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AB-3372 Taxation: administration: earnings withholding: water's edge elections. (2019-2020)

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Assembly Bill No. 3372

CHAPTER 297

An act to amend Sections 18671 and 25113 of, and to repeal and add Section 19264 of, the Revenue and Taxation Code, relating to taxation.

[Approved by Governor September 29, 2020. Filed with Secretary of State September 29, 2020.]

LEGISLATIVE COUNSEL'S DIGEST

AB 3372, Committee on Revenue and Taxation. Taxation: administration: earnings withholding: water's edge elections.

Existing law allows the Franchise Tax Board, by notice, to require any person, officer, department of the state, or political subdivision or agency of the state, a city organized under a freeholder's charter, or a political body not a subdivision or agency of the state, to withhold the amount of any income tax, interest, or penalties due from a taxpayer, or the amount representing income tax due from an employer or person who has failed to withhold, from any payments due or becoming due to the taxpayer, employer, or person. Existing law allows that notice to be served personally or by first-class mail.

This bill would additionally allow that notice to be served by electronic transmission or other electronic technology, as provided. The bill would also allow any notice or document required to be served or provided in connection with the notice to withhold to be served personally, by first-class mail, or by electronic transmission or other electronic technology.

Existing law, the Wage Garnishment Law, among other things, allows the Franchise Tax Board to issue an earnings withholding order to collect any liability under the Personal Income Tax Law or Corporation Tax Law. The Wage Garnishment Law requires service of an earnings withholding order for taxes or of any other notice or document required in connection to that order to be made by first-class mail or served personally. Existing law requires any employer who is served with an earnings withholding order to, among other things, deliver to the person from whom the income tax is sought to be collected a copy of the earnings withholding order and to complete the employer's return provided by the Franchise Tax Board and return by first-class mail.

This bill would allow the Franchise Tax Board under the Wage Garnishment Law to serve earnings withholding orders for taxes and any other notice or document required to be served or provided in connection with an earnings withholding order for taxes to government and private employers by electronic transmission or other electronic technology upon consent of the party served. The bill would allow the Franchise Tax Board to receive the employer's return by electronic transmission or other electronic technology.

The Corporation Tax Law imposes on every corporation doing business in the state, as defined, a tax according to or measured by net income and, in the case of a corporation with income derived from or attributable to sources both within and without this state, apportions the income between this state and other states and foreign countries in accordance with a single sales formula based on the sales within and without this state, except that in the case of an apportioning trade or business that derives more than 50% of its gross business receipts from conducting one or more qualified business activities, as defined, business income is apportioned in accordance with a specified 3-factor formula.

The Corporation Tax Law, for taxable years beginning on or after January 1, 2003, for purposes of determining its income derived from or attributable to sources within this state, allows corporations to make a statutory election as to whether their income is determined on a "water's-edge" basis or on a worldwide unitary basis. Under existing law, the election to report income on a water's-edge basis is made by contract between the taxpayer and the Franchise Tax Board for an initial term of 84 months, except as specified, and the water's edge election is effective only if every member of the self-assessed combined reporting group that is subject to tax under the Corporation Tax Law makes the election, except as specified.

This bill would provide, if a unitary corporation not incorporated in the United States that is not itself subject to taxation under the Corporation Tax Law in the year for which the valid water's-edge election is made, but subsequently becomes subject to taxation under the Corporation Tax Law solely due to it becoming engaged in business in this state in a taxable year beginning on or after January 1, 2021, that corporation is deemed to have elected with the other members of the unitary combined reporting group.

Vote: majority Appropriation: no Fiscal Committee: yes Local Program: no

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

SECTION 1. Section 18671 of the Revenue and Taxation Code is amended to read:

18671. (a) Subject to the limitations in subdivisions (b) and (c), the Franchise Tax Board, may, by notice, served personally, by first-class mail, or by electronic transmission or other electronic technology, require any person, officer, department of the state, or political subdivision or agency of the state including the Regents of the University of California, a city organized under a freeholder's charter, or a political body not a subdivision or agency of the state, to withhold the amount of any tax, interest, or penalties due from a taxpayer, or the amount due from an employer or person who has failed to withhold and transmit amounts due pursuant to this article, from any payments due the taxpayer, employer, or person and from any payments becoming due the taxpayer, employer, or person after receipt of the notice. The amounts withheld shall be transmitted to the Franchise Tax Board at those times as it may designate.

(b) The effect of a levy made pursuant to subdivision (a) shall be continuous from the date the notice is received until the amount due stated on the notice has been withheld, until the notice has been withdrawn, or until one year after the date the notice is received, whichever occurs first.

