

SA2005 RF0043

January 18, 2005

VIA MESSENGER

Office of the Attorney General
1300 "I" Street
Sacramento, CA 95814

Attention: Tricia Knight

RECEIVED
JAN 18 2005

INITIATIVE COORDINATOR
ATTORNEY GENERAL'S OFFICE

Re: *The Economic Recovery Tax Relief Act (Version 2)*

Dear Ms. Knight:

Pursuant to Elections Code section 9002, we request that the Attorney General prepare a title and summary of version 2 of a measure entitled "The Economic Recovery Tax Relief Act." The text of the measure, a check for \$200.00, the address at which we are registered to vote and the signed statement certifying that we will not willfully allow initiative signatures to be used for purposes other than qualification of the measure are enclosed.

Please direct all correspondence and inquiries regarding this measure to:

Roberta B. Johansen
James C. Harrison
Remcho, Johansen & Purcell
201 Dolores Avenue
San Leandro, CA 94577
Phone: (510) 346-6200
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Sincerely,

Roberta B. Johansen

James C. Harrison

Section 1. This Act shall be known and may be cited as “The Economic Recovery Tax Relief Act.”

Section 2. The people of the State of California hereby find and declare as follows:

(a) Tax loopholes are the largest source of wasteful government spending. Each year wealthy individuals and corporations take advantage of these “incentives,” whether or not they produce a single new job or a single new dollar of investment for our state.

(b) Corporations and the wealthy have received nearly two-thirds (2/3rds) of the tax savings from Proposition 13, amounting to billions of dollars, while ordinary Californians bear more and more of the state tax burden.

(c) It is the intent of the People to close those loopholes that cost the State money without providing new revenues and to make our system of sales and property taxes more fair to homeowners and consumers. To accomplish this, The Economic Recovery Tax Relief Act closes corporate loopholes in Proposition 13 and other taxes and returns the money to all Californians by lowering state sales taxes.

Section 3: Section 2.5 is added to Article XIII A of the California Constitution, to read:

SEC. 2.5. (a) Notwithstanding Section 2 or any other provision of this Constitution, for the lien date for the 2005-06 fiscal year and each lien date thereafter, the “full cash value” of nonresidential real property that is not used for commercial agricultural production is the fair market value of that property as of that date.

(b) For purposes of this section:

(1) “Nonresidential real property” means any real property other than a constructed single-family or multifamily unit that is intended to be used primarily as a permanent residence and is used primarily as a permanent residence or that is zoned as a residence, and an equal proportion of the land on which that unit is constructed.

(2) Nonresidential real property is “used for commercial agricultural production” if that real property is used and zoned for producing commercial agricultural commodities and is real property to which either of the following applies:

(A) The real property is an unimproved parcel.

(B) The parcel of real property contains only living improvements.

(3) “Unimproved parcel” means a parcel of real property to which both of the following apply:

(A) The parcel is used and zoned for producing commercial agricultural commodities.

(B) The parcel does not contain a single-family residence or a multifamily residence that was subdivided in accordance with the Subdivision Map Act (Division 2 (commencing with Section 66410) of Title 7 of the Government Code), or any successor to that law, or that was described and conveyed in one or more deeds separating the parcel from all adjoining property.

Section 4. Section 7.5 is added to Article XVI of the California Constitution, to read:

(a) At the conclusion of the 2006 fiscal year and each fiscal year thereafter, the Department of Finance, or its successor agency, shall calculate the amount of additional revenues that result from changes in the law made by the Economic Recovery Tax Relief Act, and that amount shall be deposited in a separate fund, called the Economic Recovery Tax Relief Fund, which is hereby created in the State Treasury. The moneys deposited to this fund shall not be considered General Fund revenues for purposes of Article XVI, Section 8 or Article XIII B of the California Constitution unless and until they are transferred to the General Fund or affected special funds pursuant to subdivision (d) of this section.

(b) At the conclusion of the 2006 fiscal year and each fiscal year thereafter, the Department of Finance, or its successor agency, shall transmit to the Controller its estimate of the amount of revenue that would be produced by a state sales and use tax rate of 0.25 percent over the next succeeding fiscal year. Whenever the amount of money in the Economic Recovery Tax Relief Fund equals or exceeds the amount calculated by the Department of Finance pursuant to this subdivision, the taxpayers shall be entitled to a rebate provided as a reduction of 0.25 percent in the state sales and use tax rate for a period of 12 months, commencing no later than the end of the 120 day period set forth in subdivision (c) of this section. If the amount available in the Economic Recovery Tax Relief Fund is sufficient to warrant multiple rebates, the taxpayers shall be entitled to such additional rebates in such increments of 0.25 percent as are warranted by the balance in the Fund.

