5(c)(1), 25106.5-1.) "Net income" means gross income, as computed under Chapter 6 of the CTL (commencing with R&TC section 24271), less the deductions allowed under this article and Article 2 (commencing with R&TC section 24401). (R&TC, § 24341.) California generally incorporates Subchapter C of Chapter 1 of Subtitle A of the IRC (IRC, § 301 et seq.), relating to corporate distributions and adjustments, except as otherwise provided. (R&TC, § 24451.) IRC section 316 generally defines a dividend as a distribution of property made to shareholders out of a corporation's current or accumulated E&P. (See IRC, § 316(a); R&TC, § 24451.) In addition, gross income is defined to include dividends. (See IRC, §§ 61(a)(7), 301(c)(1); R&TC, §§ 24271(a), 24451.)

R&TC section 25106(a)(1) provides that "[i]n any case in which the income of a corporation is or has been determined under this chapter with reference to the income and apportionment factors of one or more other corporations with which it is doing or has done a unitary business, all dividends paid by one to another of any of those corporations shall, to the extent those dividends are paid out of the income previously described of the unitary business, be eliminated from the income of the recipient and…shall not be taken into account under [R&TC]

---

[15] For example, Assembly Bill 91 amends California's Small Business Method of Accounting provisions to incorporate certain TCJA amendments. (See FTB Notice 2019-03.)

[16] California also does not conform to IRC section 951A, and California's water's-edge provisions do not specifically refer to that statute.

section 24344 or in any other manner in determining the tax of any member of the unitary group."[17]

Taxpayers computing income under R&TC section 25110 are allowed a deduction of 75 percent of qualifying dividends to the extent not otherwise allowed as a deduction or eliminated from income.[18] (R&TC, § 24411(a).) "Qualifying dividends" means those received by the water's-edge group from corporations if both of the following conditions are satisfied: (1) the average of the property, payroll, and sales factors within the U.S. for the corporation is less than 20 percent; and (2) more than 50 percent of the total combined voting power of all classes of stock entitled to vote is owned directly or indirectly by the water's-edge group.[19] (*Ibid.*)

For the year at issue, appellant received repatriated dividends distributed from CFCs which were excluded from the water's-edge group.[20] Intercompany dividends were eliminated from income, pursuant to R&TC section 25106. In addition, a 75 percent deduction was applied to qualifying dividends, pursuant to R&TC section 24411(a).

The water's-edge combined report applies the Uniform Division of Income for Tax Purposes Act (UDITPA) (R&TC sections 25120 through 25139) to allocate and apportion income to California. (R&TC, §§ 25101, 25110(a)(3); Cal. Code Regs., tit. 18, § 25106.5(b)(8), (b)(9).) UDITPA was adopted by California and certain other states to establish uniform rules for the attribution of a unitary enterprise's business income among the taxing jurisdictions.

---

[17] As stated in *Appeal of CTI Holdings*, *Inc.* (96-SBE-003) 1996 WL 248926, "[R&TC] section 25106 provides that dividends paid out of income from a unitary business to which the dividend declarant and recipient belong are eliminated." *Appeal of CTI Holdings*, *Inc.*, *supra*, also stated that R&TC section 25106 does not divest or strip dividends of their income characteristics or attributes.

[18] R&TC section 24411 also provides for a 100 percent dividend deduction for qualifying dividends from a construction project, the location of which is not subject to the taxpayer's control. The 100 percent deduction is not at issue here.

[19] In addition, pursuant to R&TC section 24344(c)(1), certain interest expenses incurred for purposes of foreign investment may be offset against dividends deductible under R&TC section 24411.

[20] Under California law, the qualifying dividends are included in appellant's income pursuant to the R&TC, which conforms to IRC sections 316, 301, and 61, as opposed to being treated as deemed dividends subject to the transition tax under IRC section 965, to which California does not conform. In addition, R&TC section 25106 states that, among other requirements, that dividends must be "paid" to be eliminated, and R&TC section 24411 states that qualifying dividends means, among other items, those that are "received." (See also Cal. Code Regs., tit. 18, § 24411(b)(1)(C) ["Qualifying dividends do not include amounts deemed to be dividends pursuant to [IRC] sections 78, 951 et seq., and 1248, or otherwise, unless there is a distribution, actual or constructive, or a provision in the [R&TC] requiring that a dividend be deemed to have been received."]; see also *Apple*, *supra*, 199 Cal.App.4th at p. 8 ["California …focuses on dividends 'paid,'…."].)

(*Appeal of Robert Half International Inc. & Subs*., 2019-OTA-330P (*Robert Half*).) A unitary enterprise's income is divided into business income, which is apportioned among the states according to a formula, and nonbusiness income, which is allocated directly to a single state. (See R&TC, §§ 25120(a), (d), 25123-25127, 25128.7; *Robert Half*, *supra*.)[21]

For tax years beginning on or after January 1, 2013, business income is required to be apportioned to California by multiplying business income by a single-sales apportionment formula (sales factor), unless R&TC section 25128(b) applies. (See R&TC, § 25128.7; Cal Code Regs., tit. 18, § 25106.5(c)(7)(A)1.a.) The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the tax year, and the denominator of which is the total sales of the taxpayer everywhere during the tax year. (R&TC, § 25134.) Sales is defined as all gross receipts of the taxpayer not allocated under R&TC sections 25123 to 25127 (as nonbusiness income). (R&TC, § 25120(f)(1).)

For tax years beginning on or after January 1, 2011, R&TC section 25120(f)(2) defines "[g]ross receipts" as: "[T]he gross amounts realized…on the sale or exchange of property, the performance of services, or the use of property or capital (including rents, royalties, interest, and dividends) in a transaction that produces business income, in which the income, gain, or loss is recognized (or would be recognized if the transaction were in the [U.S.]) under the [IRC], as applicable for purposes of this part." In addition, R&TC section 25120(f)(2) states that gross receipts, even if business income, shall not include items listed in subparagraphs (A) through (L). Items excluded from gross receipts under R&TC section 25120(f)(2) include, for instance, amounts received from transactions in intangible assets held in connection with a treasury function and from hedging transactions involving intangible assets. (See R&TC, § 25120(f)(2)(K), (L).)

Analysis

Appellant contends that the foreign dividends should be included in the sales factor denominator as gross receipts, without a reduction for the qualifying dividend deduction, based on the plain language of the statute, legislative history, and legal authority establishing dividends

[21] There is no dispute that the qualifying dividends under R&TC section 24411 at issue were properly treated as apportionable business income, and there is no dispute that the numerator of the water's-edge group's sales factor was properly computed.

as gross income and gross receipts notwithstanding deductions.[22] FTB contends that 75 percent of the dividends should be excluded from appellant's sales factor, pursuant to FTB Legal Ruling 2006-01 (Ruling 2006-01). Ruling 2006-01 states that a domestic corporation that received dividends from a unitary CFC excluded from the water's-edge group must include in the sales factor denominator only the net dividends after applying the qualifying dividend deduction under R&TC section 24411 because the deducted amount relates to an activity excluded from the tax base apportioned by UDITPA. Ruling 2006-01 states that this reasoning "would be equally true for all activities that do not result in net business income," meaning it would "apply regardless of whether the statute uses the term 'exempted,' 'excluded,' 'deducted,' 'not recognized,' etc." Ruling 2006-01 provides various legal authorities relating to exclusions and exemptions from income and whether those exclusions and exemptions should be reflected in the taxpayers' apportionment formula, including *Chase Brass and Copper Co. v. Franchise Tax Bd.* (1977) 70 Cal.App.3d 457 (*Chase*).[23]

R&TC section 25120(f)(2) defines gross receipts as " amounts realized (the sum of money and the fair market value of other property or services received) on the sale or exchange of property, the performance of services, or the use of property or capital (including rents, royalties, interest, and dividends) in a transaction that produces business income, in which the income, gain, or loss is recognized (or would be recognized if the transaction were in the [U.S.]) under the [IRC], as applicable for purposes of this part. Amounts realized on the sale or exchange of property shall not be reduced by the cost of goods sold or the basis of property sold." Therefore, R&TC section 25120(f)(2) defines gross receipts as including the gross (rather than net) amounts realized and recognized for the purposes of the CTL.

---

[22] Appellant also raises arguments challenging FTB's determination on constitutional grounds. OTA declines to consider these constitutional arguments based on a long-established policy of abstaining from deciding constitutional issues. (See *Appeal of Acosta and Castro*, 2022-OTA-235P.) This policy is based upon the absence of any specific statutory authority which would allow FTB to obtain judicial review of a decision in such cases and upon the belief that judicial review should be available for questions of constitutional importance. (*Ibid.*)

[23] Ruling 2006-01 also cites to cases addressing R&TC section 24425, which provides that items are nondeductible when allocable to income that is not included in the measure of tax, such as *Appeal of Zenith National Insurance Co.* (98-SBE-001) 98-SBE-001.

To reach "net income," "gross income" is reduced by deductions, including the qualifying dividend deduction under R&TC section 24411. (See R&TC, § 24341.)[24] Therefore, generally speaking, dividends enter gross receipts and gross income before the application of the deduction. Accordingly, the gross dividends are considered gross income or gross receipts, regardless of the qualifying dividend deduction. (See IRC, §§ 61(a), 316(a), 301(c)(1).) On the other hand, amounts that are "excluded" are not considered gross income or gross receipts. (See R&TC, § 24301; IRC, § 61(b).)[25] As a result, the qualifying dividend deduction does not result in the exclusion of dividends from gross income or gross receipts.

FTB argues that the qualifying dividend deduction should be treated like eliminated intercompany dividends under R&TC section 25106, which are not included in the sales factor. FTB also contends that the deducted dividends have a similar economic reality to eliminated dividends because they both reduce the tax base, such that deducted dividends should be deemed to "eliminate" gross receipts from the sales factor. However, R&TC section 25106 provides for the dividends qualifying under the statute to be "eliminated" from income. In addition, eliminated dividends are not considered in determining tax of any member of the unitary group and are expressly excluded from the sales factor by statute and regulation. (See R&TC, § 25106(a)(1) [the eliminated dividends "shall not be taken into account…in any manner in determining the tax of any member of the unitary group"]; Cal. Code Regs., tit. 18, § 25106.5-1(a)(5)(A)(1) ["Sales attributable to intercompany items are not included in [the] sales factor…."]; *Fujitsu*, *supra*, 120 Cal.App.4th at p. 481.) There is no similar language applicable to the qualifying dividend deduction in R&TC section 24411 or the regulations.

The court in *Fujitsu* noted the difference between R&TC sections 25106 and 24411, stating that R&TC section 25106 "posits its different treatment of dividends…on whether or not the income from which the dividends are paid has been included in the water's edge combined report…If the subsidiary's dividends are paid out of earnings and profits that have not been included on the combined report, it is nevertheless eligible for the 75 percent dividends received

[24] Deductions are allowed under Articles 1 and 2, Chapter 7 of the CTL, and Article 2 includes the qualifying dividend deduction under R&TC section 24411. (See R&TC, § 24341 ["'Net income' means the gross income . . . less the deductions allowed under this article [1] and Article 2"].)

[25] Exclusions are specified to be in Article 2, Chapter 6 of the CTL, and Article 3, Chapter 6 of the CTL includes "Other Exclusions." (See R&TC, § 24301 ["'gross income' does not include any of the items specified in this article [2]"].)

deduction found in [R&TC] section 24411, subdivision (a)." (*Fujitsu*, *supra*, 120 Cal.App.4th at p. 481.) Specifically, the court in *Fujitsu* stated that R&TC section 25106 "prevents dividends from subsidiaries from being taxed twice—once as earnings of the issuing subsidiary, and once as separate income to the unitary business from receipt of the dividend." (*Fujitsu*, *supra*, 120 Cal.App.4th at p. 477.) Therefore, R&TC sections 24411 and 25106, while "acting in conjunction," each provide a "different treatment of dividends…." (*Id.* at p. 481.)

In support of its arguments, FTB cites *Chase*; however, that case involved a different issue of whether FTB could "exclude" from the taxpayer's sales factor internal (i.e., intercompany) sales made to another member of the unitary combined group. (*Chase*, *supra*, 70 Cal.App.3d at p. 473.) As applicable to the present case, R&TC section 24411 does not provide that qualified dividends are excluded or eliminated from income, but that they are deducted from income. Furthermore, the court noted that former R&TC section 25101, as in effect for the tax years at issue in that case, provided FTB "discretion" to use an apportionment formula that was "fairly calculated" to determine a taxpayer's net income from sources within California, but did not mandate the use of specific factors.[26] (*Chase*, *supra*, 70 Cal.App.3d at pp. 466-468.) R&TC section 25101 now provides the tax "shall be measured by the net income derived from or attributable to sources within [California] in accordance with [UDITPA]." Therefore, the court in *Chase* applied a materially different statute. Accordingly, FTB's reliance on that case is unpersuasive.

FTB also cites *Great Western Finance v. Franchise Tax Bd.* (1971) 4 Cal.3d 1 (*Great Western*); however, that case is not applicable because the issue was whether deductions should be disallowed when allocable to "eliminated" income pursuant to R&TC section 24425, which provides that items are nondeductible when allocable to income that is "not included in the measure of tax…." (*Id.* at p. 6.) This appeal does not involve application of R&TC section 24425 and *Great Western* did not address the issue in this appeal—whether qualifying dividends deducted from income pursuant to R&TC section 24411 should be included or excluded from the sales factor. As such, OTA also finds FTB's reliance on *Great Western* to be unpersuasive.

[26] The court stated that, "[s]ince no net income is produced by the internal sales, it was not required that they be included in the computation. We think the above described methods used by [FTB] were fairly calculated to assign to California only that portion of the net income reasonably attributable to the business done in this state." (*Chase*, *supra*, 70 Cal.App.3d at p. 473.)

In further support, FTB cites *Microsoft Corp. v. Franchise Tax Bd.* (2006) 39 Cal.4th 750 (*Microsoft*), where the court examined the economic reality of the taxpayer's redemptions of marketable securities to determine whether the full redemption price (rather than the net proceeds) should be treated as gross receipts under former R&TC section 25120(e). In *Microsoft*, the court found that the redemption of a short-term marketable security at maturity was equivalent to a sale of the security to a third party before maturity when the transaction was evaluated from the perspective of the taxpayer. (*Id*. at pp. 761-762.) The court noted that when an investor sells a marketable security to a third party, the entire sales price is includible in gross receipts and, therefore, concluded that the entire amount received upon redemption should similarly be included in "gross receipts" for purposes of calculating the sales factor. (*Id*. at pp. 760-761; see also *General Mills v. Franchise Tax Bd*. (2009) 172 Cal.App.4th 1535, 1544.)

The court in *Microsoft* examined R&TC section 25120 before it was amended to define "gross receipts" under subdivision (f)(2). (*Microsoft*, *supra*, 39 Cal.4th at p. 758 ["The term 'gross receipts' is undefined"].) For the tax year at issue in this appeal, the amendment to R&TC section 25120(f)(2) defining gross receipts is applicable. Gross receipts is specifically defined to include dividends, and there is no applicable exclusion. (See R&TC, § 25120(f)(2).) Therefore, the analysis in *Microsoft* and other cases applying R&TC section 25120 before subdivision (f)(2) was added can be distinguished from the present case. Regardless, the court in *Microsoft*, held that "gross" implies the whole amount received, which is consistent with the conclusion in this Opinion. (*Microsoft*, *supra*, 39 Cal.4th at p.759; see also *Robert Half*, *supra* ["gross" implies the whole amount received, without deduction].)

In addition, under these facts, there is no basis to question the economic reality of the dividends as FTB contends. In *Appeal of CTI Holdings, Inc*., (96-SBE-003) 1996 WL 248926, the California Board of Equalization (BOE) examined the economic reality of dividends, stating that "[b]efore income can be recognized, the taxpayer is required to realize an accession to wealth and have control thereof," citing *Commissioner v. Glenshaw Glass* (1955) 348 U.S. 426. The BOE stated that "[t]here is no dispute here that appellant received payments of dividends…over which it had complete control. Thus, it is obvious that appellant realized economic gain and had recognizable income…." (*Appeal of CTI Holdings, Inc*., *supra*.) In this case, appellant received payments of dividends over which it had complete control, and realized economic gain and recognizable income equal to the gross amount received.

FTB further argues that R&TC section 25120(f)(2)(A)-(L) provides a non-exhaustive list of exclusions from gross receipts, including several that are excluded because they do not contribute to the tax base, which demonstrates a "matching principle" that should be applied to exclude the deducted dividends.[27] The plain language of R&TC section 25120, however, does not indicate that the list is non-exhaustive; rather, R&TC section 25120(f)(2) provides amounts includable in gross receipts under the IRC as applicable for purposes of the CTL, and R&TC section 25120(f)(2)(A)-(L) provides a list of exclusions from gross receipts. In this case, the dividends qualify as gross receipts under R&TC section 25120(f)(2) and there is no applicable exclusion in the plain language of the statute.

The legislative history also fails to support FTB's argument that the list of exclusions under R&TC section 25120(f)(2)(A)-(L) is non-exhaustive or that a "matching principle" mandates treating the instant dividends as excluded from gross receipts. The bill analysis relating to the 2011 amendment adding R&TC section 25120(f)(2) states that "[gross receipts] will include all gross amounts…but will explicitly exclude purely financial corporate transactions (such as corporate [t]reasury function or hedging transactions…)." (California Bill Analysis, A.B.X3 15 Sen., 2/14/2009.) By stating so, the California Legislature does not indicate that the list is non-exhaustive and only references the statutory exclusion of certain transactions that have been determined to be distortive when included in the sales factor. (See *Microsoft*, *supra*, 39 Cal.4th 750 [treasury function transactions]; *General Mills v. Franchise Tax Bd*. (2012) 208 Cal.App.4th 1290, 1313 (*General Mills*) [hedging transactions].) The Legislature could have included language in the statute signifying that the list of exclusions was non-exhaustive (e.g., "such as," "and other similar transactions"), but did not do so, which indicates that the Legislature intended for the list to be exhaustive. As a result, there is no basis to conclude that the "matching principle" that FTB describes should be applied to exclude items from gross receipts based upon whether or not they contribute to the tax base.

FTB also contends that the Legislature endorsed Ruling 2006-01 in 2016 when it enacted Senate Bill No. 2. In the bill, the Legislature stated that "[i]t is the intent of the Legislature that Legal Ruling 2006-01…regarding the treatment of apportionment factors attributable to income

[27] FTB argues that COGS are included in the sales factor because they are expenses, whereas deducted dividends should be removed, matching the treatment of those items in the tax base. While R&TC section 25120(f)(2) specifically provides that gross receipts should not be reduced for COGS, it does not specifically provide that gross receipts should be reduced by the qualifying dividend deduction.

exempt from income tax shall apply to…Section 24330 of the [R&TC]….” (Stats. 2015-2016, 2nd Ex. Sess., ch. 2, § 1.) Former R&TC section 24330, however, related to an exclusion from gross income and, therefore, the Legislature's statement is not applicable to the qualifying dividend deduction under R&TC section 24411, which is a deduction rather than an exclusion. As with Ruling 2006-01, FTB's arguments and conclusions are based upon legal authorities relating to exclusions and exemptions from income, but FTB does not provide legal authorities establishing that deductions, such as the qualifying dividend deduction at issue in this appeal, should be treated similarly, such that the deducted dividend income is excluded from gross receipts.[28]

FTB argues that OTA should give deference to its interpretation in Ruling 2006-01 that the sales factor includes only the net dividends after applying the qualifying dividend deduction. The weight given to an agency's interpretation is fundamentally situational. (See *Yamaha Corp. of America v. State Bd. of Equalization* (1998) 19 Cal.4th 1, 12 (*Yamaha*).) Here, FTB has expertise and technical knowledge as the administrator of the tax at issue, which weighs in favor of deference to FTB's interpretation. (*Id.* at p. 12.) However, FTB's interpretation of R&TC section 25120 is not in a formal regulation; rather, its interpretation is in Ruling 2006-1. In addition, FTB is interpreting a statute promulgated by the Legislature, as opposed to FTB's own regulation. These factors weigh in favor of less deference to FTB's interpretation. (*Ibid.*) Furthermore, FTB's interpretation is inconsistent with well-established law and there is no indication in the plain language or legislative history that R&TC section 25120(f)(2) applies to appellant's dividends received during the tax year as FTB contends. Accordingly, in applying its independent judgment, OTA finds that FTB's interpretation is unpersuasive. (*Yamaha*, *supra*, 19 Cal.4th at p. 4.)

Conclusion

Gross receipts from the dividends should not be reduced to account for dividends deducted under R&TC section 24411. Appellant's total taxable dividend income is $109,038,022,605, and once intercompany dividends are eliminated from gross receipts, the dividends includible in the sales factor total the qualifying dividends of $108,818,839,241. (See

[28] The statutory definitions provided in R&TC section 25120 are prefaced by the phrase “unless the context otherwise requires.” FTB argues that the “context otherwise requires” in this matter; however, FTB has not shown that such language means the deducted dividends should be excluded from gross receipts.

R&TC, § 25106(a)(1); Cal. Code Regs., tit. 18, § 25106.5-1(a)(5)(A)(1); *Fujitsu*, *supra*, 120 Cal.App.4th at p. 481.) As a result, the qualifying dividends of $108,818,839,241 are considered gross receipts includable in the sales factor denominator.

Issue 2: Whether gross receipts from the qualifying dividends should be excluded from the sales factor as a substantial and occasional sale, pursuant to Regulation section 25137(c)(1)(A).

Background

Regulation section 25137(c)(1)(A) provides that, where substantial amounts of gross receipts arise from an occasional sale of a fixed asset or other property held or used in the regular course of the taxpayer's trade or business, such gross receipts shall be excluded from the sales factor. For example, gross receipts from the sale of a factory, patent, or affiliate's stock will be excluded if substantial. (*Ibid.*) If Regulation section 25137(c)(1)(A) is found to apply, it will be the controlling standard apportionment method. (*Appeal of Fluor Corporation* (95-SBE-016) 1995 WL 799363 (*Fluor*).)

