Date of Hearing: April 19, 2021

ASSEMBLY COMMITTEE ON REVENUE AND TAXATION
Autumn R. Burke, Chairwoman

AB 71 (Luz Rivas) – As Amended March 25, 2021

2/3 vote. Fiscal committee.

SUBJECT: Homelessness funding: Bring California Home Act

SUMMARY: Conforms state law to the federal Global Intangible Low-Taxed Income (GILTI) provisions and taxes repatriated income to finance the Bring California Home Fund. Specifically, **this bill**:

1) Conforms, beginning on or after January 1, 2022, under the Personal Income Tax (PIT) Law, state law to GILTI, except as provided.

2) Provides that if a taxpayer that is not a C corporation has income under GILTI, which is derived from a corporation that is part of a combined reporting group doing business in this state and has made a water's-edge election, 50% of that income shall be apportioned to this state using the same apportionment factor as is used for the combined reporting group.

3) Provides that GILTI shall not apply to either of the following situations:

   a) The taxpayer is not a C corporation and the income under GILTI is derived from a corporation that is part of a combined reporting group doing business in this state that does not make a water's-edge election; or,

   b) The taxpayer is not a C corporation and the income under GILTI is derived from a corporation that is not part of a combined reporting group doing business in this state.

4) Provides that if a taxpayer has income under GILTI included in its gross income, the taxpayer may submit a petition to the Franchise Tax Board (FTB) for an alternative apportionment. The petition shall be in accordance with the standards and procedures established by the FTB.

5) Requires, beginning January 1, 2022, a taxpayer that makes a water's-edge election to take into account 50% of GILTI, but not the apportionment factors, of its affiliated corporations.

6) Requires, beginning January 1, 2022, a taxpayer that makes a water's-edge election to take into account 40% of the repatriation income, but not the apportionment factors, of its affiliated corporations.

7) Allows a taxpayer that includes repatriation income to either apportion 14% of the income to California or use the apportionment factor otherwise calculated for the combined group for that taxable year. The election shall be made in a form and manner prescribed by FTB.

8) Provides, with respect to GILTI, any dividend elimination will be allowed using the same rules that apply to dividends received from a controlled foreign corporation (CFC) under Revenue and Taxation Code (R&TC) Section 25110(a)(2)(A)(ii).

9) Provides that any taxpayer that includes repatriated income shall be entitled to a credit for any taxes already paid to this state on the repatriated income. The credit allowed shall be calculated by multiplying the final tax liability of the taxpayer for the taxable year in which tax was paid on repatriation income by a fraction not to exceed one, the numerator of which is repatriation income of that corporation for that taxable year and the denominator of which is the total taxable income of that corporation for that taxable year.

10) Provides a taxpayer that has made a water's–edge election with an opportunity to revoke the election for the 2022 calendar year.

11) Provides, as part of the water's-edge election, that for taxpayers not required to be included in a combined report or not authorized to be included in a combined report, the total of all business credits allowed, including carryover of any business credit under a former provision, for the taxable year shall not reduce the additional tax liability added by this bill by more than $5 million. This limitation does not apply to the credit for taxes that have already been paid on the repatriated income.

12) Provides, as part of the water's-edge election, that for taxpayers required to be included in a combined report or taxpayers authorized to be included in a combined report, the total of all business credits allowed, including carryover of any business credit under a former provision, by all members of the combined report shall not reduce the aggregate amount of the additional tax liability of all members of the combined report added by this bill by more than $5 million. The limitation does not apply to the credit for taxes that have already been paid on repatriated income.

13) Provides, under the Corporation Tax (CT) Law, that for taxpayers not required to be included in a combined report or not authorized to be included in a combined report, the total of all credits allowed, including the carryover of any credit under a former provision, for the taxable year shall not reduce the additional tax liability added by this bill by more than $5 million. This limitation does not apply to the credit for taxes that have already been paid on repatriated income, or the low-income housing tax credit (LIHTC).

14) Provides, under the CT Law, that for taxpayers required to be included in a combined report or taxpayers authorized to be included in a combined report, the total of all credits allowed, including the carryover of any credit under a former provision, by all members of the combined report shall not reduce the aggregate amount of the additional tax liability of all members of the combined report added by this bill by more than $5 million. The limitation does not apply to the credit for taxes that have already been paid on repatriated income, or the LIHTC.

15) Defines "affiliated corporation" as a corporation that is a member of a commonly controlled group, as provided in R&TC Section 25105.