(c) The amount required to be withheld pursuant to a notice issued under subdivision (a) is the lesser of the amount due stated on the notice, or either of the following:

(1) If the taxpayer, employer, or person is not a natural person, 100 percent of the amount of each payment due or becoming due the taxpayer, employer, or person during the period the levy is in effect as provided in subdivision (b).

(2) If the taxpayer, employer, or person is a natural person, 25 percent of the amount of each payment due or becoming due the taxpayer, employer, or person during the period the levy is in effect as provided in subdivision (b).

(d) Any notice or document required to be served or provided in connection with the notice to withhold described in subdivision (a) may be served personally, by first-class mail, or by electronic transmission or other electronic technology.

(e) Upon consent, the Franchise Tax Board may provide service by electronic transmission or other electronic technology under this section.

(f) For purposes of this section, the term "payments" does not include earnings as defined in subdivision (a) of Section 706.011 of the Code of Civil Procedure or funds in a deposit account as defined in paragraph (29) of subdivision (a) of Section 9102 of the Commercial Code. The term "payments" does include any of the following:

(1) Payments due for services of independent contractors, dividends, rents, royalties, residuals, patent rights, or mineral or other natural resource rights.

(2) Payments or credits due or becoming due as a result of written or oral contracts for services or sales whether denominated as wages, salary, commission, bonus, or otherwise.

(3) Any other payments or credits due or becoming due periodically as a result of an enforceable obligation to the taxpayer, employer, or person.

(g) The amendments made to this section by the act adding this subdivision shall apply to notices served or provided on or after the effective date of the act.

SEC. 2. Section 19264 of the Revenue and Taxation Code is repealed.

SEC. 3. Section 19264 is added to the Revenue and Taxation Code, to read:

19264. (a) Notwithstanding Sections 706.071, 706.073, 706.080, 706.101, and 706.105 of the Code of Civil Procedure, the Franchise Tax Board may serve earnings withholding orders for taxes and any other notice or document required to be served or provided in connection with an earnings withholding order for taxes pursuant to Article 4 (commencing with Section 706.070) of Chapter 5 of Division 2 of Title 9 of Part 2 of the Code of Civil Procedure to government and private employers by electronic transmission or other electronic technology.

(b) Upon consent of the employer, the Franchise Tax Board may provide service by electronic transmission or other electronic technology under this section.

(c) Notwithstanding Sections 706.071, 706.073, 706.080, 706.101, 706.125, and 706.126 of the Code of Civil Procedure, the Franchise Tax Board may receive the "employer's return," as described in Section 706.126 of the Code of Civil Procedure, by electronic transmission or other electronic technology.

(d) This section shall apply in the same manner and with the same force and effect and to the full extent as if this section had been incorporated in full into Article 4 (commencing with Section 706.070) of Chapter 5 of Division 2 of Title 9 of Part 2 of the Code of Civil Procedure.

(e) This section shall apply to notices served or provided on or after the effective date of the act adding this section.

SEC. 4. Section 25113 of the Revenue and Taxation Code is amended to read:

25113. (a) Except as provided in subdivision (f), for taxable years beginning on or after January 1, 2003, the election provided for in Section 25110 shall be made on an original, timely filed return for the year of the election. The election will be considered valid if both of the following conditions are satisfied:

(1) The tax is computed in a manner consistent with a water's-edge election.

(2) A written notification of election is filed with the return on a form prescribed by the Franchise Tax Board. Pursuant to regulations promulgated under this section, the Franchise Tax Board may accept the filing of other objective evidence that supports the conclusion that a water's-edge election was intended in lieu of notification on the designated form.

(b) Except as otherwise provided, a water's-edge election shall be effective only if made by every member of the self-assessed combined reporting group that is subject to taxation under this part.

(1) An election made on a group return of a self-assessed combined reporting group shall constitute an election by each taxpayer member included in that group return, unless one of those taxpayers files a separate return in which no election is made and paragraph (2) does not apply.

(2) A taxpayer that fails to make an election on its own timely filed original return shall be deemed to have elected if either of the following applies:

(A) It has a parent corporation that is an electing taxpayer that included the income and apportionment factors of the nonelecting taxpayer in the self-assessed combined reporting group reflected in the electing parent's timely filed original return, including a group return.

(B) The income and apportionment factors of the nonelecting taxpayer are reflected in the self-assessed combined reporting group of a timely filed original return of an electing taxpayer, and the notification of election filed by the electing taxpayer pursuant to paragraph (2) of subdivision (a) is signed by an officer or other authorized agent of either a parent corporation of the nonelecting taxpayer or another corporation with authority to bind the nonelecting taxpayer to an election.