A sale is substantial if its exclusion results in a five percent or greater decrease in the sales factor denominator of the taxpayer or, if the taxpayer is part of a combined reporting group, a five percent or greater decrease in the sales factor denominator of the group as a whole. (Cal. Code Regs., tit. 18, § 25137(c)(1)(A)1.) A sale is occasional if the transaction is outside of the taxpayer's normal course of business and occurs infrequently. (Cal. Code Regs., tit. 18, § 25137(c)(1)(A)2.)

Analysis

FTB argues that the distribution of dividends qualifies as a "sale" under Regulation section 25137(c)(1)(A) and, therefore, all the gross receipts from the qualifying dividends should be excluded from the sales factor as arising from a substantial and occasional sale. Specifically, FTB contends that the dividends should be considered a "sale" for purposes of Regulation section 25137(c)(1)(A) because they are included in the "sales" factor.

R&TC section 25120 provides the meaning of terms as used in R&TC sections 25120 to 25139 (UDITPA), inclusive, unless the context otherwise requires. (R&TC, § 25120.) R&TC section 25120(f)(1) defines "sales" as all gross receipts of the taxpayer not allocated under R&TC sections 25123 to 25127, inclusive. R&TC section 25120(f)(2) defines gross receipts as expressly including dividends. Therefore, dividends are "sales" for purposes of UDITPA under

R&TC section 25120(f)(1). However, a dividend is not a "sale" as used in Regulation section 25137(c)(1)(A). Regulation section 25137(c)(1)(A) applies to a "sale of a fixed asset or other property," such as "the sale of a factory, patent, or affiliate's stock." Under R&TC section 25120(f)(1) and (f)(2), sales is defined to include not only amounts from a sale of property, but also from the exchange of property, performance of services, and the use of property or capital (including rents, royalties, interest, and dividends).[29] Therefore, the definition of a "sale" in Regulation section 25137(c)(1)(A) is more limited in scope than the definition of "sales" in R&TC section 25120(f)(1).[30]

FTB contends that the reference in Regulation section 25137(c)(1)(A) to a sale of "other property" can mean the distribution of dividends. In 2001, Regulation section 25137(c)(1)(A) was amended to add the "other property" language to apply the regulation to "sales" of intangible assets, in addition to fixed assets. (See Amendment of Regulation section 25137(c)(1)(A) and new subsections (c)(1)(A)1.-2. filed 1-30-2001; operative 1-1-2001 (Register 2001, No. 5); *Appeals of Amarr Company and Amarr Company (C SGNF)*, 2022-OTA-041P (*Amarr*).) Prior to the amendment, FTB issued Legal Ruling 1997-1, which stated that gross receipts from an incidental or occasional sale of intangible property should not be distinguished from sales of fixed assets for purposes of the substantial and occasional sale rule. (See also *Amarr*, *supra*.) For instance, the 2001 amendment added that a sale could include the sale of a "patent" or "affiliate's stock." (Cal. Code Regs., tit. 18, § 25137(c)(1)(A); *Amarr*, *supra*.) Therefore, as held in *Amarr*, *supra*, Regulation section 25137(c)(1)(A) makes clear that the substantial and occasional sale rule is applicable to "sales" of both tangible assets (i.e., a factory) and intangible assets (i.e., patents or an affiliate's stock).

FTB provides no evidence or legal authorities establishing that the dividends are a sale of property under Regulation section 25137(c)(1)(A). Here, FTB has already determined that the distributions are dividends, as opposed to a sale of property, as it determined they are qualifying dividends, pursuant to R&TC section 24411. Accordingly, appellant's receipt of the dividends

---

[29] In addition, Regulation section 25134(a)(1) states that "for the purposes of the sales factor of the apportionment formula for each trade or business of the taxpayer, the term 'sales' means all gross receipts derived by the taxpayer from transactions and activity in the regular course of such trade or business."

[30] "The terminology identifying the sales or receipts factor varies among the states, but whatever term is used, the factor has a much broader scope than receipts from sales of tangible personal property." (Hellerstein, State Taxation, 9.18.)

does not qualify as a "sale" of property under Regulation section 25137(c)(1)(A) and, as a result, the dividends do not meet the requirement of the regulation that the receipts arise from a "sale."[31]

Conclusion

Regulation section 25137(c)(1)(A) does not apply to exclude the qualifying dividends from the sales factor as a substantial and occasional sale.

Issue 3: Whether FTB has shown that the use of an alternative apportionment method is warranted, pursuant to R&TC section 25137.

Background

R&TC section 25137 provides that if the allocation and apportionment provisions under UDITPA do not fairly represent the extent of the taxpayer's business activity in this state (i.e., there is "distortion"), the taxpayer may petition for or FTB may require, in respect to all or any part of the taxpayer's business activity, if reasonable: (1) separate accounting; (2) the exclusion of any one or more of the factors; (3) the inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state; or (4) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income. Regulation section 25106.5 states that the provided formula for the sales factor of the water's-edge (and worldwide) combined reporting group is applied, "except as modified under Section 25137 of the Revenue and Taxation Code." (Cal. Code Regs., tit. 18, § 25106.5(c)(7)(A)1.b.)

As FTB is the party seeking a deviation from the standard apportionment formula, it has the burden of establishing, by clear and convincing evidence, that: (1) application of the standard apportionment formula does not fairly represent appellant's activities in California; and (2) its proposed alternative apportionment methodology is reasonable.[32] (*Microsoft*, *supra*, 39 Cal.4th at p. 765.) A rough approximation under the general UDITPA standards is all that is required. (*Fluor*, *supra*.) Courts have examined the following two factors in deciding whether

---

[31] Accordingly, there is no need to address whether the receipt of the dividends is substantial and occasional. However, as discussed in Issue 3, the receipt of the repatriated dividends does not qualify as "occasional."

[32] R&TC section 25137 gives "latitude…because no statutory pattern could ever resolve satisfactorily the problems for the multitude of taxpayers with individual business characteristics." (William J. Pierce, The Uniform Division of Income for State Tax Purposes (1957) 35 Taxes 747, 781.)

there is distortion: (1) whether the activities generating the receipts were qualitatively different from the taxpayer's main line of business; and (2) whether the quantitative distortion that arose from the inclusion of the receipts was substantial. (*Microsoft*, *supra*, 39 Cal.4th at p. 766.) The qualitative and quantitative effects do not constitute two separate tests but are examined together in "assessing whether the standard formula fairly represents the company's business activity in California." (*General Mills*, *supra*, 208 Cal.App.4th at p. 1301.) Any one metric alone is not dispositive. (*Id*. at p. 1313.)

Analysis[33]

FTB argues that qualitative and quantitative factors as described in *Microsoft*, *supra*, 39 Cal.4th at p. 766, show that inclusion of the total qualifying dividends in the sales factor denominator results in distortion similar to a substantial and occasional sale. FTB's proposed alternative method is to exclude the dividend gross receipts from the sales factor, analogous to the treatment of a substantial and occasional sale.[34] Accordingly, FTB argues that the sales factor should be approximately 7.30 percent (i.e., $6,874,544,868 ÷ $94,699,397,478), as compared to a sales factor of 3.37 percent which is calculated by including the deducted dividends in the sales factor denominator.[35] FTB points to appellant's sales factor percentages from the last three years of 5.29 percent, 5.68 percent, and 6.68 percent for fiscal years ending June 30, 2015; June 30, 2016; and June 30, 2017; respectively, and contends that the current year percentage of 3.37 breaks the pattern of steady increases. Appellant contends that the change in tax law under the TCJA caused appellant to change its business practices to make actual

[33] The analysis does not address the property and payroll factors because appellant uses the single-sales factor, and the parties make no assertions as to the property or payroll factors.

[34] FTB's proposed method is to exclude all the qualifying dividend from gross receipts, analogous to the treatment that would apply under the substantial and occasional sale provisions provided in Regulation section 25137(c)(1)(A). Appellant's original return included net dividends as gross receipts in the sales factor, and appellant's claim for refund is based on the difference between the net dividends included in the sales factor on the original return, and inclusion of gross dividends as gross receipts in the sales factor in its claim for refund. Therefore, FTB's proposed method would result in appellant owing more tax than is at issue in this appeal. However, OTA can only determine whether to sustain or reverse up to the amount of the claim for refund.

[35] The 3.37 percent sales factor is based on appellant's claim for refund, which included dividends of $109,001,169,787 in the sales factor denominator. As previously discussed, appellant is entitled to include $108,818,839,241 in the sales factor denominator. Therefore, because this Opinion determines that FTB has not shown distortion, the sales factor should be recomputed based upon inclusion of $108,818,839,241 in the sales factor denominator. This appears to result in a sales factor of approximately 3.38 percent (i.e., $6,874,544,868 ÷ $203,518,236,719) rather than 3.37 percent as computed by appellant in its claim for refund.

dividend distributions in the current year and going forward. Appellant argues that, as a result, the repatriation of dividends is now a frequent event and prior year factors do not demonstrate the current year factor is distortive.

As a threshold matter, appellant asserts that if the standard apportionment formula is found to be distortive, any alternative apportionment formula should consider the apportionment factors of the excluded CFCs. FTB asserts that, because appellant elected to use the water's-edge method of reporting, it is bound by that affirmative election pursuant to the "doctrine of elections," citing *Grynberg v. Commissioner* (1984) 83 T.C. 255, 261. FTB states that the doctrine of elections is not codified but applies to "any election that affects the computation of tax" that is made under the CTL, which includes the water's edge rules, citing Senate Bill 1015 (1999). As a result, FTB asserts that the water's-edge rules preclude taking into account the apportionment factors of entities other than to the extent provided by R&TC section 25110(a). Therefore, FTB contends that R&TC section 25137 does not permit the use of an alternative method that would include the apportionment factors of CFCs excluded from the water's-edge group, other than as provided in R&TC section 25110(a). FTB asserts, however, that the water's-edge election does not prevent any request for variance or preclude a determination of whether distortion exists under R&TC section 25137. FTB asserts that distortion must first be shown before an alternative method would be examined and the doctrine of elections would apply to preclude a method contrary to R&TC section 25110(a).[36]

OTA agrees that, based on the language of R&TC section 25137, the issue of whether an alternative method is permitted, such as one that includes the CFC factors in the apportionment formula, does not arise during the distortion examination. It must first be determined if, and on what basis, there is distortion, and only when it is determined that there is distortion can it be determined if an alternative method is reasonable and whether a proposed alternative is precluded by the doctrine of elections. (See *Fluor*, *supra*.) As discussed below, because OTA determines that FTB has not shown distortion, there is no need to address whether an alternative method would be precluded under the doctrine of elections due to appellant's water's-edge election.

[36] For example, in *Media General Communications, Inc. v. South Carolina Dept. of Revenue* (2010) 388 S.C. 138, 147, the parties stipulated that the standard apportionment formulas did not fairly represent the income of the taxpayer; therefore, the only question was the whether the statute (similar to R&TC section 25137) permitted the proposed alternative apportionment method.

Qualitative Difference

Distortion may be found when the standard formula is biased by a substantial activity that is not related to the taxpayer's main line of business. (*Appeal of Crisa Corporation* (2002-SBE-004) 2002 WL 1400003 (*Crisa Corp*).) In *Microsoft*, the court cited two BOE cases, one where the BOE held that the transactions in question were qualitatively different from the taxpayer's principal business, *Appeals of Pacific Telephone and Telegraph Company* (78-SBE-028) 1978 WL 3941 (*Pacific*), and one where the BOE did not find a qualitative difference in the transactions at issue, *Appeal of Merrill, Lynch, Pierce, Fenner, & Smith, Inc*. (89-SBE-017) 1989 WL 95886 (*Merrill*). (*Microsoft*, *supra*, 39 Cal.4th at p. 765.) With regard to *Pacific*, the court in *Microsoft* stated that the case before the court was "analogous to [*Pacific*]…Microsoft's treasury functions are qualitatively different from its principal business, and the quantitative distortion from inclusion of its investment receipts is substantial."[37] (*Microsoft*, *supra*, 39 Cal.4th at p. 766.) With regard to *Merrill,* the court stated that the "taxpayer's sale of securities on its own account was not qualitatively different from its main business...." (*Ibid*.)

In *Microsoft*, the court found that receipts from Microsoft's treasury department were qualitatively different from the main line of business because, while those functions were important and intended to be profitable, the investment activity was only incidental to the principal corporate business purpose. (*Microsoft*, *supra*, 39 Cal.4th at p. 766.) In *General Mills*, the court found that hedging activities were qualitatively different from the main line of business which sold finished products, and while they served a critical supportive function to the ultimate sales of finished products for profit, they would be economically meaningless if separated from the ultimate sales of products for profit. (*General Mills*, *supra*, 208 Cal.App.4th at pp. 1305-1306.)

FTB contends that the present circumstances are analogous to a substantial and occasional sale because appellant received a large amount of gross receipts from the repatriated dividends, and the repatriated dividends were a one-time event due to the enactment of the TCJA and imposition of the transition tax under IRC section 965, and were not part of appellant's

---

[37] Other cases have similarly applied *Pacific*, *supra*, or *Merrill*, *supra*. (See *General Mills*, *supra*, 208 Cal.App.4th at p. 1301; *Limited Stores, Inc. v. Franchise Tax Bd*. (2007) 152 Cal.App.4th 1491, 1499 (*Limited*); *In re Buffets Holdings, Inc*. (2011) 455 B.R. 94, 100 (*Buffets*).)

normal course of business. (See Cal. Code Regs., tit. 18, § 25137(c)(1)(A)2.) Therefore, FTB effectively argues there is a qualitative difference because the dividends were "occasional."

A sale is occasional if the transaction is outside of the taxpayer's normal course of business and occurs infrequently. (Cal. Code Regs., tit. 18, § 25137(c)(1)(A)2.) As stated by the court in *Microsoft*, while R&TC section 25137 ordinarily applies to unique and nonrecurring situations, it does not apply only to such situations; the statutory touchstone remains whether the formula fairly represents a unitary business's activities.[38] (*Microsoft*, *supra*, 39 Cal.4th at p. 770; see also *Crisa Corp*, *supra*.)

In this case, the dividends are not comparable to an "occasional" sale under Regulation section 25137(c)(1)(A). The substantial and occasional sale rules require a separate showing that the sale is "substantial" in addition to a showing that the sale is "occasional." (See Cal. Code Regs., tit. 18, § 25137(c)(1)(A)1.) As a result, while appellant received a large amount of gross receipts due to the repatriated dividends, the examination of whether the dividends would qualify as occasional under Regulation section 25137(c)(1)(A)2. does not take into consideration the size or amount of the gross receipts. Instead, the examination considers whether the dividends were outside appellant's normal course of business and occurred infrequently. (See Cal. Code Regs., tit. 18, § 25137(c)(1)(A)2.)

Here, appellant reported dividend income from both the receipt of repatriated dividends, as well as dividend income from other than repatriated dividends, regularly each year.[39] While the enactment of the TCJA impacted the size of the dividends received from the CFCs in the

---

[38] In *Microsoft*, the court stated that declining to apply R&TC section 25137 to the circumstances in that case would create a significant loophole exploitable, whereby a unitary group could reduce its state tax liability to near zero through subtle changes in investment strategy. (*Microsoft*, *supra*, 39 Cal.4th at p. 770.) However, the evidence does not establish that the present circumstances are comparable to those circumstances described in *Microsoft*, *supra*, 39 Cal.4th at p. 770. The qualifying dividend deduction reducing apportionable net income is statutorily authorized as a deduction at a set percentage. And the TCJA, which was enacted to change prior law that "encouraged domestic corporations to minimize distributions back to the [U.S.] ….", is intended to "encourage repatriation of foreign income…." (*Silver*, *supra*, 531 F.Supp.3d at p. 351.) Therefore, the repatriation of the dividends, which are included as a gross amount in the sales factor denominator, is consistent with the intent of the TCJA.

[39] For the prior three years, appellant reported total dividend income of $2.9 billion, $4.2 billion, and $4.4 billion for fiscal years ending June 30, 2015; June 30, 2016; and June 30, 2017; respectively. These dividend income amounts include income from both repatriated dividends and from other than repatriated dividends. Appellant reported dividend income that included repatriated dividends of $1.3 billion, $609 million, and $1.9 billion for fiscal years ending June 30, 2015; June 30, 2016; and June 30, 2017; respectively. For the current fiscal year, appellant reported $3.3 billion in dividend income from other than the repatriated dividends at issue.

current tax year, it does not change the fact that, each year, appellant regularly received dividends, including repatriated dividends, from its various subsidiaries and CFCs. In addition, appellant did not receive only a single dividend distribution each year from a single subsidiary, but numerous dividends from its different subsidiaries and CFCs.[40] Therefore, appellant regularly received dividends, and the receipt of dividends was not an infrequent event.

In addition to the fact that appellant regularly received repatriated and non-repatriated dividends, the repatriated dividends at issue were not irregular or infrequent on the basis that they resulted from the imposition of the transition tax and enactment of the TCJA. Rather, the dividends were consistent with the intent of the TCJA to incentivize companies, such as appellant, to permanently change their business practices to repatriate—and not defer—repatriation of foreign earnings. (See *Silver*, *supra*, 531 F.Supp.3d at p. 351 [the TCJA is intended to "encourage repatriation of foreign income…."].) The transition tax under IRC section 965 was implemented as part of the "transition" to the new tax system under the TCJA. (See H.R. Rep. 115-409, *supra*, at p. 375 [discussing treatment of deferred foreign income upon transition].) As a result, the repatriated dividends reflect the intent of the TCJA to transition to a new tax system and change business practices in not only the current year, but also going forward. FTB does not provide any other argument or evidence to show the dividends would be "occasional" under Regulation section 25137(c)(1)(A)2. Accordingly, these circumstances are not comparable to an "occasional" sale under FTB's proffered analogy.[41]

---

[40] Dividends are commonly distributed at regular intervals during the year, such as on a quarterly basis. FTB does not provide any evidence regarding the frequency of dividends received by appellant, though FTB states that appellant's CFCs paid dividends to the water's-edge group many times every year.

[41] Because OTA does not find the dividends to be "occasional," this Opinion does not reach the question of whether distortion would be established in this case if, under FTB's analogy, the dividends were found to be both substantial and occasional. As previously noted, the statutory touchstone remains whether the formula fairly represents a unitary business's activities. (*Microsoft*, *supra*, 39 Cal.4th at p. 770.) And as discussed below, this Opinion examines quantitative metrics that take into consideration the amount of dividends included in the sales factor, as described in *Microsoft* and other similar cases, and finds that FTB has not shown sufficient quantitative distortion. (See *Microsoft*, *supra*, 39 Cal.4th at pp. 766-768; *General Mills*, *supra,* 208 Cal.App.4th at pp. 1303, 1308-1312.)

FTB does not provide any other arguments or evidence to establish a qualitative difference. Therefore, FTB has not shown that the activities generating the dividend gross receipts were qualitatively different from appellant's main line of business.[42]

Quantitative Distortion

In *Microsoft*, the court stated that "UDITPA's sales factor contains an implicit assumption that a corporation's margins will not vary inordinately from state to state," which "works well enough in the absence of huge variations in state-to-state margins…." (*Microsoft*, *supra*, 39 Cal.4th at p. 768.) The court added that "the problem is one of scale: short-term securities investments involve margins (i.e., differences between cost and sale price) that may be several orders of magnitude different than those for other commodities." (*Id*. at p. 767.) The court compared the profit margins from the treasury activities to those of its nontreasury activities and found the multiplier separating the margins to be 170, which it held to be distortive because the separation was by "several orders of magnitude."[43] (*Ibid*.)

FTB provides profit margins based on a 100 percent profit margin for the qualified dividends received and 16 percent for appellant's income excluding all the qualifying dividends, as compared to profit margins of less than 0.2 percent for treasury activities and more than 31 percent for nontreasury activities, as examined by the court in *Microsoft*, *supra*, 39 Cal.4th at p. 767.[44] FTB's profit margins, which are based on the dividend income and the income excluding the dividends, are not separated by "several orders of magnitude," but by a multiplier of 6.25, which is a small measure of separation when compared to the multiplier of 170 found to be

[42] This Opinion does not conclude that a determination of whether a sale is outside the normal course of business, as it pertains to Regulation section 25137(c)(1)(A)2., should be equated with the examination of whether certain activities are qualitatively different than those of the main line of business, as described in *Microsoft*, *supra*, 39 Cal.4th at p. 766, and *General Mills*, *supra*, 208 Cal.App.4th at pp. 1305-1306. Rather, this Opinion concludes that FTB has not shown that the dividends are "occasional" under its analogy and has not shown a qualitative difference and, as a result, there is no need to address the matter further.

[43] One order of magnitude generally means a 10 times difference.

[44] FTB's calculation of the profit margin for the qualifying dividends is not a typical profit margin calculation, as it is calculated using dividends distributed by the CFCs, divided by the same amount. FTB calculates the profit margin for all other gross receipts by dividing net income by gross receipts, excluding the qualifying dividends. If the ratio of net income to gross receipts for the qualifying dividends (25 percent) is compared to the ratio of net income to gross receipts for all other sales excluding the qualifying dividends (16 percent), the difference results in a multiplier of only 1.56 percent.

distortive in *Microsoft* and the multipliers found distortive in similar cases.[45] (*Microsoft*, *supra*, 39 Cal.4th at p. 767.) Therefore, the margins provided do not demonstrate a problem of "scale," as was found in *Microsoft*, where the treasury receipt margins were "quite small" when compared to "much higher" margins for nontreasury activities. (*Ibid.*)

In *Microsoft*, the court also determined that the treasury activities produced "minimal income" (less than 2 percent of Microsoft's business income), but "enormous receipts" (73 percent of gross receipts), which it found to be distortive. (*Microsoft*, *supra*, 39 Cal.4th at p. 771.) Here, the parties provide calculations showing that net dividends after accounting for the deduction are 61 percent of net income, and gross dividends are 53 percent of gross receipts.[46] This is not comparable to *Microsoft*, where "the net receipts are so small in comparison with Microsoft's nontreasury income and receipts…." (*Ibid.*) This is because the net dividends of $27 billion contributed a significant amount to the tax base, which is approximately $17 billion when excluding the net dividends; whereas in *Microsoft*, the net income from the treasury activities was $10.7 million as compared to nontreasury activities which produced income of $659 million. (See *Microsoft*, *supra*, 39 Cal.4th at p. 767.)