16) Defines a "business credit" as a credit allowable under the PIT Law, other than the following credits:

a) Earned income tax credit;

b) Young child tax credit;

c) Household and dependent care credit;

d) Adoption costs credit;

e) Renter's tax credit;

f) Personal exemption credit;

g) Qualified join custody head of household and a qualified taxpayer with a dependent parent credit;

h) Qualified senior head of household credit;

i) LIHTC; or,

j) A credit related to refunds pursuant to the Unemployment Insurance Code.

17) Defines "global intangible low-taxed income" in the same manner as defined in Internal Revenue Code (IRC) Section 951A, but not taking into account any subtractions made pursuant to Title 26 of the Code of Federal Regulation Section 1.951A-2(c)(7).

18) Defines "repatriation income" as income that was deemed repatriated under IRC Section 965(a), relating to the treatment of deferred foreign income as subpart F income.

19) Provides that any standard, criterion, procedure, determination, rule, notice, or guidance established or issued by the FTB to implement this bill is exempted from the rulemaking provisions of the Administrative Procedure Act.

20) Provides that this bill's provisions are severable, and that if any provision of this bill or its application is held invalid, the invalidity shall not affect other provisions or applications that can be given effect without the invalid provision or application.

21) Provides that it is the intent of the Legislature that the revenue, if any, resulting from the application of this bill in any taxable year beginning on or after January 1, 2022, be used for purposes of the Bring California Home Act.

22) Makes a number of changes to the Homeless Coordinating and Financing Council, and require the council to, among other things, identify state programs that provide housing or housing-based services and report this information to specified committees by July 31, 2022. The council would also administer allocations from the fund to counties and continuums of care that apply jointly and to large cities, as provided.

23) Requires the Controller to transfer the additional revenue generated by GILTI and the inclusion of the repatriated income from the General Fund to the Bring California Home Fund.

24) Requires the council to set aside $200,000,000 for bonus awards to recipients, and allocate 60% of the remaining amount in the fund to counties and continuums of care applying jointly and 40% to large cities, in accordance with a specified formula and subject to certain requirements.

25) Makes other housing related changes.

EXISTING FEDERAL LAW provides GILTI provisions enacted by the federal Tax Cuts and Jobs Act (TCJA), effective for taxable years of foreign corporations beginning after December 31, 2017, and for taxable years of US shareholders in which such taxable years of the foreign corporations end. Any US shareholder that owns at least 10% of the value or voting rights in a CFC must include in gross income for the taxable year its GILTI in a manner generally similar to the inclusion of Subpart F income, regardless of whether any amount is distributed to the shareholder. There is no comparable provision in state law.

EXISTING STATE LAW:

1) Requires corporations deriving income from sources both within and outside California to measure their tax liability by reference to their income derived from or attributable to sources within California. To determine the portion of total income that is attributable to California, the apportionment and allocation method is used. The apportionment method uses a formula to calculate the amount of a unitary group's total income that was generated from the group's activities in California. This formula is generally comprised of a single sales factor.

2) Provides that all affiliated US and foreign entities comprising a single trade or business are viewed for certain purposes as a whole called a "unitary group." The business income of all the affiliates that comprise a unitary group is apportioned and reported to California on a single report known as the "combined report."

3) Allows a unitary group the option of calculating its California income and activities on a water's-edge basis in lieu of combining on a worldwide basis. A water's edge election is made for at least 84 months. A group that has made a water's-edge election is allowed a deduction of 75% of qualifying dividends received from its foreign affiliates, known as the "foreign dividend deduction."

4) Restricts the amount of allowable business credits for a corporation to $5 million for taxable years beginning on or after January 1, 2020, and before January 1, 2023.

FISCAL EFFECT: The FTB estimates a General Fund revenue increase of $310 million in fiscal year (FY) 2021-22, $950 million in FY 2022-23, $950 million in FY 2023-24, and $600 million in FY 2024-25.

COMMENTS:

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

> Our state is facing an unprecedented homelessness crisis that has the potential of becoming a full-blown catastrophe due to the economic impacts of COVID-19 on low wage earners. Despite being the fifth largest economy in the world, one in four Americans experiencing homelessness reside in California. AB 71 delivers a

comprehensive plan to address homelessness by investing, for the first time ever, dedicated annual state funding to our local governments; and, implements accountability and transparency measures to ensure every dollar is used effectively.