(3) For purposes of this subdivision, a "parent corporation" of the taxpayer is a corporation that owns or constructively owns stock possessing more than 50 percent of the voting power of the taxpayer as determined under subdivisions (e) and (f) of Section 25105.

(4) If a corporation that is a member of a combined reporting group is not itself subject to taxation under this part in the year for which the water's-edge election is made, but subsequently becomes subject to taxation under this part, that corporation shall be deemed to have elected with the other taxpayer members of the combined reporting group.

(5) If a unitary corporation not incorporated in the United States that is not itself subject to taxation under this part in the year for which the valid water's-edge election is made, but subsequently becomes subject to taxation under this part solely due to subdivision (b) of Section 23101 in a taxable year beginning on or after January 1, 2021, that corporation shall be deemed to have elected with the other members of the unitary combined reporting group.

(6) A taxpayer that is engaged in more than one apportioning trade or business as defined in paragraph (6) of subdivision (d) of Section 25128 may make a separate election for each apportioning trade or business.

(c) A water's-edge election shall remain in effect or be terminated in accordance with this subdivision.

(1) Except as otherwise provided in this subdivision, if one or more electing taxpayer members of a combined reporting group later become disaffiliated or otherwise cease to be included in the combined reporting group, the water's-edge election shall remain in effect as to both the departing taxpayer members and any remaining taxpayer members.

(2) If an electing taxpayer and a nonelecting taxpayer become members of a new unitary affiliate group, the nonelecting taxpayer shall be deemed to have elected if the value of the total business assets of the electing taxpayer, and its component unitary group, if any, is larger than the value of the total business assets of the nonelecting taxpayer, and its component unitary group, if any. Otherwise, the water's-edge election shall be automatically terminated at the time the electing members become part of the combined report. For purposes of applying paragraphs (9) and (10), the commencement date of the deemed election shall be the same as the commencement date of the electing taxpayers.

(3) If taxpayers filing under water's-edge elections with different commencement dates become members of a new unitary affiliate group, the earliest election date shall be deemed to apply to all electing taxpayers if the total business assets of the earlier electing taxpayer, and its component unitary group, if any, is larger than the value of the total business assets of the later electing taxpayer, and its component unitary group, if any. Otherwise, the later election commencement date shall apply to all electing taxpayers.

(4) (A) If a taxpayer with an election that has been terminated under paragraph (9) or (10) becomes a member of a new unitary affiliate group that includes another electing or nonelecting taxpayer not affected by those paragraphs, any water's-edge election of the other taxpayer member, if applicable, shall terminate, and any restrictions on making a new water's-edge election, relating to an election terminated under those paragraphs, shall apply to all taxpayer members of the new unitary affiliate group if the total business assets of the taxpayer with the terminated election, and its component unitary group, if any, is larger than the other taxpayer, and its component unitary group, if any. Otherwise, paragraph (2) shall apply, if applicable. If paragraph (2) does not apply, all taxpayer members of the new unitary affiliate group will be treated as nonelecting taxpayers that are not subject to any restrictions on making a new water's-edge election.

(B) If two nonelecting taxpayers with different termination dates under paragraph (9) or (10) become members of a new unitary affiliate group, the earliest termination date shall be deemed to apply to all nonelecting taxpayers, as well as any restrictions on making a new water's-edge election relating to that termination, if the total business assets of the earlier terminating taxpayer, and its component unitary group, if any, is larger than the value of the total business assets of the later terminating taxpayer, and its component unitary group, if any. Otherwise, the later termination date, and the related restrictions on making a new water's-edge election, shall apply to all taxpayer members of the new unitary affiliate group.

(5) (A) Except as provided in subparagraph (B), if one or more electing taxpayers did not report their income and apportionment factors as members of a combined reporting group with one or more nonelecting taxpayers, and, pursuant to a Franchise Tax Board audit determination, the nonelecting taxpayers, are properly in the same combined reporting group as the electing taxpayers, the water's-edge election of the electing taxpayers shall remain in effect and the nonelecting taxpayers shall be deemed to have made a water's-edge election. The commencement date of the deemed water's-edge election shall be the same as the commencement date of the electing taxpayers.

(B) Subparagraph (A) may not apply if the value of total business assets of the electing taxpayers does not exceed the value of total business assets of the nonelecting taxpayers. In that event, the water's-edge election of each electing taxpayer is terminated as of the date the nonelecting taxpayers are, pursuant to the audit determination described in subparagraph (A), properly included in the same combined reporting group as the electing taxpayers.