In *Microsoft*, the court considered the amount of the business activities attributed to a single state due to inclusion of the treasury function receipts in the sales factor, noting that its analysis was based on *Pacific*, *supra*. (*Microsoft*, *supra*, 39 Cal.4th at p. 765.) In *Pacific*, the BOE found that, because investment activities accounted for 2 percent of net income but 34 percent of total gross receipts, the proportional difference was distortive because an "incidental" part of the business was being attributed a large amount of activity which caused a single state to be assigned approximately 11 percent of Pacific's business income. (*Pacific*, *supra*.) Here, while inclusion of the gross dividends in the sales factor causes 53 percent of appellant's business activities to be attributed to foreign jurisdictions, the dividends account for 61 percent of net income subject to apportionment and, therefore, comprise a significant amount

[45] Examples of other profit margin multipliers found to be distortive include 460, 53, and 81. (See *Limited*, *supra*, 152 Cal.App.4th at p. 1500; *Buffets*, *supra*, 455 B.R. at pp. 100-101; *General Mills*, *supra*, 208 Cal.App.4th at pp. 1311-1312.).

[46] $27,387,040,356 of the dividends included in net income divided by total net income of $44,387,432,997 = approximately 61 percent; $108,818,839,241 of the dividends included as gross receipts, divided by total gross receipts of $203,518,236,719 = approximately 53 percent.

DocuSign Envelope ID: 783E88BC-3614-4606-BF34-4BA4F51C6E51

of income to be apportioned.[47] As a result, these circumstances are not comparable to cases such as *Pacific* or *Microsoft*, where it was found that the location of a qualitatively different part of the business was attributed an "enormous volume" of activity which "substantially overloads the sales factor" and inadequately reflects the states' contributions.[48] (See *Pacific*, *supra*; *Microsoft*, *supra*, 39 Cal.4th at pp. 765-766.)

Quantitative distortion has also been examined by considering the degree to which inclusion of the challenged activity ultimately affects the result under the standard apportionment formula. (See *General Mills*, *supra*, 208 Cal.App.4th at p. 1312.) In *Merrill*, *supra*, calculations showing a 5.86 percent to 3.43 percent change in the apportionment formula, i.e., a 41 percent decrease, and calculations showing a 36 percent difference between apportionment formulas, were not enough to establish distortion. The BOE stated that the difference was "certainly within the substantial margin of error inherent in any method of attributing income among the components of a unitary business." (*Merrill*, *supra*.) Here, the change in the apportionment formula is from 5.63 percent to 3.37 percent, a 40 percent decrease, which is comparable to the percent change in *Merrill*. As stated in *Merrill*, distortion is not established just because "the statutory method results in a bigger denominator and a smaller numerator than would occur under the [proposed] method." (*Ibid.*)

FTB contends that the sales factors from the prior three years show a steady pattern of increases that is disrupted by significant gross receipts in the denominator of the current year sales factor.[49] However, a change in the apportionment formula alone is "unavailing" and does

---

[47] See footnote 46.

[48] In *Pacific*, *supra*, the receipts from investments activities accounted for 34 percent of total receipts, with 11 percent of income assigned to the investment activity location (34 percent ÷ 3 for a single-weighted factor) and the treasury activity accounting for 2 percent of the company's net income. In *Microsoft*, the court found that 24 percent of the unitary business would be attributable to the state of Washington and would inadequately reflect the contributions made by all other states (24 percent = [total redemptions of $5.7 billion ÷ total sales of $7.8 billion] ÷ 3 for a single-weighted factor). (*Microsoft*, *supra*, 39 Cal.4th at pp. 767, 769, fn. 19.) In addition, the treasury department investments accounted for $10.7 million (1.6 percent) of the net income subject to apportionment which totaled approximately $670 million ($10.7 million + $659 million). (*Microsoft*, at p. 767.)

[49] In *Crisa Corp*, *supra*, the BOE provided examples of unusual fact situations that may cause distortion, including when the factors in the standard formula are mismatched to the time during which the income is generated, citing *Appeal of Donald M. Drake Company* (77-SBE-012) 1977 WL 3823 (*Drake*). In *Drake*, *supra*, the BOE held there was distortion because the "income from the joint ventures, although recognized and apportioned in the year of completion, was actually earned at least partially through business activity in a prior year or years." FTB does not argue or provide evidence of distortion for the reasons provided in *Drake*. Instead, FTB points to prior years and argues they demonstrate distortion due to the current year factor breaking the trend of increases in prior year factors.

not prove distortion; rather, it must be shown that the standard method does not fairly reflect the taxpayer's business activity. (*Merrill*, *supra*.) The dividend repatriation was the result of a widespread change in tax law which was intended to incentivize companies to change business practices so that foreign subsidiaries would make dividend distributions to U.S. shareholders. The prior rules "encouraged domestic corporations to minimize distributions back to the [U.S.] and to accumulate substantial earnings offshore," whereas "the rules enacted by the TCJA… encourage repatriation of foreign income…." (*Silver*, *supra*, 531 F.Supp.3d at p. 351; see also H.R. Rep. 115-409, *supra*, at p. 370 [TCJA "will remove tax-driven incentives to keep funds offshore"].) As a result, appellant's repatriation of earnings was consistent with the intent of the TCJA. In addition, because the TCJA incentivizes companies to repatriate earnings in years after the year at issue, companies such as appellant are incentivized to change their business practices going forward. As a result, the pattern in the sales factors for prior years is not dispositive here in showing distortion. In addition, the change in the apportionment percentage is consistent with the change in business practice to repatriate dividends. Accordingly, FTB has not shown that the inclusion of the repatriated dividends in the sales factor results in quantitative distortion.[50]

Conclusion

FTB has not met its burden to show by clear and convincing evidence that the standard apportionment formula does not fairly represent appellant's activity in California.[51]

[50] A determination under R&TC section 25137 is a fact-specific inquiry and depends on the circumstances of the case. (See *Amarr*, *supra*.) Therefore, while FTB has not shown distortion here, that does not mean distortion could not be found in other circumstances involving repatriated dividends subject to the qualifying dividend deduction, where gross repatriated dividends are included in the apportionment formula and net repatriated dividends are included in apportionable net income.

[51] Because distortion has not been shown, there is no need to address whether FTB's proposed alternative method is reasonable.

HOLDINGS

1. Qualifying dividends deducted from income pursuant to R&TC section 24411 are includable in appellant's sales factor.
2. Gross receipts from the qualifying dividends should not be excluded from the sales factor as a substantial and occasional sale, pursuant to Regulation section 25137(c)(1)(A).
3. FTB has not shown that the use of an alternative apportionment method is warranted, pursuant to R&TC section 25137.

DISPOSITION

FTB's action denying the claim for refund is partially reversed to recompute the sales factor to increase gross receipts included in the sales factor denominator to include the total amount of qualifying dividends of $108,818,839,241. FTB's action is otherwise sustained.[52]

DocuSigned by:
Josh Lambert
CB1F7DA37831416...

Josh Lambert
Administrative Law Judge

We concur:

DocuSigned by:
Sheriene Anne Ridenour
67F043D83EF547C...

Sheriene Anne Ridenour
Administrative Law Judge

DocuSigned by:
John O Johnson
873D9797B9E64E1...

John O. Johnson
Administrative Law Judge

Date Issued: 7/27/2023

[52] Appellant filed a claim for refund for tax of $93,901,901 with FTB, based on the inclusion of $109,001,169,787 in the sales factor denominator. As determined in Issue 1 of this Opinion, qualifying dividends of $108,818,839,241 are considered gross receipts includable in the sales factor denominator. Therefore, appellant is entitled to a refund of tax to be computed based on the holding of this Opinion to include $108,818,839,241 in the sales factor denominator. To the extent the tax for which appellant claimed a refund exceeds the amount of tax as determined pursuant to the holding of this Opinion, FTB's action in denying the claim for refund is sustained.

EXHIBIT 3

Bill Text: CA SB167 | 2023-2024 | Regular Session | Enrolled California Senate Bill 167

NOTE: There are more recent revisions of this legislation. Read Latest Draft

Bill Title: Taxation.

Spectrum: Committee Bill

Status: *(Passed)* 2024-06-27 - Chaptered by Secretary of State. Chapter 34, Statutes of 2024. [SB167 Detail]

Download: California-2023-SB167-Enrolled.html

ENROLLED JUNE 13, 2024

PASSED IN SENATE JUNE 13, 2024

PASSED IN ASSEMBLY JUNE 13, 2024

AMENDED IN ASSEMBLY JUNE 10, 2024

CALIFORNIA LEGISLATURE— 2023–2024 REGULAR SESSION

SENATE BILL **NO. 167**

Introduced by Committee on Budget and Fiscal Review

January 18, 2023

An act to amend Section 11340.9 of the Government Code, to amend Section 25299.81 of the Health and Safety Code, to amend Sections 42885, 42886.1, and 42889 of, and to repeal Section 42882 of, the Public Resources Code, to amend Sections 6902.5, 7103, 17052.1, 17052.2, 17209, 17260, 17275.5, 17681, 18416.5, 18572, 19164, 19187, 23036, 24357, 24831, and 50108 of, to amend and repeal Sections 17052.8, 19378, and 23604 of, to amend, repeal, and add Sections 6055 and 6203.5 of, to add Sections 17039.4, 17275.6, 17276.24, 23036.4, 24416.24, and 25128.9 to, and to repeal Sections 17681.3, 17681.6, 24423, 24831.3, and 24831.6 of, the Revenue and Taxation Code, and to amend Section 8163 of the Welfare and Institutions Code, relating to taxation, and making an appropriation therefor, to take effect immediately, bill related to the budget.

LEGISLATIVE COUNSEL'S DIGEST

SB 167, Committee on Budget and Fiscal Review. Taxation.

(1) The Administrative Procedure Act governs the procedure for the adoption, amendment, or repeal of regulations by state agencies and for the review of those regulatory actions by the Office of Administrative Law. Existing law makes the act inapplicable in certain circumstances, including pursuant to a legal ruling of counsel issued by the Franchise Tax Board or the State Board of Equalization.

This bill would also make the act inapplicable pursuant to a legal ruling of counsel issued by the California Department of Tax and Fee Administration.

(2) The California Tire Recycling Act, until January 1, 2034, requires a person who purchases a new tire, as defined, to pay a California tire fee of $1.75 per tire, for deposit, except for $1^1/_2$% retained by retailers and as provided below, in the California Tire Recycling Management Fund for expenditure by the Department of Resources Recycling and Recovery upon appropriation by the Legislature for prescribed purposes related to disposal and use of used tires. Commencing January 1, 2034, existing law reduces the California tire fee to $0.75 per tire and changes the retailers' share to 3%. Existing law authorizes the department, in carrying out the act, to solicit and use any and all expertise available in, and to contract or cooperate with, other state agencies, as provided. Existing law authorizes the

department to contract with the California Department of Tax and Fee Administration to collect the California tire fee. Existing law requires the department, or its authorized agent, to be reimbursed for its costs of collection, auditing, and making refunds associated with the California Tire Recycling Management Fund, in an amount not to exceed 3% of the total annual revenue deposited in the fund.

Existing law requires the payment of sales and use taxes, and specified taxes, fees, and surcharges that are administered by the California Department of Tax and Fee Administration under the provisions of the Sales and Use Tax Law and the Fee Collection Procedures Law, respectively. A violation of the Fee Collection Procedures Law is a crime.

This bill would repeal the authorization to solicit and use any and all expertise available in, and to contract or cooperate with, other state agencies for purposes of the California Tire Recycling Act. The bill would also repeal the requirement that the department be reimbursed for its costs of collection, auditing, and making refunds associated with the California Tire Recycling Management Fund, as described. The bill would also require the California Department of Tax and Fee Administration to collect the fee imposed by the act pursuant to the Fee Collection Procedures Law. By expanding the scope of crimes, the bill would impose a state-mandated local program.

(3) The Sales and Use Tax Law (SUT) imposes taxes on retailers measured by the gross receipts from the sale of tangible personal property sold at retail in this state, or on the storage, use, or other consumption in this state of tangible personal property purchased from a retailer for storage, use, or other consumption in this state, measured by sales price. The SUT relieves a retailer of liability for sales and use tax, insofar as the measure of the tax is represented by accounts that have been found to be worthless and charged off, either for income tax purposes or based on generally accepted accounting principles, as specified, and defines "retailer" for that purpose to include certain entities affiliated with the retailer, as specified. The SUT also, if an account is held by a lender, entitles a retailer or lender that makes a proper election, as specified, to a deduction or refund of the tax that the retailer has previously reported and paid if certain conditions are met, including that the account has been found worthless and written off by the lender pursuant to the provision described above.

This bill would sunset the definition of "retailer" described above on January 1, 2025, and would require an account to have been found worthless and written off by the lender before January 1, 2025, in order for the lender to be entitled to the deduction or refund described above. The bill would, on January 1, 2028, repeal the provision described above regarding accounts held by a lender.

(4) Under existing law, the taxes imposed by the Sales and Use Tax Law are due and payable to the California Department of Tax and Fee Administration on or before the last day of the month next succeeding each quarterly period. Existing law requires that a return for the preceding quarterly period be filed with the department on or before the last day of the month following each quarterly period, as provided. The Historic Venue Restoration and Resiliency Act requires a return filed with the department to report gross receipts for sales tax purposes to segregate the taxable sales on a line or a separate form, as prescribed by the department, if the place of sale in this state is on or within the real property of a confirmed historic venue, as defined, on the day of a qualified event and requires the department to report the amount of the total gross receipts segregated on the returns filed for the prior fiscal year to the Department of Finance on or before November 1 of each year, as prescribed. The act creates the Historic Venue Restoration and Resiliency Fund and continuously appropriates the moneys in the fund for transmission by the Controller to cities and counties with historic venues, as specified. The act requires an amount equal to 5% of the total amount of gross receipts, or adjusted gross receipts, for the prior fiscal year reported to the Department of Finance by the department to be included in the next annual Governor's Budget for deposit into the fund and requires the Controller to, no later than 30 days after the enactment of the annual Budget Act, transfer the amount appropriated by the Legislature to the Controller, as described above, to the fund. Existing law repeals these provisions on July 1, 2030.

This bill would, among other changes related to the administration of the act, require that the return filed with the department, and the report to the Department of Finance, as described above, specify the taxable sales made at a qualified event for each confirmed historic venue. The bill would extend operation of the act's provisions until November 1, 2030, but would limit the requirement to segregate taxable sales on the return to qualified events that occur on or before June 30, 2029. The bill would additionally require, no later than 15 days after enactment of the annual Budget Act, the Department of Finance to, for each confirmed historic venue located within the geographic boundaries of a city or county, report to the Controller the amounts to be allocated from the fund to each city and county, as prescribed.

The act requires a city or county with a confirmed historic venue to notify, within 90 days of any qualified event at the confirmed historic venue, any retailers subject to the return requirement described above making sales at the confirmed historic venue.

This bill would instead require a city or county, or its designee, to, at least 10 days before a qualified event scheduled to take place at a confirmed historic venue within the geographic boundaries of that city or county, notify any retailers subject to the return requirement described above that the city or county, or its designee, knows, or has reason to know, will be making sales during that qualified event of that return requirement.

The act requires, on or before January 1, 2027, and annually thereafter, a city or county, as defined, that receives money from the fund to deliver a report to the department regarding how that money is being used.

This bill would delete that provision.

The act requires the department to annually deliver a report to specified committees of the Legislature concerning, among other things, the amount of revenue transmitted to a city or county with respect to each confirmed historic venue.

This bill would specify that this annual report is due November 1 of each year. The bill would require the Controller to provide the department with the information related to the allocation of revenue to cities and counties, as described above, on or before September 1 of each year.

(5) The Personal Income Tax Law and the Corporation Tax Law, in modified conformity with federal income tax laws, allow various deductions in computing the income that is subject to the taxes imposed by those laws, including a deduction for a net operating loss, as specified. Existing law disallows the net operating loss deduction, as specified, for taxable years beginning on or after January 1, 2020, and before January 1, 2022.

This bill would disallow the net operating loss deduction for taxable years beginning on or after January 1, 2024, and before January 1, 2027.

(6) The Personal Income Tax Law and the Corporation Tax Law authorize various credits against the taxes imposed by those laws. Existing law, for taxable years beginning on or after January 1, 2020, and before January 1, 2022, limits the total tax reduction by all business credits, as defined, to $5,000,000 per taxable year, and allows the amounts disallowed by that limit to be carried over, as specified.

This bill would similarly apply a $5,000,000 business credit limit and related carryover provisions to taxable years beginning on or after January 1, 2024, and before January 1, 2027, as provided, unless a specified exception applies. The bill would also state the intent of the Legislature to enact legislation allowing taxpayers to utilize their credits after the limitation period ends by electing to receive a refund of those tax credits, as specified.

(7) The Sales and Use Tax Law, in lieu of specified credits allowed under the Personal Income Tax Law and the Corporation Tax Law for qualified expenditures paid or incurred by a taxpayer for the production of a qualified motion picture, allows a qualified taxpayer or affiliate to make an irrevocable election to apply that income tax credit amount against qualified sales and use taxes imposed on the qualified taxpayer in the reporting periods in the following 5 years. Under existing law, amounts included in the election are excluded from the $5,000,000 business credit limitation described above.

Existing law, for irrevocable elections made on and after June 29, 2020, imposes, until January 1, 2022, a cap of $5,000,000 per taxable year on those tax credit amounts the taxpayer would otherwise be allowed to apply against those sales and use taxes for taxable years beginning on or after January 1, 2020, and before January 1, 2022, as specified.

This bill similarly, for irrevocable elections made on and after the operative date of this bill, would impose, until January 1, 2027, that $5,000,000 per taxable year cap for taxable years beginning on or after January 1, 2024, and before January 1, 2027, as specified.

(8) The Personal Income Tax Law, beginning on or after January 1, 2015, in modified conformity with federal income tax laws, allows an Earned Income Tax Credit against personal income tax and a payment from the Tax Relief and Refund Account for an allowable credit in excess of tax liability to an eligible individual that is equal to that portion of the Earned Income Tax Credit allowed by federal law, as determined by the earned income tax credit adjustment factor, as specified. That credit phases out based on specified tables as the qualified taxpayer's income increases.

The Personal Income Tax Law also allows a refundable young child tax credit against the taxes imposed under that law for each taxable year beginning on or after January 1, 2019, and a refundable foster youth tax credit for taxable years beginning on or after January 1, 2022, to a qualified taxpayer in a specified amount multiplied by the earned income tax credit adjustment factor, as provided. Those credits are reduced by a specified amount for each $100 the qualified taxpayer earns beyond a threshold amount.

This bill would require the Franchise Tax Board to calculate a graduated reduction amount for the young child tax credit and the foster youth tax credit so that the amount of those credits is equal to zero for a qualified taxpayer that earns more than the maximum amount of earned income that results in a California Earned Income Tax Credit greater than $0. The bill would apply that new graduated reduction amount for taxable years beginning on or after January 1, 2024. By increasing the payments from the Tax Relief and Refund Account, a continuously appropriated fund, the bill would make an appropriation.

(9) The Corporation Tax Law, for taxable years beginning on or after January 1, 2016, and before January 1, 2031, allows, with regard to the manufacture of a new advanced strategic aircraft for the United States Air Force, a credit against the taxes imposed under that law for $17^1/_2$% of qualified wages, as defined, paid or incurred by the qualified taxpayer to qualified full-time employees, subject to specified limitations. The Corporation Tax Law provides for an alternative minimum tax and provides that, except for specified credits, no credit shall reduce the regular tax, as defined, below the tentative minimum tax. Existing law, for taxable years beginning on or after January 1, 2020, and before January 1, 2026, authorizes the strategic aircraft credit to reduce the regular tax below the tentative minimum tax.

This bill would extend that authorization through taxable years beginning before January 1, 2031.

(10) The Personal Income Tax Law and the Corporation Tax Law, in modified conformity with federal income tax laws, allow a credit calculated based on a taxpayers qualified enhanced oil recovery costs, as defined.

This bill would provide the above-referenced credit applies for taxable years beginning before January 1, 2024, and would repeal the credit effective December 1, 2024.

(11) The Personal Income Tax Law and the Corporation Tax Law, in modified conformity with federal income tax laws, allow a deduction for intangible drilling and development costs in the case of oil and gas wells and geothermal wells, and a deduction for depletion of natural resource deposits. That law calculates the deduction for depletion of natural resource deposits as a percentage of gross income from the property in the case of specified natural resources, including oil, gas, and shale.

This bill would disallow the deduction for intangible drilling and development costs in the case of oil and gas wells paid or incurred on or after January 1, 2024. The bill would also disallow, for taxable years beginning on or after January 1, 2024, the calculation of depletion as a percentage of gross income from the property for specified natural resources, including coal, oil, oil shale, and gas.

(12) Existing federal law provides that refiners of crude oil with average daily refinery runs for a taxable year that are greater than 75,000 barrels cannot calculate a depletion deduction as a percentage of gross income, as described above. Existing state law does not conform to this exception for large producers.

This bill would repeal the provision that provides state law does not conform to the above-described exception.