2) Supporters state that this bill "includes ongoing revenue scaled to meet the need, invested in proven solutions to dramatically curtail homelessness, and tracked through strict accountability measures. Other states have succeeded in significantly reducing homelessness through state investment in targeted, effective interventions. For example, reductions in homelessness in large states like New Jersey and Michigan, which reduced homelessness by 49% and 70%, respectively, were preceded by comprehensive state strategies and funding to reduce homelessness. Federal and state funding for ongoing, comprehensive, evidence-based strategies to house veterans experiencing homelessness reduced homelessness among veterans by 50% over the last 10 years. Homelessness among veterans decreased by 40% in California, even while homelessness among other populations increased. Moreover, 30 years of studies shows providing people experiencing homelessness with housing and services not only reduces homelessness, it decreases public costs of hospital and nursing home admissions, recidivism to jails and prisons, and foster care placement."

3) Opponents "respect the legislation's goal of fighting homelessness and are eager to support other efforts to address homelessness, but do not believe AB 71 will accomplish its goal and could actually make homelessness worse by standing in the way of economic recovery."

4) Committee Staff Comments:

   a) *Background*: According to the author's office, "corporations are taking advantage of a tax loophole to evade paying taxes by claiming they make most of their profits overseas in low- or no-tax countries." This transfer of income is known as "profit shifting" whereby multinational corporations exploit mismatches or loopholes in the international tax rules by artificially shifting profits to low- or no-tax jurisdictions to lower the amount of tax they pay. According to the Organisation for Economic Co-operation and Development (OECD), governments, citizens, and businesses all lose when profits are shifted to low- or no-tax jurisdictions. First, governments lose much needed revenue, citizens either have to pay for existing services or go without those services, and purely domestic businesses have a hard time competing with multinational enterprises[1]. Although the magnitude of profit shifting is uncertain, there appears to be ample evidence of its existence and its increase in recent years[2].

   b) *Water's-edge election vs worldwide combined reporting*: By way of background, the "unitary business principle" recognizes that the value of a business is found in the combination of all its activities even if the value or income of that business is earned in several jurisdictions. Thus, corporations engaged in interstate commerce, and situated in the several states through which their business extends, may be valued as a unit for the purposes of taxation[3]. States are allowed to combine multiple businesses under a

[1] OECD, *Ending Offshore Profit Shifting*
[2] Jane G. Gravelle, *Policy Options to Address Corporate Profit Shifting: Carrots or Sticks?,* April 2016
[3] *Adams Express Co. v. Ohio State Auditor*, 165 U.S. 194 (1897)

combined report so long as the overall business is a unitary business[4]. The unitary business principle also applies to multinational corporations where a domestic US corporation has foreign subsidiaries or where a foreign corporation has US subsidiaries[5]. Once the value is determined, the income may then be apportioned to the various jurisdictions based on a reasonable formula[6]. The ability to tax multiple, multinational corporations as a unitary business is known as worldwide combined reporting.

However, in the early 1980s, foreign countries began pressuring the federal government to preempt a state's use of worldwide combined reporting[7]. In response, many states, including California, began offering a water's edge election[8]. In general, a "water's-edge election" permits a corporation to exclude its foreign income from the combined report, which generally excludes that income from the total unit value that is then apportioned to the various jurisdictions. As explained by Professor Shanske, "[i]t is important to be clear that the states were never trying to tax the foreign income as such; rather, as the income of a unitary business the states successfully argued that this income should be subject to apportionment so that the [multinational corporation's] in-state income can be more accurately determined"[9].

c) *GILTI*: Before the enactment of the TCJA, the US generally taxed its firms and residents on their worldwide income. US firms were allowed to defer tax on foreign subsidiaries' active business earnings until those earnings were repatriated to the US, generally as dividends. The prior system generally discouraged repatriating foreign profits since corporations only faced additional taxes once profits were brought back to the US[10]. In order to address this distortion, the TCJA generally exempts earnings from active businesses of US firms' foreign subsidiaries, even if the earnings are repatriated.

   Although the change may have partially addressed the distortion, eliminating the repatriation tax may also exacerbate profit shifting to low-tax or no-tax jurisdictions. According to former Multistate Tax Commission Executive Director, Dan Bucks, "congress recognized that the switch to the territorial system exposed the federal corporate tax to increased profit shifting, and that's why it included GILTI and [the base erosion and antiabuse tax (BEAT), and other measures like a lowering of the corporate tax rate to try to counteract [profit shifting].[11]" Therefore, Congress added a new minimum tax on GILTI of 10.5%.