(C) For purposes of applying the business asset test of this paragraph, the term "business assets" shall have the same meaning as subparagraph (A) of paragraph (6), except that the business assets of other members of the unitary affiliate group that are not taxpayers shall not be taken into account.

(D) Notwithstanding subparagraph (A), nonelecting taxpayers may not be deemed to have made a water's-edge election if the Franchise Tax Board audit determination described in subparagraph (A) is withdrawn or otherwise overturned.

(6) For purposes of paragraphs (2) to (5), inclusive, the following shall apply:

(A) "Business assets" are assets, including intangible assets, other than stock of a member of the unitary affiliate group, which are used in the conduct of the business of the unitary affiliate group or would produce business income to the unitary affiliate group, if an election were not in place, if the assets were sold. Business assets shall be valued at net book value.

(B) The phrase "unitary affiliate group" refers to all of those corporations that would constitute a unitary group if a water's-edge election were not made.

(C) The phrase "new unitary affiliate group" refers to a unitary affiliate group that is created by a new affiliation of two or more corporations, or by the addition of one or more new members to an existing unitary affiliate group.

(D) The phrase "component unitary group" means that portion of a group of corporations that have become members of a new unitary affiliate group that were members of their own respective unitary affiliate group prior to entering the new unitary affiliate group, disregarding any corporations that did not become part of the new unitary group.

(7) In the application of paragraphs (2) to (4), inclusive, a series of acquisitions as steps of a single transaction shall be aggregated as a single change of membership.

(8) In the event of a merger or consolidation, the water's-edge status and election commencement date or termination date of the surviving corporation shall be consistent with the result that would have been obtained under paragraphs (2) to (4), inclusive, if the surviving corporation had acquired the stock of the transferor corporation.

(9) A water's-edge election may be terminated without the consent of the Franchise Tax Board after it has been in effect for at least 84 months. The termination shall be made on an original, timely filed return for the first year in which the water's-edge election is to be terminated. To be effective, the termination shall be made by every taxpayer that is a member of the water's-edge group in the same manner as the election provided under subdivisions (a) and (b).

(10) A water's-edge election may be terminated before the 84-month period described in paragraph (9) has elapsed, but only with the consent of the Franchise Tax Board. A request for termination shall be made at the time and in the manner specified by the Franchise Tax Board.

(A) The request may be granted for good cause. For purposes of this section, good cause shall have the same meaning as specified in Treasury Regulations Section 1.1502-75(c).

(B) The Franchise Tax Board shall consent to a termination requested by all members of a water's-edge group, if the purpose of the request is to permit the state to contract with an expatriate corporation, or its subsidiary, pursuant to paragraph (2) of subdivision (b) of Section 10286 of the Public Contract Code. A water's-edge election terminated pursuant to this subparagraph shall, however, be effective for the year in which the expatriate corporation, or its subsidiary, enters into the contract with the state.

(11) Except for deemed elections as provided in paragraphs (2), (4), and (5), if a water's-edge election is terminated under paragraph (9) or (10), another election may not be made under this section for any taxable year that begins within the 84-month period following the last day of the election period that was terminated. The Franchise Tax Board may waive the application of this prohibition period for good cause.

(12) A water's-edge election shall remain in effect until terminated.

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

(1) A "combined reporting group" means those corporations whose income and apportionment factors are properly considered pursuant to this chapter in computing the income of the individual taxpayer that is derived from or attributable to sources within this state, taking into account a valid water's-edge election.

(2) A "group return" refers to the single return which taxpayer members of a combined reporting group may elect by contract to file, in the form and manner prescribed by the Franchise Tax Board, in lieu of filing their own respective returns.

(3) A "self-assessed combined reporting group" means that group of corporations whose income and apportionment factors are reflected in a combined report prepared pursuant to this chapter in a timely filed return, taking into account the effects of a purported water's-edge election, whether or not the membership of the corporations in that combined report was correctly determined.

(e) The Franchise Tax Board may prescribe any regulations as may be necessary or appropriate to carry out the purposes of this section.

(f) To the extent that a taxpayer would have been required to file on a water's-edge basis in its first taxable year beginning on or after January 1, 2003, pursuant to a water's-edge election made in a prior year under Section 25111, the terms of Section 25111 may not apply and the election shall be deemed to have been made under the terms of this section. However, the commencement date of the election made in a prior year under Section 25111 shall continue to be treated as the commencement date of the water's-edge election period for purposes of applying this section.