(13) The Personal Income Tax Law conforms as of a specified date to federal income tax laws with respect to itemized deductions, including business deductions and items not deductible, except as specifically provided. The Corporation Tax Law does not conform to those federal income tax provisions, but specifically provides for deductions for purposes of that law.

Existing federal income tax laws disallow a deduction or credit for business expenses of a trade or business whose activities consist of trafficking specified controlled substances, including marijuana. For taxable years beginning on or after January 1, 2020, and before January 1, 2025, the Personal Income Tax Law does not conform to those federal income tax law provisions with respect to deductions.

This bill would extend the provisions of the Personal Income Tax Law that specifically do not conform to federal income tax law with respect to the above-referenced deductions through taxable years beginning before January 1, 2030.

(14) The Personal Income Tax Law and the Corporation Tax Law, in modified conformity with federal income tax law, allow a deduction for qualified conservation contributions, as defined. Existing federal law, the Consolidated Appropriations Act, 2023, among other things, imposed limitations and reporting requirements upon the deduction for qualified conservation contributions. That act also made conforming changes relating to statute of limitations and penalties, as specified.

This bill, for contributions made on or after January 1, 2024, would conform state law to the above-referenced changes in federal law, except as provided, and would make additional conforming changes.

(15) Existing law authorizes the Franchise Tax Board to implement an alternative communication method that would allow the Franchise Tax Board to provide notification to the taxpayer in a preferred electronic communication method designated by the taxpayer that a specified notice, statement, bill, or other communication is available for viewing in the taxpayer’s folder on the Franchise Tax Board’s internet website, and would allow the taxpayer to file a protest, notification, and other communication to the Franchise Tax Board in a secure manner. This provision ceases to be operative and is repealed on January 1, 2025.

This bill would extend that provision indefinitely.

(16) The Personal Income Tax Law and the Corporation Tax Law, in modified conformity with federal income tax laws, provide for the postponement of certain tax-related deadlines in the case of a declared state of emergency. Under existing law, the Franchise Tax Board determines whether a taxpayer is affected by a state of emergency declared by the Governor.

This bill would instead require the Director of Finance to determine whether a taxpayer is affected by a state of emergency. The bill would require the above-described federal income tax laws, relating to the postponement of certain tax-related deadlines, to apply to an impacted taxpayer during an additional relief period that requests relief, as specified. The bill would define various terms for these purposes, including an impacted taxpayer to mean a taxpayer who, among other things, requests relief, as specified, and who is required, upon request, to submit supporting documentation related to the declared disaster, as provided. The bill would define supporting documentation to mean, among other things, a statement, signed under penalty of perjury, from a tax professional indicating the impacted taxpayer’s books and records, as described, were destroyed in the disaster area or jurisdiction for which the Governor has proclaimed a state of emergency. By expanding the scope of the crime of perjury, the bill would impose a state-mandated local program. The bill would authorize the Franchise Tax Board to adopt regulations that are necessary or appropriate to implement these provisions, as specified. The bill would state that its provisions apply to any federally declared disaster or Governor-proclaimed state of emergency on or after the effective date of the bill.

(17) The Personal Income Tax Law and the Corporation Tax Law authorize the Franchise Tax Board to enter an agreement for purposes of collecting delinquent accounts with respect to amounts assessed or imposed under those laws. Existing law requires the Franchise Tax Board to notify the Controller of its contracting costs under the above-described agreements, and requires the Controller to transfer that amount to the continuously appropriated Delinquent Tax Collection Fund for the purpose of reimbursing the Franchise Tax Board for its contracting costs.

This bill would repeal the provisions relating to reimbursement of the Franchise Tax Board for the above-described costs, and would terminate the Delinquent Tax Collection Fund, as of June 30, 2024.

(18) The Corporation Tax Law imposes taxes measured by net income on every corporation doing business within the limits of this state, subject to certain exceptions. In the case of a business with business income derived from or attributable to sources both within and without this state, existing law, the Uniform Division of Income for Tax Purposes Act, apportions the business income between this state and other states and foreign countries by multiplying the business income by the sales factor, except as provided. Existing law provides that certain amounts are not included in income for various reasons, including, but not limited to, exclusion, deduction, exemption, or nonrecognition. Under existing law, the Franchise Tax Board does not include in the apportionment formula amounts that do not give rise to apportionable income.

This bill would exclude from the apportionment formula any amount that does not give rise to apportionable income, consistent with existing law and practice of the Franchise Tax Board, as described above. This bill would make findings and declarations relating to the intent of the Legislature that the provisions of the bill are not a change in, but are declaratory of, existing law. The bill would apply these provisions to taxable years beginning before, on, or after the effective date of this bill.

(19) Existing law authorizes a one-time Better for Families Tax Refund payment to each qualified recipient, as defined, in an applicable amount, as specified. That law requires that each payment include an expiration date, and that any unexpended or unclaimed balance

of the payments issued be returned to the state no later than May 31, 2026.

This bill would instead require any unexpended or unclaimed balance to be returned to the Franchise Tax Board, which will deposit the moneys in the General Fund.

(20) Existing law, the Barry Keene Underground Storage Tank Cleanup Trust Fund Act of 1989, requires an owner of an underground storage tank, as defined, for which a permit is required by law to pay storage fees for each gallon of petroleum placed into the tank. The act establishes the Underground Storage Tank Cleanup Fund and requires the storage fees, among other moneys, to be deposited into the fund. The act authorizes the State Water Resources Control Board to expend the moneys in the fund, upon appropriation by the Legislature, to pay for corrective actions in response to unauthorized releases from underground storage tanks and for the cleanup and oversight of unauthorized releases at abandoned tank sites, among other specified purposes.

The act provides for the repeal of certain provisions on January 1, 2036, but also provides that certain associated rights, obligations, and authorities that apply before the January 1, 2036, repeal date do not terminate upon repeal of the other provisions of the act, such as the collection of unpaid fees by the California Department of Tax and Fee Administration for deposit into the fund, as specified.

This bill would additionally provide that the making of any refunds and effecting any credits, the disposition of the moneys collected, and the commencement of any action or proceeding regarding certain fees do not terminate upon repeal of the act. The bill would also provide that the payment of administrative costs of the department and certain refunds do not terminate upon repeal of the act, as specified.

(21) The bill would state that its provisions are severable.

(22) This bill would include a change in state statute that would result in a taxpayer paying a higher tax within the meaning of Section 3 of Article XIII A of the California Constitution, and thus would require for passage the approval of $^{2}/_{3}$ of the membership of each house of the Legislature.

(23) The California Constitution requires the state to reimburse local agencies and school districts for certain costs mandated by the state. Statutory provisions establish procedures for making that reimbursement.

This bill would provide that no reimbursement is required by this act for a specified reason.

(24) This bill would declare that it is to take effect immediately as a bill providing for appropriations related to the Budget Bill.

Digest Key

Vote: 2/3 Appropriation: yes Fiscal Committee: yes Local Program: yes

---

Bill Text

THE PEOPLE OF THE STATE OF CALIFORNIA DO ENACT AS FOLLOWS:

SECTION 1. Section 11340.9 of the Government Code is amended to read:

11340.9. This chapter does not apply to any of the following:

(a) An agency in the judicial or legislative branch of the state government.

(b) A legal ruling of counsel issued by the Franchise Tax Board, State Board of Equalization, or the California Department of Tax and Fee Administration.

(c) A form prescribed by a state agency or any instructions relating to the use of the form, but this provision is not a limitation on any requirement that a regulation be adopted pursuant to this chapter when one is needed to implement the law under which the form is issued.

(d) A regulation that relates only to the internal management of the state agency.

(e) A regulation that establishes criteria or guidelines to be used by the staff of an agency in performing an audit, investigation, examination, or inspection, settling a commercial dispute, negotiating a commercial arrangement, or in the defense, prosecution, or settlement of a case, if disclosure of the criteria or guidelines would do any of the following:

(1) Enable a law violator to avoid detection.

(2) Facilitate disregard of requirements imposed by law.

(3) Give clearly improper advantage to a person who is in an adverse position to the state.

(f) A regulation that embodies the only legally tenable interpretation of a provision of law.

(g) A regulation that establishes or fixes rates, prices, or tariffs.

(h) A regulation that relates to the use of public works, including streets and highways, when the effect of the regulation is indicated to the public by means of signs or signals or when the regulation determines uniform standards and specifications for official traffic control devices pursuant to Section 21400 of the Vehicle Code.

(i) A regulation that is directed to a specifically named person or to a group of persons and does not apply generally throughout the state.

SEC. 2. Section 25299.81 of the Health and Safety Code is amended to read:

25299.81. (a) Except as provided in subdivisions (b) and (c), this chapter shall remain in effect only until January 1, 2036, and as of that date is repealed.

(b) Notwithstanding subdivision (a), this section, Article 1 (commencing with Section 25299.10), Article 2 (commencing with Section 25299.11), and Article 4 (commencing with Section 25299.36) shall not be repealed and shall remain in effect on January 1, 2036.

(c) The repeal of certain portions of this chapter does not terminate any of the following rights, obligations, or authorities, or any provision necessary to carry out these rights and obligations:

(1) The filing and payment of claims against the fund, including the costs specified in subdivisions (c), (e), and (h) of Section 25299.51, claims filed under Section 25299.50.3, and claims for commingled plumes, as specified in Article 11 (commencing with Section 25299.90), until the moneys in the fund are exhausted. Upon exhaustion of the fund, any remaining claims shall be invalid.

(2) The repayment of loans, outstanding as of January 1, 2036, due and payable to the board.

(3) The recovery of moneys reimbursed to a claimant to which the claimant is not entitled, or the resolution of any cost recovery action.

(4) The collection of unpaid fees by the California Department of Tax and Fee Administration pursuant to the Underground Storage Tank Maintenance Fee Law (Part 26 (commencing with Section 50101) of Division 2 of the Revenue and Taxation Code) that are imposed pursuant to Article 5 (commencing with Section 25299.40), as that article read on December 31, 2035, or have become due before January 1, 2036, including any interest or penalties that accrue before, on, or after January 1, 2036, associated with those unpaid fees, the making of any refunds and effecting of any credits, the disposition of the moneys collected, and the commencement of any action or proceeding regarding fees imposed pursuant to Article 5 (commencing with Section 25299.40).

(5) The payment for the administrative costs of the California Department of Tax and Fee Administration pursuant to subdivision (b) of Section 25299.51 and refunds pursuant to subdivision (g) of Section 25299.51.

(6) (A) The filing of an application for funds from, and the making of payments from, the Underground Storage Tank Petroleum Contamination Orphan Site Cleanup Fund pursuant to Section 25299.50.2, any action for the recovery of moneys paid pursuant to Section 25299.50.2 to which the recipient is not entitled, and the resolution of that cost recovery action.

(B) Upon liquidation of funds in the Underground Storage Tank Petroleum Contamination Orphan Site Cleanup Fund, the obligation to make a payment from the Underground Storage Tank Petroleum Contamination Orphan Site Cleanup Fund is terminated.

(7) (A) The payment of loans and grants, consistent with the terms of agreements that were effective before January 1, 2036, from the fund pursuant to this chapter or the Petroleum Underground Storage Tank Financing Account pursuant to Chapter 6.76 (commencing with Section 25299.100). Upon exhaustion of the fund, any remaining claims for payment of grants or loans shall be invalid.

(B) The amount of money disbursed for grants and loans pursuant to Chapter 6.76 (commencing with Section 25299.100) shall not exceed the sum of the following:

(i) The amount that reverts to the fund pursuant to Section 25299.111.

(ii) Amounts recovered through the repayment of loans granted pursuant to Chapter 6.76 (commencing with Section 25299.100).

(iii) The resolution of any cost recovery action filed before January 1, 2036, or the initiation of an action or other collection process to recover defaulted loan moneys due to the board or to recover money paid to a grant or loan recipient pursuant to Chapter 6.76 (commencing with Section 25299.100) to which the recipient is not entitled.

(8) (A) The imposition and collection of civil liability pursuant to Article 7 (commencing with Section 25299.70), as that article read on December 31, 2035.

(B) Subparagraph (A) shall not be construed as extending or modifying any applicable statute of limitations.

(d) The board shall continuously post and update on its internet website, but at a minimum, annually on or before September 30, information that describes the status of the fund and shall make recommendations, when appropriate, to improve the efficiency of the program.

SEC. 3. Section 42882 of the Public Resources Code is repealed.

SEC. 4. Section 42885 of the Public Resources Code, as amended by Section 20 of Chapter 355 of the Statutes of 2022, is amended to read:

42885. (a) For purposes of this section, “California tire fee” means the fee imposed pursuant to this section.

(b) (1) A person who purchases a new tire, as defined in subdivision (g), shall pay a California tire fee of one dollar and seventy-five cents ($1.75) per tire.

(2) The retail seller shall charge the retail purchaser the amount of the California tire fee as a charge that is separate from, and not included in, any other fee, charge, or other amount paid by the retail purchaser.

(3) The retail seller shall collect the California tire fee from the retail purchaser at the time of sale and may retain $1^{1}/_{2}$ percent of the fee as reimbursement for any costs associated with the collection of the fee. The retail seller shall remit the remainder to the state on a quarterly schedule for deposit in the California Tire Recycling Management Fund, which is hereby created in the State Treasury.

(c) The California Department of Tax and Fee Administration shall collect the fee imposed by this article pursuant to the Fee Collection Procedures Law (Part 30 (commencing with Section 55001)) of Division 2 of the Revenue and Taxation Code. For purposes of this section, the reference in the Fee Collection Procedures Law to “feepayer” shall include a person required to pay the fee imposed by this section, which includes the retail seller.

(d) The California tire fee imposed pursuant to subdivision (b) shall be separately stated by the retail seller on the invoice given to the customer at the time of sale. Any other disposal or transaction fee charged by the retail seller related to the tire purchase shall be identified separately from the California tire fee.

(e) A person or business who knowingly, or with reckless disregard, makes a false statement or representation in a document used to comply with this section is liable for a civil penalty for each violation or, for continuing violations, for each day that the violation continues. Liability under this section may be imposed in a civil action and shall not exceed twenty-five thousand dollars ($25,000) for each violation.

(f) In addition to the civil penalty that may be imposed pursuant to subdivision (e), the department may impose an administrative penalty in an amount not to exceed five thousand dollars ($5,000) for each violation of a separate provision or, for continuing violations, for each day that the violation continues, on a person who intentionally or negligently violates a permit, rule, regulation, standard, or requirement issued or adopted pursuant to this chapter. The department shall adopt regulations that specify the amount of the administrative penalty and the procedure for imposing an administrative penalty pursuant to this subdivision.

(g) For purposes of this section, “new tire” means a pneumatic or solid tire intended for use with onroad or off-road motor vehicles, motorized equipment, construction equipment, or farm equipment that is sold separately from the motorized equipment, or a new tire sold with a new or used motor vehicle, as defined in Section 42803.5, including the spare tire, construction equipment, or farm equipment. “New tire” does not include retreaded, reused, or recycled tires.

(h) The California tire fee shall not be imposed on a tire sold with, or sold separately for use on, any of the following:

(1) A self-propelled wheelchair.

(2) A motorized tricycle or motorized quadricycle, as defined in Section 407 of the Vehicle Code.

(3) A vehicle that is similar to a motorized tricycle or motorized quadricycle and is designed to be operated by a person who, by reason of the person’s physical disability, is otherwise unable to move about as a pedestrian.

(i) This section shall remain in effect only until January 1, 2034, and as of that date is repealed, unless a later enacted statute, that is enacted before January 1, 2034, deletes or extends that date.

SEC. 5. Section 42885 of the Public Resources Code, as amended by Section 21 of Chapter 355 of the Statutes of 2022, is amended to read:

42885. (a) For purposes of this section, “California tire fee” means the fee imposed pursuant to this section.

(b) (1) Every person who purchases a new tire, as defined in subdivision (g), shall pay a California tire fee of seventy-five cents ($0.75) per tire.

(2) The retail seller shall charge the retail purchaser the amount of the California tire fee as a charge that is separate from, and not included in, any other fee, charge, or other amount paid by the retail purchaser.

(3) The retail seller shall collect the California tire fee from the retail purchaser at the time of sale and may retain 3 percent of the fee as reimbursement for any costs associated with the collection of the fee. The retail seller shall remit the remainder to the state on a quarterly schedule for deposit in the California Tire Recycling Management Fund, which is hereby created in the State Treasury.

(c) The California Department of Tax and Fee Administration shall collect the fee imposed by this article pursuant to the Fee Collection Procedures Law (Part 30 (commencing with Section 55001)) of Division 2 of the Revenue and Taxation Code. For purposes of this section, the reference in the Fee Collection Procedures Law to “feepayer” shall include a person required to pay the fee imposed by this section, which includes the retail seller.

(d) The California tire fee imposed pursuant to subdivision (b) shall be separately stated by the retail seller on the invoice given to the customer at the time of sale. Any other disposal or transaction fee charged by the retail seller related to the tire purchase shall be identified separately from the California tire fee.

(e) Any person or business who knowingly, or with reckless disregard, makes any false statement or representation in any document used to comply with this section is liable for a civil penalty for each violation or, for continuing violations, for each day that the violation

continues. Liability under this section may be imposed in a civil action and shall not exceed twenty-five thousand dollars ($25,000) for each violation.

(f) In addition to the civil penalty that may be imposed pursuant to subdivision (e), the department may impose an administrative penalty in an amount not to exceed five thousand dollars ($5,000) for each violation of a separate provision or, for continuing violations, for each day that the violation continues, on any person who intentionally or negligently violates any permit, rule, regulation, standard, or requirement issued or adopted pursuant to this chapter. The department shall adopt regulations that specify the amount of the administrative penalty and the procedure for imposing an administrative penalty pursuant to this subdivision.

(g) For purposes of this section, "new tire" means a pneumatic or solid tire intended for use with onroad or off-road motor vehicles, motorized equipment, construction equipment, or farm equipment that is sold separately from the motorized equipment, or a new tire sold with a new or used motor vehicle, as defined in Section 42803.5, including the spare tire, construction equipment, or farm equipment. "New tire" does not include retreaded, reused, or recycled tires.

(h) The California tire fee may not be imposed on any tire sold with, or sold separately for use on, any of the following:

(1) Any self-propelled wheelchair.

(2) Any motorized tricycle or motorized quadricycle, as defined in Section 407 of the Vehicle Code.

(3) Any vehicle that is similar to a motorized tricycle or motorized quadricycle and is designed to be operated by a person who, by reason of the person's physical disability, is otherwise unable to move about as a pedestrian.

(i) This section shall become operative on January 1, 2034.

SEC. 6. Section 42886.1 of the Public Resources Code is amended to read:

42886.1. (a) The California Department of Tax and Fee Administration, if it deems it necessary in order to ensure payment to or facilitate the collection by the state of the amount of fees, may require returns and payment of the amount of fees for a yearly period.

(b) On or before the 15th day of the month following each designated yearly period, a return for the preceding designated yearly period shall be filed with the California Department of Tax and Fee Administration in the form as the California Department of Tax and Fee Administration may prescribe.

SEC. 7. Section 42889 of the Public Resources Code, as amended by Section 22 of Chapter 355 of the Statutes of 2022, is amended to read:

42889. (a) All revenues, interest, and penalties derived from the California Tire Fee, less refunds and reimbursement to the California Department of Tax and Fee Administration for expenses incurred in the administration and collection of the fee imposed by this article, shall be deposited as follows:

(1) An amount equal to seventy-five cents ($0.75) per tire on which the fee is imposed shall be in the Air Pollution Control Fund. The state board shall expend those moneys, or allocate those moneys to the districts for expenditure, to fund programs and projects that mitigate or remediate air pollution caused by tires in the state, to the extent that the state board or the applicable district determines that the program or project remediates air pollution harms created by tires upon which the fee described in Section 42885 is imposed.

(2) The remaining moneys collected pursuant to Section 42885 shall be deposited in the California Tire Recycling Management Fund to fund the waste tire program, and shall be appropriated to the department in the annual Budget Act in a manner consistent with the five-year plan adopted and updated by the department. These moneys shall be expended for the payment of refunds under this chapter and for the following purposes:

(A) To pay the administrative overhead cost of this chapter, not to exceed 6 percent of the total revenue deposited in the fund annually, or an amount otherwise specified in the annual Budget Act.

(B) To pay the costs associated with operating the tire recycling program specified in Article 3 (commencing with Section 42870).

(C) To pay the costs associated with the development and enforcement of regulations relating to the storage of waste tires and used tires. The department shall consider designating a city, county, or city and county as the enforcement authority of regulations relating to the storage of waste tires and used tires, as provided in subdivision (c) of Section 42850, and regulations relating to the hauling of waste and used tires, as provided in subdivision (b) of Section 42963. If the department designates a local entity for that purpose, the department shall provide sufficient, stable, and noncompetitive funding to that entity for that purpose, based on available resources, as provided in the five-year plan adopted and updated as provided in subdivision (a) of Section 42885.5. The department may consider and create, as appropriate, financial incentives for citizens who report the illegal hauling or disposal of waste tires as a means of enhancing local and statewide waste tire and used tire enforcement programs.

(D) To pay the costs of cleanup, abatement, removal, or other remedial action related to waste tire stockpiles throughout the state, including all approved costs incurred by other public agencies involved in these activities by contract with the department. Not less than six million five hundred thousand dollars ($6,500,000) shall be expended by the department during each of the following fiscal years for this purpose: 2001–02 to 2006–07, inclusive.

(E) To make studies and conduct research directed at promoting and developing alternatives to the landfill disposal of waste tires.

(F) To assist in developing markets and new technologies for used tires and waste tires. The department's expenditure of funds for purposes of this subdivision shall reflect the priorities for waste management practices specified in subdivision (a) of Section 40051.