   In general, GILTI is income earned from intangible assets by foreign subsidiaries of US-based multinational corporations. Intangible assets include intellectual property such as patents, copyrights, and trademarks. Individuals or entities subject to GILTI are US

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[4] Darien Shanske, *White Paper on Eliminating the Water's Edge Election and Moving to Mandatory Worldwide Combined Reporting*, Tax Notes, September 17, 2018.
[5] *Id*.
[6] *Id*.
[7] *Id*.
[8] *Id*.
[9] *Id*.
[10] Kyle Pomerleau, *A Hybrid Approach: The Treatment of Foreign Profits under the Tax Cuts and Jobs Act*, Tax Foundation, May 13, 2018.
[11] Salt in the Public Interest, *Taxing GILTI Is Good, Bur Worldwide Combination Is Great*, Tax Notes State, June 17, 2019.

shareholders or CFCs. GILTI operates, in part, as a way of finding shifted income by identifying suspiciously high returns[12]. GILTI is calculated as the total active income earned by a US firm's foreign affiliates that exceeds 10% of the firm's depreciable tangible property. A corporation can generally deduct 50% of the GILTI and claim a foreign tax credit for 80% of foreign taxes paid or accrued on GILTI. If a foreign tax rate is zero, the effective US tax rate on GILTI will be 10.5%, which is half of the regular 21% corporate tax rate. In general, if the foreign tax rate is 13.125% or higher, there will be no US tax after the 80% credit for foreign taxes[13].

d) *What does this bill do*? This bill conforms state law to the federal GILTI provisions, and requires a taxpayer that has made a water's-edge election and a taxpayer that is not a corporation but derives GILTI income from a combined reporting group to include 50% of GILTI for state purposes. As noted earlier, GILTI identifies shifted income by formula. If GILTI identifies $10 billion in a CFC in Ireland that was not really earned there, part of the $10 billion may have been shifted from the US and part of the $10 billion may have been shifted from another country like Germany. The 50% is used as a reasonable estimate of how much of the shifted income came from the US[14]. If the taxpayer believes that the 50% amount is inappropriate, this bill allows a taxpayer, for taxable year 2022 only, to revoke the water's-election and use worldwide combined reporting. This bill also limits a taxpayer's ability to offset the additional tax liability created by these provisions with existing tax credits by more than $5 million.

e) *Why should states tax GILTI*? First, there is good evidence that the earnings are partially domestic insofar as profits have been shifted[15]; and, as noted earlier, there appears to be evidence that profit shifting is increasing. As such, those earnings should have always been included as part of the water's edge election. And second, as noted earlier, the federal government's change to a more territorial system, and the elimination of the repatriation tax, may inadvertently be encouraging multinational corporations to shift profits oversees despite additional safety measures like GILTI, BEAT, and a reduction in the federal corporate tax rate. To the extent the federal corporate tax incentivizes erosion of the corporate tax base, the TCJA may in turn lead to a narrowing of the state's own corporate tax base under a water's edge election. According to Dan Bucks, "All of the states that are water's-edge or separate-entity states are exposed to substantial risk from the federal switch to its version of a territorial tax system. That switch, without some effective state action — be it global combined reporting, tax haven reporting, or inclusion of GILTI in its tax base — exposes the states to a substantial risk of increased profit shifting.[16]" GILTI might actually be a necessary measure to address a further narrowing of the state's corporate tax base.

f) *Deemed repatriation*: As noted above, prior to the TCJA, the US generally taxed its corporations and residents on their worldwide income. However, a US corporation could

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[12] Darien Shanske and David Gamage, *States Should Conform to GILTI, Part 3: Elevator Pitch and Q&A*, Tax Notes, Oct. 14, 2019.
[13] What is global intangible low-taxed income and how is it taxed under the TCJA, Tax Policy Center.
[14] Darien Shanske and David Gamage, *Why States Can Tax the GILTI*, Tax Notes, March 18, 2019.
[15] Darien Shanske and David Gamage, *Why (and How) States Should Tax the Repatriation*, Tax Notes, April 23, 2018.
[16] *Id., Taxing GILTI Is Good, Bur Worldwide Combination Is Great*

defer foreign income by retaining earnings indefinitely through a foreign subsidiary. A US corporation would pay US tax on the foreign earnings only when they were repatriated, and the earnings would be taxed, when repatriated, at a rate of 35%. After the enactment of the TCJA, the US generally exempts earnings from active businesses of US firms' foreign subsidiaries, even if the earnings are repatriated. However, as part of the transition, the TCJA taxes these earnings as if they were repatriated but at preferred lower rates: foreign earnings held in cash and cash equivalents were taxed at 15.5% and those not held in cash or cash equivalents at only 8%. Corporations are allowed to pay the tax on the deemed repatriations in installments over eight years.