(G) To pay the costs associated with implementing and operating a waste tire and used tire hauler program and manifest system pursuant to Chapter 19 (commencing with Section 42950).

(H) To pay the costs to create and maintain an emergency reserve, which shall not exceed one million dollars ($1,000,000).

(I) To pay the costs of cleanup, abatement, or other remedial action related to the disposal of waste tires in implementing and operating the Farm and Ranch Solid Waste Cleanup and Abatement Grant Program established pursuant to Chapter 2.5 (commencing with Section 48100) of Part 7.

(J) To fund border region activities specified in paragraph (8) of subdivision (b) of Section 42885.5.

(K) For expenditure pursuant to paragraph (3) of subdivision (a) of, and paragraph (3) of subdivision (b) of, Section 17001.

(b) This section shall remain in effect only until January 1, 2034, and as of that date is repealed, unless a later enacted statute that is enacted before January 1, 2034, deletes or extends that date.

SEC. 8. Section 42889 of the Public Resources Code, as amended by Section 23 of Chapter 355 of the Statutes of 2022, is amended to read:

42889. (a) All revenues, interest, and penalties derived from the California tire fee, less refunds and reimbursement to the California Department of Tax and Fee Administration for expenses incurred in the administration and collection of the fee imposed by this article, shall be deposited in the California Tire Recycling Management Fund in the State Treasury. Funding for the waste tire program shall be appropriated to the department in the annual Budget Act. The moneys in the fund shall be expended for the following purposes:

(1) To pay the administrative overhead cost of this chapter, not to exceed 5 percent of the total revenue deposited in the fund annually, or an amount otherwise specified in the annual Budget Act.

(2) To pay the costs associated with operating the tire recycling program specified in Article 3 (commencing with Section 42870).

(3) To pay the costs associated with the development and enforcement of regulations relating to the storage of waste tires and used tires. The department shall consider designating a city, county, or city and county as the enforcement authority of regulations relating to the storage of waste tires and used tires, as provided in subdivision (c) of Section 42850, and regulations relating to the hauling of waste and used tires, as provided in subdivision (b) of Section 42963. If the department designates a local entity for that purpose, the department shall provide sufficient, stable, and noncompetitive funding to that entity for that purpose, based on available resources, as provided in the five-year plan adopted and updated as provided in subdivision (a) of Section 42885.5. The department may consider and create, as appropriate, financial incentives for citizens who report the illegal hauling or disposal of waste tires as a means of enhancing local and statewide waste tire and used tire enforcement programs.

(4) To pay the costs of cleanup, abatement, removal, or other remedial action related to waste tire stockpiles throughout the state, including all approved costs incurred by other public agencies involved in these activities by contract with the department. Not less than six million five hundred thousand dollars ($6,500,000) shall be expended by the department during each of the following fiscal years for this purpose: 2001–02 to 2006–07, inclusive.

(5) To fund border region activities specified in paragraph (8) of subdivision (b) of Section 42885.5.

(6) For expenditure pursuant to paragraph (3) of subdivision (a) of, and paragraph (3) of subdivision (b) of, Section 17001.

(b) This section shall become operative on January 1, 2034.

SEC. 9. Section 6055 of the Revenue and Taxation Code is amended to read:

6055. (a) (1) A retailer is relieved from liability for sales tax that became due and payable, insofar as the measure of the tax is represented by accounts that have been found to be worthless and charged off for income tax purposes by the retailer or, if the retailer is not required to file income tax returns, charged off in accordance with generally accepted accounting principles. A retailer that has previously paid the tax may, under rules and regulations prescribed by the department, take as a deduction the amount found worthless and charged off by the retailer. If these accounts are thereafter in whole or in part collected by the retailer, the amount collected shall be included in the first return filed after the collection and the tax shall be paid with the return.

(2) (A) Before January 1, 2025, for purposes of this subdivision, the term "retailer" shall include any entity affiliated with the retailer under Section 1504 of Title 26 of the United States Code.

(B) An entity that is a retailer under this paragraph shall not be entitled to a deduction under paragraph (1) on or after January 1, 2025.

(b) (1) In the case of accounts held by a lender, a retailer or lender that makes a proper election under paragraph (4) shall be entitled to a deduction or refund of the tax that the retailer has previously reported and paid if all of the following conditions are met:

(A) A deduction was not previously claimed or allowed on any portion of the accounts.

(B) The accounts have been found worthless and written off by the lender in accordance with the requirements of subdivision (a) before January 1, 2025.

(C) The contract between the retailer and the lender contains an irrevocable relinquishment of all rights to the account from the retailer to the lender.

(D) The retailer remitted the tax on or after January 1, 2000.

(E) The party electing to claim the deduction or refund under paragraph (4) files a claim in a manner prescribed by the department.

(2) If the retailer or the lender thereafter collects in whole or in part any accounts, one of the following shall apply:

(A) If the retailer is entitled to the deduction or refund under the election specified in paragraph (4), the retailer shall include the amount collected in its first return filed after the collection and pay tax on that amount with the return.

(B) If the lender is entitled to the deduction or refund under the election specified in paragraph (4), the lender shall pay the tax to the department in accordance with Section 6451.

(3) For purposes of this subdivision, the term "lender" means any of the following:

(A) Any person that holds a retail account which that person purchased directly from a retailer who reported the tax.

(B) Any person that holds a retail account pursuant to that person's contract directly with the retailer that reported the tax.

(C) Any person that is either an affiliated entity, under Section 1504 of Title 26 of the United States Code, of a person described in subparagraph (A) or (B), or an assignee of a person described in subparagraph (A) or (B).

(4) For purposes of this section, a "proper election" shall be established when the retailer that reported the tax and the lender prepare and retain an election form, signed by both parties, designating which party is entitled to claim the deduction or refund. This election may not be amended or revoked unless a new election, signed by both parties, is prepared and retained by the retailer and the lender.

(c) This section shall remain operative until January 1, 2028, and as of that date is repealed.

SEC. 10. Section 6055 is added to the Revenue and Taxation Code, to read:

6055. (a) A retailer is relieved from liability for sales tax that became due and payable, insofar as the measure of the tax is represented by accounts that have been found to be worthless and charged off for income tax purposes by the retailer or, if the retailer is not required to file income tax returns, charged off in accordance with generally accepted accounting principles. A retailer that has previously paid the tax may, under rules and regulations prescribed by the department, take as a deduction the amount found worthless and charged off by the retailer. If these accounts are thereafter in whole or in part collected by the retailer, the amount collected shall be included in the first return filed after the collection and the tax shall be paid with the return.

(b) This section shall become operative on January 1, 2028.

SEC. 11. Section 6203.5 of the Revenue and Taxation Code is amended to read:

6203.5. (a) (1) A retailer is relieved from liability to collect use tax that became due and payable, insofar as the measure of the tax is represented by accounts that have been found to be worthless and charged off for income tax purposes by the retailer or, if the retailer is not required to file income tax returns, charged off in accordance with generally accepted accounting principles. A retailer that has previously paid the amount of the tax may, under rules and regulations prescribed by the department, take as a deduction the amount found worthless and charged off by the retailer. If these accounts are thereafter in whole or in part collected by the retailer, the amount collected shall be included in the first return filed after the collection and the amount of the tax shall be paid with the return.

(2) (A) Before January 1, 2025, for purposes of this subdivision, the term "retailer" shall include any entity affiliated with the retailer under Section 1504 of Title 26 of the United States Code.

(B) An entity that is a retailer under this paragraph shall not be entitled to a deduction under paragraph (1) on or after January 1, 2025.

(b) (1) In the case of accounts held by a lender, a retailer or lender that makes a proper election under paragraph (4) shall be entitled to a deduction or refund of the tax that the retailer has previously reported and paid if all of the following conditions are met:

(A) A deduction was not previously claimed or allowed on any portion of the accounts.

(B) The accounts have been found worthless and written off by the lender in accordance with the requirements of subdivision (a) before January 1, 2025.

(C) The contract between the retailer and the lender contains an irrevocable relinquishment of all rights to the account from the retailer to the lender.

(D) The retailer remitted the tax on or after January 1, 2000.

(E) The party electing to claim the deduction or refund under paragraph (4) files a claim in a manner prescribed by the department.

(2) If the retailer or the lender thereafter collects in whole or in part any accounts, one of the following shall apply:

(A) If the retailer is entitled to the deduction or refund under the election specified in paragraph (4), the retailer shall include the amount collected in its first return filed after the collection and pay tax on that amount with the return.

(B) If the lender is entitled to the deduction or refund under the election specified in paragraph (4), the lender shall pay the tax to the department in accordance with Section 6451.

(3) For purposes of this subdivision, the term "lender" means any of the following:

(A) Any person that holds a retail account which that person purchased directly from a retailer who reported the tax.

(B) Any person that holds a retail account pursuant to that person's contract directly with the retailer that reported the tax.

(C) Any person that is either an affiliated entity, under Section 1504 of Title 26 of the United States Code, of a person described in subparagraph (A) or (B), or an assignee of a person described in subparagraph (A) or (B).

(4) For purposes of this section, a "proper election" shall be established when the retailer that reported the tax and the lender prepare and retain an election form, signed by both parties, designating which party is entitled to claim the deduction or refund. This election may not be amended or revoked unless a new election, signed by both parties, is prepared and retained by the retailer and the lender.

(c) This section shall remain operative until January 1, 2028, and as of that date is repealed.

SEC. 12. Section 6203.5 is added to the Revenue and Taxation Code, to read:

6203.5. (a) A retailer is relieved from liability to collect use tax that became due and payable, insofar as the measure of the tax is represented by accounts that have been found to be worthless and charged off for income tax purposes by the retailer or, if the retailer is not required to file income tax returns, charged off in accordance with generally accepted accounting principles. A retailer that has previously paid the amount of the tax may, under rules and regulations prescribed by the department, take as a deduction the amount found worthless and charged off by the retailer. If these accounts are thereafter in whole or in part collected by the retailer, the amount collected shall be included in the first return filed after the collection and the amount of the tax shall be paid with the return.

(b) This section shall become operative on January 1, 2028.

SEC. 13. Section 6902.5 of the Revenue and Taxation Code is amended to read:

6902.5. (a) For the purposes of this section:

(1) "Qualified taxpayer" means a person who is a qualified taxpayer within the meaning of paragraph (17) of subdivision (b) of Section 17053.85, 17053.95, 23685, or 23695, paragraph (19) of subdivision (b) of Section 17053.98 or 23698, or paragraph (20) of subdivision (b) of Section 17053.98.1 or 23698.1.

(2) "Affiliate" means a qualified taxpayer's affiliated corporation that has been assigned any portion of the credit amount by the qualified taxpayer pursuant to subdivision (c) of Section 23685, subdivision (c) of Section 23695, subdivision (c) of Section 23698, or subdivision (c) of Section 23698.1.

(3) "Credit amount" means an amount equal to the tax credit amount that would otherwise be allowed to a qualified taxpayer pursuant to Section 17053.85, 17053.95, 17053.98, 17053.98.1, 23685, 23695, 23698, or 23698.1, but for the election made pursuant to this section.

(4) "Production period" means the production period as defined in paragraph (12) of subdivision (b) of Section 17053.85, 17053.95, 23685, or 23695, in paragraph (14) of subdivision (b) of Section 17053.98 or 23698, or in paragraph (15) of subdivision (b) of Section 17053.98.1 or Section 23698.1.

(5) (A) "Qualified sales and use taxes" means any state sales and use taxes imposed by Part 1 (commencing with Section 6001), on the operative date of the act adding this section.

(B) Notwithstanding subparagraph (A), "qualified sales and use taxes" does not mean taxes imposed by Section 6051.2, 6051.5, 6201.2, 6201.5, Part 1.5 (commencing with Section 7200), Part 1.6 (commencing with Section 7251), or Section 35 of Article XIII of the California Constitution.

(b) (1) A qualified taxpayer may, in lieu of claiming the credit allowed by Section 17053.85, 17053.95, 17053.98, 17053.98.1, 23685, 23695, 23698, or 23698.1, make an irrevocable election to apply the credit amount against qualified sales and use taxes imposed on the qualified taxpayer in accordance with this section.

(2) An affiliate may, in lieu of claiming the assigned portion of the credit allowed by Section 23685, 23695, 23698, or 23698.1, make an irrevocable election to apply the assigned portion of the credit amount against qualified sales and use taxes imposed on the affiliate in accordance with this section.

(c) (1) A qualified taxpayer or affiliate shall submit to the California Department of Tax and Fee Administration an irrevocable election, in a form as prescribed by the California Department of Tax and Fee Administration, which shall include, but not be limited to, the following information:

(A) Representation that the claimant is a qualified taxpayer or an affiliate.

(B) Statement of the dates on which the production period began and ended.

(C) The credit amount, and if an affiliate, the portion of the credit amount assigned to it and documentation supporting the assignment of that portion of the credit amount.

(D) The amount of qualified sales and use taxes the claimant remitted to the California Department of Tax and Fee Administration during the period commencing on the first day of the calendar quarter commencing immediately before the beginning of the production period, and ending on the date the claimant was required to file its most recent sales and use tax return with the California Department of Tax and Fee Administration.

(E) A copy of the credit certificate issued pursuant to subparagraph (C) of paragraph (2) of subdivision (g) of Section 17053.85 or 23685 or subparagraph (D) of paragraph (3) of subdivision (g) of Section 17053.95, 17053.98, 23695, 23698, or subparagraph (C) of paragraph (3) of subdivision (g) of Section 17053.98.1 or 23698.1.

(2) The election shall be filed on or before the date on which the qualified taxpayer or affiliate would first be allowed to claim a credit pursuant to Section 17053.85, 17053.95, 17053.98, 17053.98.1, 23685, 23695, 23698, or 23698.1 on its tax return.

(3) (A) For those amounts for which an irrevocable election is made in lieu of tax credits allowed pursuant to Section 17053.85, 17053.95, 17053.98, 23685, 23695, or 23698 that would otherwise be allowed for any taxable year beginning on or after January 1, 2020, and before January 1, 2022, subdivision (d) and paragraph (1) of subdivision (e) shall only apply to those in-lieu credit amounts that do not exceed five million dollars ($5,000,000) for that taxable year.

(B) For those amounts for which an irrevocable election is made in lieu of tax credits allowed pursuant to Section 17053.85, 17053.95, 17053.98, 23685, 23695, or 23698 that would otherwise be allowed for any taxable year beginning on or after January 1, 2020, and before January 1, 2022, that are in excess of five million dollars ($5,000,000) for that taxable year, subdivision (f) shall apply.

(C) For those amounts for which an irrevocable election is made in lieu of tax credits allowed pursuant to Section 17053.85, 17053.95, 17053.98, 23685, 23695, or 23698 that would otherwise be allowed for any taxable year beginning on or after January 1, 2024, and before January 1, 2027, subdivision (d) and paragraph (1) of subdivision (e) shall only apply to those in-lieu credit amounts that do not exceed five million dollars ($5,000,000) for that taxable year and, for those amounts that are in excess of five million dollars ($5,000,000) for that taxable year, subdivision (g) shall apply.

(d) (1) The claimant may elect to obtain a refund of qualified sales and use taxes paid during the period described in subparagraph (D) of paragraph (1) of subdivision (c). If the claimant elects to obtain a refund of qualified sales and use taxes, the claimant shall file a claim for refund with the irrevocable election described in subdivision (c). The refund amount shall not exceed, for a qualified taxpayer, the credit amount, or for an affiliate, the portion of the credit amount assigned to it.

(2) No interest shall be paid on any amount refunded or credited pursuant to paragraph (1).

(e) (1) If the claimant does not elect to obtain a refund or in the case where the credit amount, or assigned portion, exceeds the amount of its claim for refund for the qualified sales and use taxes, the claimant may, for the reporting periods in the five years following the last reporting period as described in subparagraph (D) of paragraph (1) of subdivision (c), offset any remaining credit amount, or assigned portion, against the qualified sales and use taxes imposed during those reporting periods.

(2) Notwithstanding paragraph (1), the total amount of refunds or credit offsets claimed under subdivision (d) and paragraph (1) of this subdivision in lieu of tax credits allowed pursuant to Section 17053.85, 17053.95, 17053.98, 23685, 23695, or 23698 that would otherwise be allowed for a taxable year beginning on or after January 1, 2020, and before January 1, 2022, and for a taxable year beginning on or after January 1, 2024, and before January 1, 2027, shall not exceed five million dollars ($5,000,000).

(f) Notwithstanding subdivision (d) and paragraph (1) of subdivision (e), for those amounts for which an irrevocable election is made in lieu of tax credits allowed pursuant to Section 17053.85, 17053.95, 17053.98, 23685, 23695, or 23698 that would otherwise be allowed for any taxable year beginning on or after January 1, 2020, and before January 1, 2022, that are in excess of five million dollars ($5,000,000) for that taxable year, both of the following shall apply:

(1) The claimant may elect to obtain a refund of the qualified sales and use taxes paid or offset that excess credit amount, or assigned portion against the qualified sales and use taxes imposed, during the reporting periods that occur during the 2021 calendar year. The total amount of refunds or credit offsets claimed under this paragraph, subdivision (d), and paragraph (1) of subdivision (e) shall not exceed five million dollars ($5,000,000) in the 2021 calendar year for each claimant.

(2) If the claimant has not exhausted the excess credit amount, or assigned portion, as provided by paragraph (1), the claimant may offset the remaining excess credit amount, or assigned portion, against the qualified sales and use taxes imposed during the reporting periods in the five years following and including the reporting period beginning on and after January 1, 2022.

(g) (1) Notwithstanding subdivision (d) and paragraph (1) of subdivision (e), the total amount of refunds or credit offsets claimed under subdivision (d) and paragraph (1) of subdivision (e) in lieu of tax credits allowed pursuant to Section 17053.85, 17053.95, 17053.98, 23685, 23695, or 23698 that would otherwise be allowed for a taxable year beginning on or after January 1, 2024, and before January 1, 2027, shall not exceed five million dollars ($5,000,000). For those amounts for which an irrevocable election is made in lieu of tax credits allowed pursuant to Section 17053.85, 17053.95, 17053.98, 23685, 23695, or 23698 that would otherwise be allowed for any taxable year beginning on or after January 1, 2024, and before January 1, 2027, that are in excess of five million dollars ($5,000,000) for that taxable year, both of the following shall apply:

(A) The claimant may elect to obtain a refund of the qualified sales and use taxes paid or offset that excess credit amount, or assigned portion against the qualified sales and use taxes imposed, during the reporting periods that occur during the 2024, 2025, and 2026 calendar years. The total amount of refunds or credit offsets claimed under this paragraph, subdivision (d) of Section

6902.5, and paragraph (1) of subdivision (e) of Section 6902.5 shall not exceed five million dollars ($5,000,000) in each of the 2024, 2025, and 2026 calendar years for each claimant.

(B) If the claimant has not exhausted the excess credit amount, or assigned portion, as provided by paragraph (1), the claimant may offset the remaining excess credit amount, or assigned portion, against the qualified sales and use taxes imposed during the reporting periods in the five years following and including the reporting period beginning on and after January 1, 2027.

(2) For purposes of this subdivision, "claimant" means a qualified taxpayer together with its affiliates.

(h) Section 6961 shall apply to any refund, or part thereof, that is erroneously made and any credit, or part thereof, that is erroneously allowed pursuant to this section.

(i) The California Department of Tax and Fee Administration shall provide an annual listing to the Franchise Tax Board, in a form and manner agreed upon by the California Department of Tax and Fee Administration and the Franchise Tax Board, of the qualified taxpayers, or affiliates that have been assigned a portion of the credit allowed under Section 23685 pursuant to subdivision (c) of Section 23685, Section 23695 pursuant to subdivision (c) of Section 23695, Section 23698 pursuant to subdivision (c) of Section 23698, or Section 23698.1 pursuant to subdivision (c) of Section 23698.1, who, during the year, have made an irrevocable election pursuant to this section and the credit amount, or portion of the credit amount, claimed by each qualified taxpayer or affiliate.

(j) The California Department of Tax and Fee Administration may prescribe rules and regulations for the administration of this section.

(k) The amendments made to this section by Chapter 8 of the Statutes of 2020 shall not apply to irrevocable elections made before the operative date of the act adding this subdivision.

(l) The amendments made to this section by Chapter 3 of the Statutes of 2022 shall apply to irrevocable elections made on and after June 29, 2020.

(m) The amendments made to this section by the act adding this subdivision shall not apply to irrevocable elections made before the operative date of the act adding this section.

SEC. 14. Section 7103 of the Revenue and Taxation Code is amended to read:

7103. (a) For purposes of this section:

(1) "City" means a city within the geographic boundaries of a county.

(2) "Confirmed historic venue" means a historic venue that has received a confirmation by the department pursuant to subdivision (g).

(3) "County" means the County of Alameda, the County of Santa Clara, and the County of Los Angeles.

(4) "Fund" means the Historic Venue Restoration and Resiliency Fund created pursuant to subdivision (c).

(5) "Historic venue" means a venue in the state that meets all of the following criteria:

(A) The venue meets any of the following criteria:

(i) The venue contains a structure built before 1940.

(ii) The venue contains a structure officially designated by the United States National Park Service or the United States Department of the Interior as a National Historic Landmark.

(iii) The venue is located at a site continuously used for live, ticketed events for more than 50 years.

(B) The venue has total fixed seating capacity of at least 15,000 people.

(C) The venue hosts live entertainment or sporting events.

(D) The venue is owned by a public entity.

(6) "Qualified event" means a live event at a confirmed historic venue to which tickets are offered for public sale.

(b) Notwithstanding any other law, a return filed with the department to report gross receipts for sales tax purposes shall, for each confirmed historic venue, segregate the taxable sales made at a qualified event on a line or a separate form, as prescribed by the department, if the place of sale in this state is on or within the real property of a confirmed historic venue on the day of a qualified event that occurred on or before June 30, 2029.

(c) (1) The Historic Venue Restoration and Resiliency Fund is hereby created in the State Treasury.

(2) Notwithstanding Section 13340 of the Government Code, moneys in the fund shall be continuously appropriated without regard to fiscal year and allocated pursuant to subdivisions (e) and (f).

(d) (1) The department shall, for each confirmed historic venue, report the total amount of taxable sales made at a qualified event that were segregated on the returns filed for the prior fiscal year pursuant to subdivision (b) to the Department of Finance on or before November 1 of each year.

(2) (A) The total taxable sales made at a qualified event that were reported pursuant to paragraph (1) shall be subject to review, which may be a review of a sample of returns, by the department for errors.

(B) The department shall note any errors identified in the review and the approximate impact of those errors on the total taxable sales made at a qualified event that were in the report to the Department of Finance required by this subdivision to allow an adjusted total taxable sales amount to be determined.

(e) (1) An amount equal to 5 percent of the total amount of taxable sales, or adjusted taxable sales, for the prior fiscal year reported to the Department of Finance by the department pursuant to subdivision (d) shall be included in the next annual Governor's Budget for deposit into the fund for the Controller to allocate to cities and counties pursuant to subdivision (f).

(2) (A) No later than 15 days after enactment of the annual Budget Act, the Department of Finance shall, for each confirmed historic venue located within the geographic boundaries of a city or county, report to the Controller the amounts to be allocated from the fund to each city and county.

(B) The amounts to be allocated pursuant to subparagraph (A) to each city and county shall be in proportion to the taxable sales subject to subdivision (b) derived from qualified events at each confirmed historic venue identified by that city or county.

(3) No later than 30 days after the enactment of the annual Budget Act, the amount appropriated by the Legislature to the Controller pursuant to this subdivision shall be transferred by the Controller to the fund.

(f) (1) Beginning January 1, 2025, the Controller shall annually allocate, as promptly as feasible, the moneys in the fund to each city or county pursuant to the report required by paragraph (2) of subdivision (e).

(2) (A) A city or county shall distribute funds received pursuant to this subdivision only for any of the following purposes and pursuant to subparagraph (B):

(i) Capital infrastructure improvements and preservation of a confirmed historic venue.

(ii) Preventive maintenance of a confirmed historic venue related to patrons safety.

(iii) Technological improvements at a confirmed historic venue.

(iv) Security enhancements at a confirmed historic venue.

(v) Bringing a confirmed historic venue into compliance with the federal Americans with Disabilities Act of 1990 (42 U.S.C. Sec. 12101 et seq.).

(vi) Energy efficiency improvements at a confirmed historic venue.

(vii) Upgrades related to implementation of federal and state policies at a confirmed historic venue.

(B) A city or county shall distribute funds to each confirmed historic venue within the geographic boundaries of that city or county in accordance with the amounts allocated by the Controller for that purpose pursuant to paragraph (1).

(g) (1) (A) A city or county shall identify a historic venue within its jurisdiction to the department, in a form and manner prescribed by the department, for a confirmation as a historic venue.

(B) (i) Subject to clause (ii), if the venue identified pursuant to subparagraph (A) is a historic venue, the department shall issue a confirmation to the city or county as promptly as feasible.

(ii) The department shall not issue a confirmation pursuant to clause (i) if a city or county is currently receiving revenue transmitted pursuant to subdivision (f) with respect to the historic venue.

(2) A city or county, or its designee, that receives a confirmation from the department pursuant to paragraph (1) shall, at least 10 days before a qualified event scheduled to take place at a confirmed historic venue within the geographic boundaries of that city or county, notify any retailers subject to subdivision (b) that the city or county, or its designee, knows, or has reason to know, will be making sales during that qualified event of their reporting obligation pursuant to subdivision (b).

(h) On or before November 1 of each year, the department shall deliver a report to the Assembly Committee on Revenue and Taxation and the Senate Committee on Governance and Finance concerning both of the following:

(1) The identity of any confirmed historic venue and the city or county that identified that venue pursuant to subdivision (g).

(2) (A) The amount of revenue allocated in the preceding fiscal year pursuant to this section to a city or county with respect to each confirmed historic venue.

(B) On or before September 1 of each year, the Controller shall provide to the department the information required to be included in the report pursuant to subparagraph (A).

(i) This section shall remain operative only until November 1, 2030, and as of that date is repealed.

SEC. 15. Section 17039.4 is added to the Revenue and Taxation Code, to read:

17039.4. (a) Notwithstanding any provision of this part or Part 10.2 (commencing with Section 18401) to the contrary, for taxpayers not required to be included in a combined report under Section 25101 or 25110, or taxpayers not authorized to be included in a

combined report under Section 25101.15, for each taxable year beginning on or after January 1, 2024, and before January 1, 2027, the total of all business credits otherwise allowable under any provision of Chapter 2 (commencing with Section 17041), including the carryover of any business credit under a former provision of that chapter, for the taxable year shall not reduce the "net tax," as defined in Section 17039, by more than five million dollars ($5,000,000).

(b) Notwithstanding any provision of this part or Part 10.2 (commencing with Section 18401) to the contrary, for taxpayers required to be included in a combined report under Section 25101 or 25110, or taxpayers authorized to be included in a combined report under Section 25101.15, for each taxable year beginning on or after January 1, 2024, and before January 1, 2027, the total of all business credits otherwise allowable under any provision of Chapter 2 (commencing with Section 17041), including the carryover of any business credit under a former provision of that chapter, by all members of the combined report shall not reduce the aggregate amount of "tax," as defined in Section 23036, of all members of the combined report by more than five million dollars ($5,000,000).

(c) For purposes of this section, "business credit" means a credit allowable under any provision of Chapter 2 (commencing with Section 17041) other than the following credits:

(1) The credit allowed by Section 17052 (relating to credit for earned income).

(2) The credit allowed by Section 17052.1 (relating to credit for young child).

(3) The credit allowed by Section 17052.2 (relating to credit for foster youth).

(4) The credit allowed by Section 17052.6 (relating to credit for household and dependent care).

(5) The credit allowed by Section 17052.10 (relating to the elective tax under the Small Business Relief Act).

(6) The credit allowed by Section 17052.25 (relating to credit for adoption costs).

(7) The credit allowed by Section 17053.5 (relating to renter's tax credit).

(8) The credit allowed by Section 17054 (relating to credit for personal exemption).

(9) The credit allowed by Section 17054.5 (relating to credit for qualified joint custody head of household and a qualified taxpayer with a dependent parent).

(10) The credit allowed by Section 17054.7 (relating to credit for qualified senior head of household).

(11) The credit allowed by Section 17058 (relating to credit for low-income housing).

(12) The credit allowed by Section 17061 (relating to refunds pursuant to the Unemployment Insurance Code).

(d) Any amounts included in an election pursuant to Section 6902.5, relating to an irrevocable election to apply credit amounts under Section 17053.85, 17053.95, 17053.98, 23685, 23695, or 23698 against qualified sales and use tax, as defined in Section 6902.5, are not included in the five-million-dollar ($5,000,000) limitation set forth in subdivision (a) or (b).

(e) The amount of any credit otherwise allowable for the taxable year under Section 17039 that is not allowed due to application of this section shall remain a credit carryover amount under this part.

(f) The carryover period for any credit that is not allowed due to the application of this section shall be increased by the number of taxable years the credit or any portion thereof was not allowed.

(g) Notwithstanding anything to the contrary in this part or Part 10.2 (commencing with Section 18401), the credits listed in subdivision (c) shall be applied after any business credits, as limited by subdivision (a) or (b), are applied.

(h) Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code does not apply to any standard, criterion, procedure, determination, rule, notice, or guideline established or issued by the Franchise Tax Board pursuant to this section.

SEC. 16. Section 17052.1 of the Revenue and Taxation Code is amended to read:

17052.1. (a) (1) For each taxable year beginning on or after January 1, 2019, there shall be allowed against the "net tax," as defined by Section 17039, a young child tax credit to a qualified taxpayer, in an amount as determined under paragraph (2).

(2) (A) (i) The amount of the young child tax credit shall be equal to one thousand one hundred seventy-six dollars ($1,176), multiplied by the earned income tax credit adjustment factor for the taxable year as specified for in Section 17052.

(ii) The amount of the young child tax credit specified under clause (i) shall be recomputed annually in the same manner as the recomputation of income tax brackets under subdivision (h) of Section 17041.

(B) The young child tax credit allowable in any taxable year to any qualified taxpayer shall be limited to the maximum amount specified in clause (i) of subparagraph (A) as recomputed under clause (ii) of subparagraph (A).

(C) (i) The young child tax credit shall be reduced by twenty dollars ($20) for each one hundred dollars ($100), or fraction thereof, by which the qualified taxpayer's earned income, as defined in Section 17052, exceeds the "threshold amount." For purposes of this section, the "threshold amount" shall be twenty-five thousand dollars ($25,000).

(ii) (I) For each taxable year beginning on or after January 1, 2022, and before January 1, 2023, the twenty dollars ($20) in clause (i) shall be recomputed annually in the same manner as the recomputation of income tax brackets under subdivision (h) of Section 17041, except that the resulting products shall be rounded off to the nearest cent.

(II) For taxable years beginning after the taxable year in which the minimum wage, as defined in paragraph (1) of subdivision (b) of Section 1182.12 of the Labor Code, is set at fifteen dollars ($15) per hour, and before January 1, 2024, the amount calculated under subclause (I) shall substitute for the twenty dollars ($20) in clause (i).

(III) The Franchise Tax Board shall calculate a graduated reduction amount in such a manner that, for a qualified taxpayer with earned income of one dollar ($1) or more in excess of the maximum earned income that results in a credit amount greater than zero dollars ($0) pursuant to Section 17052, the amount of the credit under this section is equal to zero. For taxable years beginning on or after January 1, 2024, the graduated reduction amount calculated pursuant to this subclause shall be substituted for the twenty dollars ($20) in clause (i).

(iii) For taxable years beginning after the taxable year in which the minimum wage, as defined in paragraph (1) of subdivision (b) of Section 1182.12 of the Labor Code, is set at fifteen dollars ($15) per hour, the "threshold amount" in this subparagraph shall be recomputed annually in the same manner as the recomputation of income tax brackets under subdivision (h) of Section 17041.

(D) The young child tax credit authorized by this section shall only be operative for taxable years for which resources are authorized in the annual Budget Act for the Franchise Tax Board to oversee and audit returns associated with the credit allowed under Section 17052.

(b) (1) "Qualified taxpayer" means an eligible individual who has at least one qualifying child and who satisfies either of the following:

(A) Has been allowed a tax credit under Section 17052.

(B) Meets all of the following requirements:

(i) Would otherwise have been allowed a tax credit under Section 17052, but has earned income, as defined in Section 32(c)(2) of the Internal Revenue Code, as modified by Section 17052, of zero dollars ($0) or less.

(ii) Does not have net losses in excess of thirty thousand dollars ($30,000) in the taxable year.

(iii) Does not have wages, salaries, tips, and other employee compensation in excess of thirty thousand dollars ($30,000) in the taxable year.

(2) For each taxable year beginning on or after January 1, 2022, the amounts specified under clauses (ii) and (iii) of subparagraph(B) shall be recomputed annually in the same manner as the recomputation of income tax brackets under subdivision (h) of Section 17041.

(c) "Qualifying child" shall have the same meaning as under Section 17052, except that the child shall be younger than six years of age as of the last day of the taxable year.

(d) (1) The Franchise Tax Board may prescribe rules, guidelines, procedures, or other guidance to carry out the purposes of this section. Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code shall not apply to any rule, guideline, or procedure prescribed by the Franchise Tax Board pursuant to this section.

(2) (A) The Franchise Tax Board may prescribe any regulations necessary or appropriate to carry out the purposes of this section, including any regulations to prevent improper claims from being filed or improper payments from being made with respect to net earnings from self-employment.

(B) The adoption of any regulations pursuant to subparagraph (A) may be adopted as emergency regulations in accordance with the rulemaking provisions of the Administrative Procedure Act (Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code) and shall be deemed an emergency and necessary for the immediate preservation of the public peace, health and safety, or general welfare. Notwithstanding Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code, these emergency regulations shall not be subject to the review and approval of the Office of Administrative Law. The regulations shall become effective immediately upon filing with the Secretary of State, and shall remain in effect until revised or repealed by the Franchise Tax Board.

(e) If the amount allowable as a credit under this section exceeds the tax liability computed under this part for the taxable year, the excess shall be credited against other amounts due, if any, and the balance, if any, shall be paid from the Tax Relief and Refund Account and refunded to the qualified taxpayer.

(f) Notwithstanding any other law, amounts refunded pursuant to this section shall be treated in the same manner as the federal earned income refund for the purpose of determining eligibility to receive benefits under Division 9 (commencing with Section 10000) of the Welfare and Institutions Code or amounts of those benefits.

(g) (1) In accordance with Section 41, the purpose of the Young Child Tax Credit is to reduce poverty among California's poorest working families and young children. To measure whether the credit achieves its intended purpose, the Franchise Tax Board shall annually prepare a written report on the following:

(A) The number of tax returns claiming the credit.

(B) The number of qualifying children represented on tax returns claiming the credit.

(C) The average credit amount on tax returns claiming the credit.

(2) The Franchise Tax Board shall provide the written report to the Senate Committee on Budget and Fiscal Review, the Assembly Committee on Budget, the Senate and Assembly Committees on Appropriations, the Senate Committee on Governance and Finance, the Assembly Committee on Revenue and Taxation, and the Senate and Assembly Committees on Human Services.

(h) The Legislature finds and declares that, to the extent they are otherwise qualified for a credit under this section, undocumented persons are eligible for the tax credit authorized by this section within the meaning of subsection (d) of Section 1621 of Title 8 of the United States Code.

(i) The amendments made to this section by the act adding this subdivision shall apply for taxable years beginning on or after January 1, 2022, except as provided in subparagraph (C) of paragraph (2) of subdivision (a).

SEC. 17. Section 17052.2 of the Revenue and Taxation Code is amended to read:

17052.2. (a) (1) For each taxable year beginning on or after January 1, 2022, there shall be allowed against the "net tax," as defined by Section 17039, a foster youth tax credit to a qualified taxpayer, in an amount as determined under paragraph (2).

(2) (A) The amount of the foster youth tax credit shall be equal to one thousand one hundred seventy-six dollars ($1,176), multiplied by the earned income tax credit adjustment factor for the taxable year, as specified in Section 17052.

(B) For taxable years beginning on or after January 1, 2022, the amount in subparagraph (A) shall be recomputed annually in the same manner as the recomputation of income tax brackets under subdivision (h) of Section 17041.

(C) (i) The foster youth tax credit shall be reduced by twenty dollars ($20) for each one hundred dollars ($100), or fraction thereof, by which the qualified taxpayer's earned income, as defined in Section 17052, exceeds the threshold amount.

(ii) (I) For taxable years beginning on or after January 1, 2022, and before January 1, 2023, the twenty dollars ($20) in clause (i) shall be recomputed in the same manner as the recomputation of income tax brackets under subdivision (h) of Section 17041, except that for purposes of this clause, subparagraph (B) of paragraph (2) of subdivision (h) of Section 17041 shall be modified by substituting "nearest cent" for "nearest one dollar ($1)."

(II) For taxable years beginning after the taxable year in which the minimum wage, as defined in paragraph (1) of subdivision (b) of Section 1182.12 of the Labor Code, is set at fifteen dollars ($15) per hour, and before January 1, 2024, the amount calculated under subclause (I) shall substitute for the twenty dollars ($20) in clause (i).

(III) The Franchise Tax Board shall calculate a graduated reduction amount in such a manner that, for a qualified taxpayer with earned income of one dollar ($1) or more in excess of the maximum earned income that results in a credit amount greater than zero dollars ($0) pursuant to Section 17052, the amount of the credit under this section is equal to zero. For taxable years beginning on or after January 1, 2024, the graduated reduction amount calculated pursuant to this subclause shall be substituted for the twenty dollars ($20) in clause (i).

(iii) For taxable years beginning after the taxable year in which the minimum wage, as defined in paragraph (1) of subdivision (b) of Section 1182.12 of the Labor Code, is set at fifteen dollars ($15) per hour, the threshold amount shall be recomputed annually in the same manner as the recomputation of income tax brackets under subdivision (h) of Section 17041.

(b) The foster youth tax credit authorized by this section shall only be operative for taxable years for which resources are authorized in the annual Budget Act for the Franchise Tax Board to oversee and audit returns associated with the earned income tax credit allowed under Section 17052.

(c) For purposes of this section, the following definitions shall apply:

(1) "Qualified taxpayer," means an individual who satisfies all of the following:

(A) Has been allowed a tax credit under Section 17052 for the taxable year.

(B) Is 18 to 25 years of age, inclusive, as of the last day of the taxable year.

(C) Was in foster care while 13 years of age or older in an AFDC-FC placement, as described in Section 11402 of the Welfare and Institutions Code, including a tribally approved home, as defined in subdivision (r) of Section 224.1 of the Welfare and Institutions Code, or Approved Relative Caregiver Funding Program eligible placement, as described in Article 6 (commencing with Section 11450) of Chapter 2 of Part 3 of Division 9 of the Welfare and Institutions Code, by a Title IV-E agency, pursuant to a voluntary placement agreement or a juvenile court order.

(2) "Threshold amount" shall be twenty-five thousand dollars ($25,000).

(3) "Title IV-E agency" means either of the following:

(A) A county child welfare agency or probation department that administers foster care placements under Title IV-E of the federal Social Security Act (Part E (commencing with Section 670) of Subchapter IV of Chapter 7 of Title 42 of the United States Code).

(B) An Indian tribe, tribal organization, or tribal consortium located in California or with lands that extend into the state that has an agreement with the State Department of Social Services pursuant to Section 10553.1 of the Welfare and Institutions Code to administer foster care placement under Title IV-E of the federal Social Security Act (Part E (commencing with Section 670) of Subchapter IV of Chapter 7 of Title 42 of the United States Code).

(d) (1) As provided for in Section 10850.8 of the Welfare and Institutions Code, and subject to federal approvals or waivers, the State Department of Social Services shall provide to the Franchise Tax Board the data regarding a qualified taxpayer placed by a Title IV-E agency that may be necessary to verify that an individual qualifies for the foster youth tax credit. The data provided shall remain confidential and shall be used only for purposes directly connected with the foster youth tax credit.

(2) In the event federal approval or waivers pursuant to paragraph (1) are not provided, the Franchise Tax Board and the State Department of Social Services shall explore alternative methods to verify foster care status for individuals described in paragraph (1) of subdivision (c) in a manner consistent with state and federal law.

(3) The State Department of Social Services shall seek all appropriate federal waivers or approvals for the implementation of this subdivision as necessary. This subdivision shall be implemented only if necessary federal waivers or approvals are granted.

(e) (1) The Franchise Tax Board may prescribe rules, guidelines, procedures, or other guidance to carry out the purposes of this section.

(2) The Franchise Tax Board may prescribe any regulations necessary or appropriate to carry out the purposes of this section, including any regulations to prevent improper claims from being filed or improper payments from being made with respect to net earnings from self-employment.

(3) Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code shall not apply to any regulation, guideline, or procedure prescribed by the Franchise Tax Board pursuant to this section.

(f) If the amount allowable as a credit under this section exceeds the tax liability computed under this part for the taxable year, the excess shall be credited against other amounts due, if any, and the balance, if any, shall be paid from the Tax Relief and Refund Account and refunded to the qualified taxpayer.

(g) Notwithstanding any other law, amounts refunded pursuant to this section shall be treated in the same manner as the federal earned income refund for the purpose of determining eligibility to receive benefits under Division 9 (commencing with Section 10000) of the Welfare and Institutions Code or amounts of those benefits.

(h) Notwithstanding any other law, the payment authorized pursuant to this section shall not be taken into account as income, and shall not be taken into account as resources for a period of 12 months from receipt, for purposes of determining the eligibility of such individual, or any other individual, for benefits or assistance or the amount or extent of benefits or assistance under any state or local program not covered in subdivision (g). With respect to a state or local program, this subdivision shall only be implemented to the extent that it does not conflict with federal law relating to that program, and that any required federal approval or waiver is first obtained for that program.

(i) The Legislature finds and declares that, to the extent they are otherwise qualified for a credit under this section, undocumented persons are eligible for the tax credit authorized by this section within the meaning of subsection (d) of Section 1621 of Title 8 of the United States Code.

(j) (1) In accordance with Section 41, the purpose of the Foster Care Tax Credit is to reduce poverty among California's young adults who have been in the foster care program. To measure whether the credit achieves its intended purpose, the Franchise Tax Board shall annually prepare a written report on the following:

(A) The number of tax returns claiming the credit.

(B) The average credit amount on tax returns claiming the credit.

(2) The Franchise Tax Board shall provide the written report, in compliance with Section 9795 of the Government Code, to the Senate Committee on Budget and Fiscal Review, the Assembly Committee on Budget, the Senate and Assembly Committees on Appropriations, the Senate Committee on Governance and Finance, the Assembly Committee on Revenue and Taxation, and the Senate and Assembly Committees on Human Services.

(3) The disclosure provisions of this subdivision shall be treated as an exception to Section 19542 under Article 2 (commencing with 19542) of Chapter 7 of Part 10.2.

SEC. 18. Section 17052.8 of the Revenue and Taxation Code is amended to read:

17052.8. For each taxable year beginning on or after January 1, 1996, and before January 1, 2024, there shall be allowed as a credit against the "net tax" (as defined by Section 17039) an amount determined as follows:

(a) (1) (A) The amount of the credit shall be equal to one-third of the federal credit computed in accordance with Section 43 of the Internal Revenue Code.

(B) If a taxpayer elects, under Section 43(e) of the Internal Revenue Code, not to apply Section 43 for federal tax purposes, this election is binding and irrevocable for state purposes, and for purposes of subparagraph (A), the federal credit shall be zero.