g) *What does this bill do*? This bill requires a taxpayer that has made a water's-edge election to include 40% of any repatriation income. As noted earlier with respect to GILTI, this bill attempts to make a reasonable determination as to how much has been shifted out of the US. The 40% for repatriation is lower than the 50% used for GILTI, in part, because some of that income might have been earned abroad and just left abroad. A taxpayer is then required to either apportion 14% of the repatriation to California or use the apportionment factor otherwise calculated for the combined group.

h) *Why should states tax deemed repatriation*? According to Professors Shanske and Gamage, there are several reasons why states should tax deemed repatriated funds, but the primary reason for taxing these funds is that these earnings are, at least partially, domestic[17]. There appears to be significant evidence that at least a substantial portion of the earnings parked abroad were, in fact, earned in the US and should have always been part of the state's corporate tax base[18]. Therefore, taxing repatriated income is a way of recapturing General Fund revenue that has been put away for a rainy day, ready to be used for large state projects.

i) *Housing provisions*: This bill would enact the Bring California Home Act, which would establish the Bring California Home Fund in the State Treasury, and modify the Homeless Coordinating and Financing Council to focus on preventing and ending homelessness in California. This bill would require the Controller to annually transfer specified amounts, based on the increased GF revenue from GILTI and deemed repatriated income, to the Bring California Home Fund.

   The council would be charged with collecting data and identifying state programs that provide housing or housing-based services and report this information to specified committees by July 31, 2022. The council would also administer allocations from the fund to counties and continuums of care that apply jointly and to large cities, as provided. The council would have to set aside $200,000,000 for bonus awards to recipients, and would have to allocate 60% of the remaining amount in the fund to counties and continuums of care applying jointly and 40% to large cities, in accordance with a specified formula and subject to certain requirements.

   The council would allocate available funding in two-year cycles, with the first round allocated no later than March 31, 2023, and develop a simple application that an eligible entity may use to apply for funding, as well as common standards for recipients to

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[17] Id., *Why (and How) States Should Tax the Repatriation*
[18] Id.

monitor, report, and ensure accountability, provide services, and subsidize housing. The council and each recipient would establish performance outcomes for the initial cycle and outcome goals before each subsequent grant cycle, as provided, and the council would award bonus funding to a recipient, if the recipient has achieved those performance outcomes, or reduce or deny that bonus funding if the recipient has not achieved those performance outcomes. Failure of the recipient to use money allocated to it for an authorized purpose would require the council to either select an alternative entity to administer the recipient's allocation in accordance with specified requirements or solely establish performance outcomes and program priorities for that recipient jurisdiction and work with local, regional, or statewide entities to administer the allocation on behalf of the recipient. For a full discussion of the housing provisions of this bill, please see the Housing and Economic Development Committee's analysis of AB 71.

REGISTERED SUPPORT / OPPOSITION:

Support

All Home
Alliance for Children's Rights
Alliance of Californians for Community Empowerment Action
American Family Housing
Bend the Arc: Jewish Action, Southern California
Bet Tzedek
Brilliant Corners
California Association of Student Councils
California Calls
California Coalition for Rural Housing
California Housing Partnership Corporation
California Partnership to End Domestic Violence
City of Los Angeles
City of Oakland
Coalition on Homelessness, San Francisco
Community Action Marin
Community Corporation of Santa Monica
Corporation for Supportive Housing
County of Los Angeles
Destination: Home
Dignitymoves
Downtown Women's Center
East Bay Housing Organizations
Episcopal Community Services of San Francisco
Everyone Home
Hopics
Housing Authority of the City of Oakland
Housing California
Housing Consortium of The East Bay
Housing Is a Human Right OC
Interface Children & Family Services
John Burton Advocates for Youth

Justice in Aging
LA Care Health Plan
Linc Housing
Los Angeles Homeless Services Authority
Lyric
Mogavero Architects
Multi-faith Action Coalition
Mutual Housing California
National Alliance to End Homelessness
Non Profit Housing Association of Northern California
Oakland Homeless Advocacy Working Group
Open Heart Kitchen
Operation Dignity INC
Prevention Institute
Project: Peacemakers, Incorporated
Public Law Center
Rainbow Services, Ltd.
San Diego Housing Federation
Skid Row Housing Trust
St. Mary's Center
Steinberg Institute
The Women's Foundation of California
Union Station Homeless Services
United Way of Greater Los Angeles
Weingart Center Association

Opposition

Central Valley Business Federation

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