(2) "Qualified enhanced oil recovery project" shall include only projects located within California.

(3) The credit allowed under this subdivision shall not be allowed to any taxpayer for whom a depletion allowance is not permitted to be computed under Section 613 of the Internal Revenue Code by reason of paragraphs (2), (3), or (4) of subsection (d) of Section 613A of the Internal Revenue Code.

(b) Section 43(d) of the Internal Revenue Code shall apply.

(c) In the case where the credit allowed by this section exceeds the “net tax,” the excess may be carried over to reduce the “net tax” for the succeeding 15 years.

(d) In the case where property which qualifies as part of the taxpayer’s “qualified enhanced oil recovery costs” also qualifies for a credit under any other section in this part, the taxpayer shall make an election on its original return as to which section applies to all costs allocable to that item of qualified property. Any election made under this section, and any specification contained in that election, may not be revoked except with the consent of the Franchise Tax Board.

(e) No deduction shall be allowed as otherwise provided in this part for that portion of any costs paid or incurred for the taxable year which is equal to the amount of the credit allowed under this section attributable to those costs.

(f) The basis of any property for which a credit is allowed under this section shall be reduced by the amount of the credit attributable to the property. The basis adjustment shall be made for the taxable year for which the credit is allowed.

(g) No credit may be claimed under this section with respect to any amount for which any other credit has been claimed under this part.

(h) This section shall remain in effect only until December 1, 2024, and as of that date is repealed.

SEC. 19. Section 17209 of the Revenue and Taxation Code is amended to read:

17209. (a) For each taxable year beginning on or after January 1, 2020, and before January 1, 2030, Section 280E of the Internal Revenue Code, relating to expenditures in connection with the illegal sale of drugs, shall not apply to the carrying on of any trade or business that is commercial cannabis activity by a licensee.

(b) For purposes of this section, “commercial cannabis activity” and “licensee” shall have the same meanings as set forth in Division 10 (commencing with Section 26000) of the Business and Professions Code.

(c) This section shall remain in effect only until December 1, 2030, and as of that date is repealed.

SEC. 20. Section 17260 of the Revenue and Taxation Code is amended to read:

17260. (a) No deduction, other than depreciation, shall be allowed for expenditures for tertiary injectants as provided by Section 193 of the Internal Revenue Code.

(b) Section 263(a) of the Internal Revenue Code shall not apply to expenditures for which a deduction is allowed under Section 17266 or 17267.2.

(c) Section 263(c) of the Internal Revenue Code, relating to intangible drilling and development costs in the case of oil and gas wells and geothermal wells, shall not apply to intangible drilling and development costs, in the case of oil and gas wells, paid or incurred on or after January 1, 2024.

SEC. 21. Section 17275.5 of the Revenue and Taxation Code is amended to read:

17275.5. (a) No deduction shall be denied under Section 170(f)(8) of the Internal Revenue Code, relating to substantiation requirement for certain contributions, upon a showing that the requirements in Section 170(f)(8) of the Internal Revenue Code have been met with respect to that contribution for federal purposes.

(b) Section 170(f)(10)(F) of the Internal Revenue Code, relating to excise tax on premiums paid, shall not apply.

(c) The provisions of Section 170(f)(11)(E) of the Internal Revenue Code, relating to qualified appraisal and appraiser, shall apply to appraisals prepared with respect to returns or submissions filed on or after January 1, 2010.

(d) Section 170(f)(13) of the Internal Revenue Code, relating to contributions of certain interests in buildings located in registered historic districts, shall not apply.

(e) Section 170(f)(18) of the Internal Revenue Code, relating to contributions to donor advised funds, shall not apply.

(f) For contributions made on or after January 1, 2024, the amendments made by Section 605(b) of Public Law 117-328 adding paragraph (19) to Section 170(f) of the Internal Revenue Code, relating to certain qualified conservation contributions, shall apply.

SEC. 22. Section 17275.6 is added to the Revenue and Taxation Code, to read:

17275.6. (a) For contributions made on or after January 1, 2024, the amendments made by Section 605(a)(1) of Public Law 117-328 adding paragraph (7) to Section 170(h) of the Internal Revenue Code, relating to limitation on deduction for qualified conservation contributions made by passthrough entities, shall apply, except as otherwise provided.

(b) Section 170(h)(7)(G) of the Internal Revenue Code, relating to regulations, as added by Section 605(a)(1) of Public Law 117-328, shall not apply.

(c) For contributions made on or after January 1, 2024, the amendments made by Section 605(a)(3) of Public Law 117-328, relating to extension of statute of limitations for listed transactions, shall apply and are modified by substituting “Section 19755” for “sections 6501(c)(10) and 6235(c)(6) of such Code.”

(d) Section 605(d)(2) of Public Law 117-328, relating to opportunity to correct, shall apply.

SEC. 23. Section 17276.24 is added to the Revenue and Taxation Code, to read:

17276.24. (a) Notwithstanding Sections 17276, 17276.1, 17276.4, 17276.7, and 17276.22, Sections 17276.2, 17276.5, and 17276.6, as those sections read on November 29, 2014, Section 17276.20, as that section read on December 31, 2015, and Section 172 of the Internal Revenue Code, a net operating loss deduction shall not be allowed for any taxable year beginning on or after January 1, 2024, and before January 1, 2027.

(b) For any net operating loss or carryover of a net operating loss for which a deduction is denied by subdivision (a), the carryover period under Section 172 of the Internal Revenue Code shall be extended as follows:

(1) By one year, for losses incurred in taxable years beginning on or after January 1, 2025, and before January 1, 2026.

(2) By two years, for losses incurred in taxable years beginning on or after January 1, 2024, and before January 1, 2025.

(3) By three years, for losses incurred in taxable years beginning before January 1, 2024.

(c) For a taxable year beginning on or after January 1, 2024, and before January 1, 2027, this section shall not apply to a taxpayer that has either of the following:

(1) Net business income of less than one million dollars ($1,000,000) for the taxable year.

(2) Modified adjusted gross income of less than one million dollars ($1,000,000) for the taxable year.

(d) For purposes of this section:

(1) "Business income" means any of the following:

(A) Income from a trade or business, whether conducted by the taxpayer or by a passthrough entity owned directly or indirectly by the taxpayer.

(B) Income from rental activity.

(C) Income attributable to a farming business.

(2) "Modified adjusted gross income" means the amount described in paragraph (2) of subdivision (h) of Section 17024.5, determined without regard to the deduction allowed under Section 172 of the Internal Revenue Code, relating to net operating loss deduction.

(3) "Passthrough entity" means a partnership or an S corporation.

SEC. 24. Section 17681 of the Revenue and Taxation Code is amended to read:

17681. (a) Subchapter I of Chapter 1 of Subtitle A of the Internal Revenue Code, relating to natural resources, shall apply, except as otherwise provided.

(b) For taxable years beginning on or after January 1, 2024, Section 613(b)(2)(B) of the Internal Revenue Code, in the case of oil shale, shall not apply.

(c) For taxable years beginning on or after January 1, 2024, Section 613(b)(4) of the Internal Revenue Code, relating to 10 percent, in the case of coal, shall not apply.

(d) For taxable years beginning on or after January 1, 2024, Section 613A of the Internal Revenue Code, relating to limitations on percentage depletion in the case of oil and gas wells, shall not apply.

SEC. 25. Section 17681.3 of the Revenue and Taxation Code is repealed.

SEC. 26. Section 17681.6 of the Revenue and Taxation Code is repealed.

SEC. 27. Section 18416.5 of the Revenue and Taxation Code is amended to read:

18416.5. (a) The Franchise Tax Board may, by regulation, implement an alternative communication method that would allow the Franchise Tax Board, at the request of the taxpayer or the taxpayer's authorized representative, to provide notification to the taxpayer in a preferred electronic communication method designated by the taxpayer that a notice, statement, bill, or other communication required or authorized under Part 10 (commencing with Section 17001), this part, or Part 11 (commencing with Section 23001) is available for viewing in the taxpayer's limited access secure folder on the Franchise Tax Board's internet website and would allow the taxpayer or the taxpayer's authorized representative to file a protest, notification, and other communication to the Franchise Tax Board in a secure manner. Prior to obtaining the consent of a taxpayer to participate in the alternative communication method authorized by this section, the Franchise Tax Board shall advise the taxpayer or the taxpayer's authorized representative of the ramifications of electing to receive notifications from the Franchise Tax Board in the manner selected and of failing to take appropriate action in response to one or more of those notifications.

(b) Sending electronic notification to a taxpayer or the taxpayer's authorized representative pursuant to the taxpayer's request made in accordance with regulations authorized under subdivision (a) shall not be considered a violation of Section 19542 or 19542.1. Any electronic notification provided to a taxpayer using the alternative communication method authorized by this section shall include plain

language advising the taxpayer that a failure to act may cause the taxpayer to forego procedural or administrative rights to challenge the proposed action.

(c) Notwithstanding any other law regarding the use of United States mail, any notice, statement, bill, protest, and other communication from the Franchise Tax Board to a taxpayer or the taxpayer's authorized representative and from a taxpayer or the taxpayer's authorized representative to the Franchise Tax Board pursuant to the alternative communication method authorized by this section shall be treated as if it were mailed by United States mail, postage prepaid.

SEC. 28. Section 18572 of the Revenue and Taxation Code is amended to read:

18572. (a) Section 7508A of the Internal Revenue Code, relating to postponement of certain tax-related deadlines, shall apply, except as otherwise provided.

(b) Section 7508A of the Internal Revenue Code, relating to postponement of certain tax-related deadlines, shall apply to a taxpayer determined by the Director of Finance to be affected by a state of emergency declared by the Governor.

(c) Notwithstanding any other provision of law, the postponement of certain tax-related deadlines under this section shall be determined by the Director of Finance.

(d) (1) Section 7508A of the Internal Revenue Code, relating to postponement of certain tax-related deadlines, shall apply to an impacted taxpayer, during an additional relief period, that requests relief pursuant to this section.

(2) For purposes of this subdivision, the following definitions shall apply:

(A) "Additional relief period" means the period beginning on the date the state postponement period expires, if any, and ending on the date the federal postponement period expires.

(B) "Federal postponement period" means the postponement period as defined in Section 301.7508A-1(d)(3) of Title 26 of the Code of Federal Regulations.

(C) "Impacted taxpayer" means a taxpayer that meets both of the following:

(i) Otherwise qualifies for relief under subdivision (a) or (b), but did not file their California tax return or make payments of tax or fee, as required under Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23001), or this part, before the expiration of the state postponement period.

(ii) Requests relief pursuant to this section in the form and manner prescribed by the Franchise Tax Board and shall, upon request, submit supporting documentation related to the declared disaster, pursuant to this section.

(D) "State postponement period" means the postponement period determined by the Director of Finance pursuant to subdivision (c).

(E) "Supporting documentation" means any of the following:

(i) A letter from the Federal Emergency Management Agency that approves assistance to the impacted taxpayer pursuant to the federal Robert T. Stafford Disaster Relief and Emergency Assistance Act (42 U.S.C. Sec. 5121 et seq.).

(ii) A determination of award letter from the Small Business Administration disaster loan program that approves assistance to the impacted taxpayer.

(iii) A statement, signed under penalty of perjury, from a tax professional indicating the impacted taxpayer's books and records that are necessary to meet a tax deadline were destroyed in the disaster area or jurisdiction for which the Governor has proclaimed a state of emergency.

(iv) A law enforcement report issued to the impacted taxpayer, related to theft or looting due to lawlessness occurring during the disaster or emergency and in the disaster area or jurisdiction for which the Governor proclaimed a state of emergency.

(v) An insurance claim submitted by or on behalf of the impacted taxpayer, related to the disaster or conditions of emergency.

(vi) Verification of disaster relief related to housing assistance, property damage, employment, public health, mortgage assistance, or business operation received from a government entity, banking institution, or organization described in Section 501(c)(3) of the Internal Revenue Code.

(e) (1) The Franchise Tax Board may adopt regulations that are necessary or appropriate to implement this section.

(2) The Administrative Procedure Act (Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code) shall not apply to any standard, criterion, procedure, determination, rule, notice, guideline, or any other guidance established or issued by the Franchise Tax Board pursuant to this section.

(f) The amendments made to this section by the act adding this subdivision shall apply to any federally declared disaster or Governor-proclaimed state of emergency on or after the effective date of the act adding this subdivision.

SEC. 29. Section 19164 of the Revenue and Taxation Code is amended to read:

19164. (a) (1) (A) An accuracy-related penalty shall be imposed under this part and shall be determined in accordance with Section 6662 of the Internal Revenue Code, relating to imposition of accuracy-related penalty on underpayments, except as otherwise

provided.

(B) (i) Except for understatements relating to reportable transactions to which Section 19164.5 applies, in the case of any proposed deficiency assessment issued after the last date of the amnesty period specified in Chapter 9.1 (commencing with Section 19730) for any taxable year beginning prior to January 1, 2003, the penalty specified in Section 6662(a) of the Internal Revenue Code shall be computed by substituting "40 percent" for "20 percent."

(ii) Clause (i) shall not apply to any taxable year of a taxpayer beginning prior to January 1, 2003, if, as of the start date of the amnesty program period specified in Section 19731, the taxpayer is then under audit by the Franchise Tax Board, or the taxpayer has filed a protest under Section 19041, or the taxpayer has filed an appeal under Section 19045, or the taxpayer is engaged in settlement negotiations under Section 19442, or the taxpayer has a pending judicial proceeding in any court of this state or in any federal court relating to the tax liability of the taxpayer for that taxable year.

(2) With respect to corporations, this subdivision shall apply to all of the following:

(A) All taxable years beginning on or after January 1, 1990.

(B) Any other taxable year for which an assessment is made after July 16, 1991.

(C) For purposes of this section, references in Section 6662(e) of the Internal Revenue Code and the regulations thereunder, relating to treatment of an affiliated group that files a consolidated federal return, are modified to apply to those entities required to be included in a combined report under Section 25101 or 25110. For these purposes, entities included in a combined report pursuant to paragraph (4) or (6) of subdivision (a) of Section 25110 shall be considered only to the extent required to be included in the combined report.

(3) Section 6662(d)(1)(B) of the Internal Revenue Code is modified to provide that in the case of a corporation, other than an "S" corporation, there is a substantial understatement of tax for any taxable year if the amount of the understatement for the taxable year exceeds the lesser of:

(A) Ten percent of the tax required to be shown on the return for the taxable year (or, if greater, two thousand five hundred dollars ($2,500)).

(B) Five million dollars ($5,000,000).

(4) Section 6662(d)(2)(A) of the Internal Revenue Code is modified to additionally provide that the excess determined under Section 6662(d)(2)(A) of the Internal Revenue Code shall be determined without regard to items to which Section 19164.5 applies and without regard to items with respect to which a penalty is imposed by Section 19774.

(5) The provisions of Sections 6662(e)(1) and 6662(h)(2) of the Internal Revenue Code shall apply to returns filed on or after January 1, 2010.

(b) The amendments made by Section 605(a)(2) of Public Law 117-328 adding Sections 6662(b)(10) and 6662(h)(2)(D) to, and amending Section 6664(c)(2) of, the Internal Revenue Code, relating to application of accuracy-related penalties, shall apply to returns filed on or after January 1, 2024.

(c) For purposes of Section 6662(d) of the Internal Revenue Code, Section 6664 of the Internal Revenue Code, Section 6694(a)(1) of the Internal Revenue Code, and this part, the Franchise Tax Board may prescribe a list of positions for which the Franchise Tax Board believes there is not substantial authority or there is no reasonable belief that the tax treatment is more likely than not the proper tax treatment. That list (and any revisions thereof) shall be published through the use of Franchise Tax Board Notices or other published positions. In addition, the "listed transactions" identified and published pursuant to the preceding sentence shall be published on the internet website of the Franchise Tax Board.

(d) A fraud penalty shall be imposed under this part and shall be determined in accordance with Section 6663 of the Internal Revenue Code, relating to imposition of fraud penalty, except as otherwise provided.

(e) (1) Section 6664 of the Internal Revenue Code, relating to definitions and special rules, shall apply, except as otherwise provided.

(2) Section 6664(c)(3) of the Internal Revenue Code shall apply to returns filed on or after January 1, 2010.

(3) Section 6664(c)(4) of the Internal Revenue Code shall apply to appraisals prepared with respect to returns or submissions filed on or after January 1, 2010.

(f) Except for purposes of subdivision (e) of Section 19774, Section 6662(b)(6) of the Internal Revenue Code shall not apply.

(g) Except for purposes of subdivision (e) of Section 19774, Section 6662(i) of the Internal Revenue Code, relating to increase in penalty in case of nondisclosed noneconomic substance transactions, shall not apply.

(h) Section 6665 of the Internal Revenue Code, relating to applicable rules, shall apply, except as otherwise provided.

(i) The amendments made to this section by Chapter 14 of the Statutes of 2011 shall apply to notices mailed on or after January 1, 2012.

SEC. 30. Section 19187 of the Revenue and Taxation Code is amended to read:

19187. (a) The Franchise Tax Board shall include with each notice imposing a penalty under this part information that contains the name of the penalty, the section of this part under which the penalty is imposed, and a description of the computation of the penalty.

Upon the request of the taxpayer, the Franchise Tax Board shall also provide a computation of the penalty imposed.

(b) (1) No penalty under this part shall be imposed unless the initial determination of the imposition of the penalty is personally approved in writing by the immediate supervisor of the individual making that determination or a higher level official as designated by the executive officer, or the officer's delegee.

(2) Paragraph (1) shall not apply to any of the following:

(A) Any addition to tax under Sections 19131, 19132, 19136, or 19142.

(B) Any addition to tax imposed pursuant to subdivision (b) of Section 19164.

(C) Any other penalty automatically calculated through electronic means.

(D) Any penalty resulting from a change or correction by the Commissioner of Internal Revenue or other officer of the United States or other competent authority required to be reported under subdivision (a) of Section 18622.

(c) For purposes of this section, "penalty" includes any addition to tax or any additional amount.

(d) This section shall apply to notices issued and penalties imposed after December 31, 2001.

(e) The amendments made to this section by the act adding this subdivision shall apply for additions to tax imposed on or after January 1, 2024.

SEC. 31. Section 19378 of the Revenue and Taxation Code is amended to read:

19378. (a) The Franchise Tax Board shall determine the amount of the contracting costs incurred under Section 19377 and notify the Controller of that amount which shall be transferred from the Personal Income Tax Fund or the Corporation Tax Fund to the Delinquent Tax Collection Fund, which is hereby created.

(b) The Controller shall transfer that amount determined pursuant to subdivision (a) from the Delinquent Tax Collection Fund to the Franchise Tax Board for reimbursement of its contracting costs. The moneys remaining in the Delinquent Tax Collection Fund after disbursements shall be transferred to the Personal Income Tax Fund or the Corporation Tax Fund by the Controller upon notification by the Franchise Tax Board. Notwithstanding Section 13340 of the Government Code, the moneys transferred pursuant to this section are hereby continuously appropriated, without regard to fiscal years.

(c) The funds generated through this section shall not be used in place of funds from other sources that are available for appropriation to the Franchise Tax Board.

(d) This section shall become operative on July 1, 1993.

(e) This section shall remain in effect only until June 30, 2024, and as of that date is repealed.

SEC. 32. Section 23036 of the Revenue and Taxation Code is amended to read:

23036. (a) (1) The term "tax" includes any of the following:

(A) The tax imposed under Chapter 2 (commencing with Section 23101).

(B) The tax imposed under Chapter 3 (commencing with Section 23501).

(C) The tax on unrelated business taxable income, imposed under Section 23731.

(D) The tax on "S" corporations imposed under Section 23802.

(2) The term "tax" does not include any amount imposed under paragraph (1) of subdivision (e) of Section 24667 or paragraph (2) of subdivision (f) of Section 24667.

(b) For purposes of Article 5 (commencing with Section 18661) of Chapter 2, Article 3 (commencing with Section 19031) of Chapter 4, Article 6 (commencing with Section 19101) of Chapter 4, and Chapter 7 (commencing with Section 19501) of Part 10.2, and for purposes of Sections 18601, 19001, and 19005, the term "tax" also includes all of the following:

(1) The tax on limited partnerships, imposed under Section 17935, the tax on limited liability companies, imposed under Section 17941, and the tax on registered limited liability partnerships and foreign limited liability partnerships imposed under Section 17948.

(2) The alternative minimum tax imposed under Chapter 2.5 (commencing with Section 23400).

(3) The tax on built-in gains of "S" corporations, imposed under Section 23809.

(4) The tax on excess passive investment income of "S" corporations, imposed under Section 23811.

(c) Notwithstanding any other provision of this part, credits are allowed against the "tax" in the following order:

(1) Credits that do not contain carryover provisions.

(2) Credits that, when the credit exceeds the "tax," allow the excess to be carried over to offset the "tax" in succeeding taxable years, except for those credits that are allowed to reduce the "tax" below the tentative minimum tax, as defined by Section 23455.

The order of credits within this paragraph shall be determined by the Franchise Tax Board.

(3) The minimum tax credit allowed by Section 23453.

(4) Credits that are allowed to reduce the "tax" below the tentative minimum tax, as defined by Section 23455, except the credit described in paragraph (5).

(5) For taxable years beginning on or after January 1, 2025, the credit allowed by Section 23698.1.

(6) Credits for taxes withheld under Section 18662.

(d) Notwithstanding any other provision of this part, each of the following applies:

(1) A credit may not reduce the "tax" below the tentative minimum tax (as defined by paragraph (1) of subdivision (a) of Section 23455), except the following credits:

(A) The credit allowed by former Section 23601 (relating to solar energy).

(B) The credit allowed by former Section 23601.4 (relating to solar energy).

(C) The credit allowed by former Section 23601.5 (relating to solar energy).

(D) The credit allowed by Section 23609 (relating to research expenditures).

(E) The credit allowed by former Section 23609.5 (relating to clinical testing expenses).

(F) The credit allowed by Section 23610.5 (relating to low-income housing).

(G) The credit allowed by former Section 23612 (relating to sales and use tax credit).

(H) The credit allowed by Section 23612.2 (relating to enterprise zone sales or use tax credit).

(I) The credit allowed by former Section 23612.6 (relating to Los Angeles Revitalization Zone sales tax credit).

(J) The credit allowed by former Section 23622 (relating to enterprise zone hiring credit).

(K) The credit allowed by Section 23622.7 (relating to enterprise zone hiring credit).

(L) The credit allowed by former Section 23623 (relating to program area hiring credit).

(M) The credit allowed by former Section 23623.5 (relating to Los Angeles Revitalization Zone hiring credit).

(N) The credit allowed by former Section 23625 (relating to Los Angeles Revitalization Zone hiring credit).

(O) The credit allowed by Section 23633 (relating to targeted tax area sales or use tax credit).

(P) The credit allowed by Section 23634 (relating to targeted tax area hiring credit).

(Q) The credit allowed by former Section 23649 (relating to qualified property).

(R) For taxable years beginning on or after January 1, 2011, the credit allowed by Section 23685 (relating to qualified motion pictures).

(S) For taxable years beginning on or after January 1, 2014, the credit allowed by Section 23689 (relating to GO-Biz California Competes Credit).

(T) For taxable years beginning on or after January 1, 2016, the credit allowed by Section 23695 (relating to qualified motion pictures).

(U) For taxable years beginning on or after January 1, 2014, the credit allowed by Section 23686 (relating to the College Access Tax Credit Fund).

(V) For taxable years beginning on or after January 1, 2017, the credit allowed by Section 23687 (relating to the College Access Tax Credit Fund).

(W) For taxable years beginning on or after January 1, 2020, and before January 1, 2031, the credit allowed by Section 23636 (relating to the new advanced strategic aircraft credit).

(X) For taxable years beginning on or after January 1, 2020, the credit allowed by Section 23698 (relating to the California Motion Picture and Television Production Credit).

(Y) For taxable years beginning on or after January 1, 2025, the credit allowed by Section 23698.1 (relating to the California Motion Picture and Television Production Credit).

(2) A credit against the tax may not reduce the minimum franchise tax imposed under Chapter 2 (commencing with Section 23101).

(e) Any credit which is partially or totally denied under subdivision (d) is allowed to be carried over to reduce the "tax" in the following year, and succeeding years if necessary, if the provisions relating to that credit include a provision to allow a carryover of the unused portion of that credit.

(f) Unless otherwise provided, any remaining carryover from a credit that has been repealed or made inoperative is allowed to be carried over under the provisions of that section as it read immediately prior to being repealed or becoming inoperative.

(g) Unless otherwise provided, if two or more taxpayers share in costs that would be eligible for a tax credit allowed under this part, each taxpayer is eligible to receive the tax credit in proportion to their respective share of the costs paid or incurred.

(h) Unless otherwise provided, in the case of an "S" corporation, any credit allowed by this part is computed at the "S" corporation level, and any limitation on the expenses qualifying for the credit or limitation upon the amount of the credit applies to the "S" corporation and to each shareholder.

(i) (1) With respect to any taxpayer that directly or indirectly owns an interest in a business entity that is disregarded for tax purposes pursuant to Section 23038 and any regulations thereunder, the amount of any credit or credit carryforward allowable for any taxable year attributable to the disregarded business entity is limited in accordance with paragraphs (2) and (3).

(2) The amount of any credit otherwise allowed under this part, including any credit carryover from prior years, that may be applied to reduce the taxpayer's "tax," as defined in subdivision (a), for the taxable year is limited to an amount equal to the excess of the taxpayer's regular tax (as defined in Section 23455), determined by including income attributable to the disregarded business entity that generated the credit or credit carryover, over the taxpayer's regular tax (as defined in Section 23455), determined by excluding the income attributable to that disregarded business entity. A credit is not allowed if the taxpayer's regular tax (as defined in Section 23455), determined by including the income attributable to the disregarded business entity is less than the taxpayer's regular tax (as defined in Section 23455), determined by excluding the income attributable to the disregarded business entity.

(3) If the amount of a credit allowed pursuant to the section establishing the credit exceeds the amount allowable under this subdivision in any taxable year, the excess amount may be carried over to subsequent taxable years pursuant to subdivisions (d), (e), and (f).

(j) (1) Unless otherwise specifically provided, in the case of a taxpayer that is a partner or shareholder of an eligible pass-thru entity described in paragraph (2), any credit passed through to the taxpayer in the taxpayer's first taxable year beginning on or after the date the credit is no longer operative may be claimed by the taxpayer in that taxable year, notwithstanding the repeal of the statute authorizing the credit prior to the close of that taxable year.

(2) For purposes of this subdivision, "eligible pass-thru entity" means any partnership or "S" corporation that files its return on a fiscal year basis pursuant to Section 18566, and that is entitled to a credit pursuant to this part for the taxable year that begins during the last year a credit is operative.

(3) This subdivision applies to credits that become inoperative on or after the operative date of the act adding this subdivision.

(k) The amendments made to this section by the act adding this subdivision shall apply as follows:

(1) The amendments to subdivision (c) shall be operative for taxable years beginning on or after January 1, 2025.

(2) The amendments to subparagraph (X) of paragraph (1) of subdivision (d) shall be operative for taxable years beginning on or after January 1, 2020.

(3) The amendments to subparagraph (Y) of paragraph (1) of subdivision (d) shall be operative for taxable years beginning on or after January 1, 2025.

SEC. 33. Section 23036.4 is added to the Revenue and Taxation Code, to read:

23036.4. (a) Notwithstanding any provision of this part or Part 10.2 (commencing with Section 18401) to the contrary, except as provided in subdivision (d), for taxpayers not required to be included in a combined report under Section 25101 or 25110, or taxpayers not authorized to be included in a combined report under Section 25101.15, for each taxable year beginning on or after January 1, 2024, and before January 1, 2027, the total of all credits otherwise allowable under any provision of Chapter 3.5 (commencing with Section 23604) including the carryover of any credit under a former provision of that chapter, for the taxable year shall not reduce the "tax," as defined in Section 23036, by more than five million dollars ($5,000,000).

(b) Notwithstanding any provision of this part or Part 10.2 (commencing with Section 18401) to the contrary, except as provided in subdivision (d), for taxpayers required to be included in a combined report under Section 25101 or 25110, or taxpayers authorized to be included in a combined report under Section 25101.15, for each taxable year beginning on or after January 1, 2024, and before January 1, 2027, the total of all credits otherwise allowable under any provision of Chapter 3.5 (commencing with Section 23604), including the carryover of any credit under a former provision of that chapter, by all members of the combined report shall not reduce the aggregate amount of "tax," as defined in Section 23036, of all members of the combined report by more than five million dollars ($5,000,000).

(c) Any amounts included in an election pursuant to Section 6902.5, relating to an irrevocable election to apply credit amounts under Section 17053.85, 17053.95, 17053.98, 23685, 23695, or 23698 against qualified sales and use tax, as defined in Section 6902.5, are not included in the five million dollar ($5,000,000) limitation set forth in subdivision (a) or (b).

(d) The limitation under subdivision (a) or (b) shall not apply to the credit allowed by Section 23610.5 (relating to credit for low-income housing).

(e) The amount of any credit otherwise allowable for the taxable year under Section 23036 that is not allowed due to the application of this section shall remain a credit carryover amount under this part.

(f) The carryover period for any credit that is not allowed due to the application of this section shall be increased by the number of taxable years the credit or any portion thereof was not allowed.

(g) Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code does not apply to any standard, criterion, procedure, determination, rule, notice, or guideline established or issued by the Franchise Tax Board pursuant to this section.

SEC. 34. Section 23604 of the Revenue and Taxation Code is amended to read:

23604. For each taxable year beginning on or after January 1, 1996, and before January 1, 2024, there shall be allowed as a credit against the "tax" (as defined by Section 23036) an amount determined as follows:

(a) (1) (A) The amount of the credit shall be equal to one-third of the federal credit computed in accordance with Section 43 of the Internal Revenue Code.

(B) If a taxpayer elects, under Section 43(e) of the Internal Revenue Code, not to apply Section 43 for federal tax purposes, this election is binding and irrevocable for state purposes, and for purposes of subparagraph (A), the federal credit shall be zero.

(2) "Qualified enhanced oil recovery project" shall include only projects located within California.

(3) The credit allowed under this subdivision shall not be allowed to any taxpayer for whom a depletion allowance is not permitted to be computed under Section 613 of the Internal Revenue Code by reason of paragraphs (2), (3), or (4) of subsection (d) of Section 613A of the Internal Revenue Code.

(b) Section 43(d) of the Internal Revenue Code shall apply.

(c) In the case where the credit allowed by this section exceeds the "tax," the excess may be carried over to reduce the "tax" for the succeeding 15 years.

(d) In the case where property which qualifies as part of the taxpayer's "qualified enhanced oil recovery costs" also qualifies for a credit under any other section in this part, the taxpayer shall make an election on its original return as to which section applies to all costs allocable to that item of qualified property. Any election made under this section, and any specification contained in that election, may not be revoked except with the consent of the Franchise Tax Board.

(e) No deduction shall be allowed as otherwise provided in this part for that portion of any costs paid or incurred for the taxable year which is equal to the amount of the credit allowed under this section attributable to those costs.

(f) The basis of any property for which a credit is allowed under this section shall be reduced by the amount of the credit attributable to the property. The basis adjustment shall be made for the taxable year for which the credit is allowed.

(g) No credit may be claimed under this section with respect to any amount for which any other credit has been claimed under this part.

(h) This section shall remain in effect only until December 1, 2024, and as of that date is repealed.

SEC. 35. Section 24357 of the Revenue and Taxation Code is amended to read:

24357. (a) There shall be allowed as a deduction any charitable contribution, as defined in Section 24359, the payment of which is made within the taxable year. A charitable contribution shall be allowable as a deduction only if verified under regulations prescribed by the Franchise Tax Board.

(b) (1) In the case of a corporation reporting its income on the accrual basis, the corporation may elect to treat the contribution as paid during that taxable year if both of the following occur:

(A) The board of directors authorizes a charitable contribution during the taxable year.

(B) Payment of the contribution is made after the close of that taxable year and on or before the 15th day of the third month following the close of the taxable year.

(2) The election allowed by paragraph (1) may be made only at the time of the filing of the return for the taxable year, and shall be signified in the manner as the Franchise Tax Board shall by regulations prescribe.

(c) For purposes of this section, payment of a charitable contribution that consists of a future interest in tangible personal property shall be treated as made only when all intervening interests in, and rights to the actual possession or enjoyment of, the property have expired or are held by persons other than the taxpayer or those standing in a relationship to the taxpayer described in Section 24428. For purposes of the preceding sentence, a fixture which is intended to be severed from the real property shall be treated as tangible personal property.

(d) No deduction shall be allowed under this section for traveling expenses (including amounts expended for meals and lodging) while away from home, whether paid directly or by reimbursement, unless there is no significant element of personal pleasure, recreation, or vacation in that travel.

(e) (1) Section 170(f)(8) of the Internal Revenue Code, relating to substantiation requirement for certain contributions, shall apply, except as otherwise provided.

(2) No deduction shall be denied under Section 170(f)(8) of the Internal Revenue Code, relating to substantiation requirement for certain contributions, upon a showing that the requirements in Section 170(f)(8) of the Internal Revenue Code have been met with respect to that contribution for federal purposes.

(f) Section 170(f)(9) of the Internal Revenue Code, relating to denial of deduction where contribution for lobbying activities, shall apply, except as otherwise provided.

(g) (1) Notwithstanding any other provision of law to the contrary, for purposes of this section and Section 24341, Section 170 of the Internal Revenue Code, relating to charitable, etc., contributions and gifts, shall be applied to allow a taxpayer to elect to treat any contribution described in paragraph (2) made in January 2005, as if that contribution was made on December 31, 2004, and not in January 2005.

(2) A contribution is described in this paragraph if that contribution is a cash contribution made for the relief of victims in areas affected by the December 26, 2004, Indian Ocean tsunami for which a charitable contribution deduction is allowable under this section.

(h) (1) Section 170(f)(11)(E) of the Internal Revenue Code, relating to qualified appraisal and appraiser, shall apply, except as otherwise provided.

(2) This subdivision shall apply to appraisals prepared with respect to returns or submissions filed on or after January 1, 2010.

(i) (1) Section 170(f)(16) of the Internal Revenue Code, relating to contributions of clothing and household items, shall apply, except as otherwise provided.

(2) This subdivision shall apply to contributions made on or after January 1, 2010.

(j) (1) Section 170(f)(17) of the Internal Revenue Code, relating to recordkeeping, shall apply, except as otherwise provided.

(2) This subdivision shall apply to contributions made on or after January 1, 2010.

(k) (1) Section 170(o) of the Internal Revenue Code, relating to special rules for fractional gifts, shall apply, except as otherwise provided.

(2) This subdivision shall apply to contributions made on or after January 1, 2010.

(l) (1) (A) The amendments made by Section 605(a)(1) of Public Law 117-328 adding paragraph (7) to Section 170(h) of the Internal Revenue Code, relating to limitation on deduction for qualified conservation contributions made by passthrough entities, shall apply, except as otherwise provided.

(B) Section 170(h)(7)(G) of the Internal Revenue Code, relating to regulations, as added by Section 605(a)(1) of Public Law 117-328, shall not apply.

(C) Section 605(a)(3) of Public Law 117-328, relating to extension of statute of limitations for listed transactions, shall apply and is modified by substituting "Section 19755" for "sections 6501(c)(10) and 6235(c)(6) of such Code."

(2) The amendments made by Section 605(b) of Public Law 117-328 adding paragraph (19) to Section 170(f) of the Internal Revenue Code, relating to certain qualified conservation contributions, shall apply.

(3) This subdivision shall apply to contributions made on or after January 1, 2024.

(m) Section 605(d)(2) of Public Law 117-328, relating to opportunity to correct, shall apply.

SEC. 36. Section 24416.24 is added to the Revenue and Taxation Code, to read:

24416.24. (a) Notwithstanding Sections 24416, 24416.1, 24416.4, 24416.7, and 24416.22, former Sections 24416.2, 24416.5, 24416.6, and 24416.20, and Section 172 of the Internal Revenue Code, a net operating loss deduction shall not be allowed for any taxable year beginning on or after January 1, 2024, and before January 1, 2027.

(b) For any net operating loss or carryover of a net operating loss for which a deduction is denied by subdivision (a), the carryover period under Section 172 of the Internal Revenue Code shall be extended as follows:

(1) By one year, for losses incurred in taxable years beginning on or after January 1, 2025, and before January 1, 2026.

(2) By two years, for losses incurred in taxable years beginning on or after January 1, 2024, and before January 1, 2025.

(3) By three years, for losses incurred in taxable years beginning before January 1, 2024.

(c) The disallowance of any net operating loss deduction for any taxable year beginning on or after January 1, 2024, and before January 1, 2027, pursuant to subdivision (a) shall not apply to a taxpayer with income subject to tax under this part of less than one million dollars ($1,000,000) for the taxable year.

SEC. 37. Section 24423 of the Revenue and Taxation Code is repealed.

SEC. 38. Section 24831 of the Revenue and Taxation Code is amended to read:

24831. (a) Subchapter I of Chapter 1 of Subtitle A of the Internal Revenue Code, relating to natural resources, shall apply, except as otherwise provided.

(b) For taxable years beginning on or after January 1, 2024, Section 613(b)(2)(B) of the Internal Revenue Code, in the case of oil shale, shall not apply.

(c) For taxable years beginning on or after January 1, 2024, Section 613(b)(4) of the Internal Revenue Code, relating to 10 percent, in the case of coal, shall not apply.

(d) For taxable years beginning on or after January 1, 2024, Section 613A of the Internal Revenue Code, relating to limitations on percentage depletion in the case of oil and gas wells, shall not apply.

SEC. 39. Section 24831.3 of the Revenue and Taxation Code is repealed.

SEC. 40. Section 24831.6 of the Revenue and Taxation Code is repealed.

SEC. 41. Section 25128.9 is added to the Revenue and Taxation Code, to read:

25128.9. (a) The Legislature finds and declares all of the following:

(1) In 1966, the California Legislature enacted the Uniform Division of Income for Tax Purposes Act under Sections 25120 through 25139, inclusive, of the Revenue and Taxation Code.

(2) That act provides for the allocation and apportionment of income of taxpayer having income from business activities which is taxable both within and without the state.

(3) On April 28, 2006, the Franchise Tax Board issued Franchise Tax Board Legal Ruling 2006-1 (the Legal Ruling), regarding the treatment of apportionment factors attributable to income exempt from income tax under the Corporation Tax Law.

(4) It is the intent of the Legislature that the Legal Ruling shall apply with respect to apportionment factors attributable to the income of taxpayers subject to tax under the Corporation Tax Law.

(5) It is the intent of the Legislature that this section does not constitute a change in, but is declaratory of, existing law.

(6) It is the intent of the Legislature that the clarification in this section apply to any apportionment formula currently and formerly allowed under this article.

(b) (1) A transaction or activity, to the extent that it generates income or loss not included in "net income," as defined in Section 24341, subject to apportionment, shall be excluded from the apportionment formulas under this part, including Sections 25128, 25128.7, and 25141, and former Section 25128.5.

(2) For the purposes of this section, "not included in 'net income,'" means income from transactions and activities that is not included in net income subject to apportionment for any reason, including, but not limited to, exclusion, deduction, exemption, elimination, or nonrecognition.

(c) (1) The Franchise Tax Board may adopt regulations that are necessary or appropriate to carry out the purpose of this section, which is to prevent inclusion within the apportionment formula of transactions and activities that give rise to income that is not subject to apportionment.

(2) The Administrative Procedure Act (Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code) shall not apply to any regulation, standard, criterion, procedure, determination, rule, notice, guideline, or any other guidance established or issued by the Franchise Tax Board pursuant to this section.

(d) This section shall apply to taxable years beginning before, on, or after the effective date of the act adding this section.

SEC. 42. Section 50108 of the Revenue and Taxation Code is amended to read:

50108. (a) The fee imposed pursuant to Sections 25299.41 and 25299.43 of the Health and Safety Code shall be administered and collected by the California Department of Tax and Fee Administration in accordance with this part.

(b) The repeal of certain portions of Chapter 6.75 (commencing with Section 25299.10) of Division 20 of the Health and Safety Code by the act adding this subdivision does not terminate the rights, obligations, or authorities, or any provision necessary to carry out the rights and obligations for the California Department of Tax and Fee Administration to collect unpaid fees pursuant to this part that are imposed pursuant to Article 5 (commencing with Section 25299.40) of Chapter 6.75 of Division 20 of the Health and Safety Code, as that article read on December 31, 2035, or that have become due before January 1, 2036, including any interest or penalties that accrue before, on, or after January 1, 2036, associated with those unpaid fees, for deposit into the Underground Storage Tank Cleanup Fund, the making of any returns and effecting of any credits, the disposition of the moneys collected, and the commencement of any action or proceeding regarding fees imposed pursuant to Article 5 (commencing with Section 25299.40) of Chapter 6.75 of Division 20 of the Health and Safety Code.

SEC. 43. Section 8163 of the Welfare and Institutions Code is amended to read:

8163. Notwithstanding any other law, the state may contract with a third-party vendor for services relating to the distribution of payments made pursuant to this chapter in the form and manner best determined to expedite payment and mitigate fraud. A contract for services entered into pursuant to this section may include terms and conditions that are in the state's best interest, but shall include an expiration date on each form of payment issued of no later than April 30, 2026, and a requirement that any unexpended or unclaimed balance of the payments issued shall, upon expiration, be returned to the Franchise Tax Board which will deposit the moneys in the General Fund, and all unused balances returned, no later than May 31, 2026.

SEC. 44. It is the intent of the Legislature to hereby supersede or overrule, as applicable, the State Board of Equalization's Memorandum Opinion "In the Matter of the Claim for Refund Under the Sales and Use Tax Law of WFS Financial, Inc." (December 14, 2000).

SEC. 45. It is the intent of the Legislature to enact legislation to do the following:

(a) Ensure that taxpayers subject to a temporary credit limitation beginning calendar year 2024 can utilize their credits after the limitation period ends by electing to receive a refund of those tax credits calculated based on the amount of credits the taxpayer would have otherwise used to reduce tax liability during the taxable years in which the limitation was effective.

(b) Allow an electing taxpayer to claim the refundable portion of its tax credits during defined taxable years commencing with the taxable year immediately following the last taxable year of the credit limitation period.

(c) Include specific provisions to prevent overstatement of the amount of refundable tax credits, including, but not limited to the following:

(1) The refundable credit amount can be adjusted by the Franchise Tax Board if it determines the refundable credit amount is overstated.

(2) The Franchise Tax Board can issue assessments to recover overstated refunds generated in previous years and adjust amounts of tax due in subsequent years.

SEC. 46. The provisions of this act are severable. If any provision of this act or the application thereof to any person or circumstance is held invalid, that invalidity shall not affect other provisions or applications of the act that can be given effect without the invalid provision or application.

SEC. 47. No reimbursement is required by this act pursuant to Section 6 of Article XIII B of the California Constitution because the only costs that may be incurred by a local agency or school district will be incurred because this act creates a new crime or infraction, eliminates a crime or infraction, or changes the penalty for a crime or infraction, within the meaning of Section 17556 of the Government Code, or changes the definition of a crime within the meaning of Section 6 of Article XIII B of the California Constitution.

SEC. 48. This act is a bill providing for appropriations related to the Budget Bill within the meaning of subdivision (e) of Section 12 of Article IV of the California Constitution, has been identified as related to the budget in the Budget Bill, and shall take effect immediately.