(c) The State Controller shall notify the State Board of Equalization when accumulated monies in the Economic Recovery Tax Relief Fund equal or exceed the amount calculated by the Department of Finance, or its successor agency, as required pursuant to subdivision (b) of this section. Within 120 days of receiving such notification from the State Controller, the State Board of Equalization, or its successor agency responsible for administering the Sales and Use Tax Law, shall implement the sales and use tax rate reduction to which taxpayers are entitled pursuant to subdivision (b) of this section.

(d) It is the intent of this section to neither increase nor decrease the amount of funds that otherwise would be available for allocation to school districts and community college districts pursuant to Section 8 of Article XVI of the California Constitution. In order to effectuate that intent, in any fiscal year in which the sales tax reduction required by subdivision (b) occurs, the State Controller shall transfer monies from the Economic Recovery Tax Relief Fund to the General Fund and affected special funds during that same fiscal year to offset the actual revenue reduction to state funds affected by the sales tax rate reduction required by this section. Any funds so transferred are available for appropriation and once transferred shall be considered General Fund revenues for purposes of Articles XIII B and Article XVI, Section 8 of the California Constitution.

Section 5. Section 14 is added to Article XIII B of the California Constitution, to read:

Section 14: The taxes imposed pursuant to the Economic Recovery Tax Relief Act and deposited in the Economic Recovery Tax Relief Fund shall not be considered General Fund revenues for the purposes of this Article or of Section 8 of Article XVI unless and until they are transferred to the General Fund or other special funds for allocation to school districts and community college districts as required by that Act.

Section 6. Section 12202.2 is added to the Revenue and Taxation Code to read:

12202.2. Notwithstanding the rate specified by Sections 12202 and 12202.1, the gross premiums tax paid by insurers for any premiums collected on or after January 1, 2006 shall be 2.46 percent.

Section 7: Part 21 (commencing with Section 42002) is added to Division 2 of the Revenue and Taxation Code, to read:

PART 21. OIL SEVERANCE TAX

42002. (a) "Oil" means petroleum, or other crude oil, condensate, casinghead gasoline, or other mineral oil which is mined, produced or withdrawn from below the surface of the soil or water in this state.

(b) "Producer" means any person owning, controlling, managing, or leasing any oil well in excess of 30,000 barrels during any month of the current or preceding year, or any person who produces or extracts in any manner any oil in excess of 30,000 barrels during any month of the current or preceding year by taking it from the earth or water in this state, or any person who acquires in excess of 30,000 barrels during any month of the current or preceding year the severed oil from a person or agency exempt from property taxation under the Constitution or laws of the United States or under the Constitution or laws of the State of California, and shall include any person owning any royalty or other interest in any oil or its value in excess of 30,000 barrels during any month of the current or preceding year whether produced by him or her, or by some other person on his or her behalf, either by lease, contract, or otherwise.

(c) "Production" means the total gross amount of oil produced, including the gross amount thereof attributable to a royalty interest.

(d) "Severed" or "severing" means the extraction or withdrawing from below the surface of the earth or water of any oil, whether extraction or withdrawal shall be by natural flow, mechanical flow, forced flow, pumping, or any other means employed to get the oil from below the surface of the earth or water and shall include the withdrawing by any means whatsoever of oil upon which the tax has not been paid, from any surface reservoir, natural or artificial, or from a water surface.

(e) "Gross value" means the sale price at the mouth of the well in the case of oil. If oil is exchanged for something other than cash, or if there is no sale at the time of severance or if the

relation between the buyer and the seller is such that the consideration paid, if any, is not indicative of the true value or market price, then the board shall determine the value of the oil subject to tax, based on the cash price paid to producers for like quality oil in the vicinity of the well.

(f) "Barrel of oil" means 42 United States gallons of 231 cubic inches per gallon computed at a temperature of 60 degrees Fahrenheit.

(g) "Board" means the State Board of Equalization.

42010. On and after January 1, 2006, there is hereby imposed an oil severance tax upon the privilege of severing oil from the earth or water in this state for, sales, transport, consumption, storage, profit, or use. The tax shall be borne ratably by all persons within the term "producer" as that term is defined in subdivision (b) of Section 42002. The tax shall be applied equally to all portions of the gross value of each barrel of oil severed, and shall be imposed at the rate of 3 percent.

42011. Except as otherwise provided in this part, the tax shall be upon the entire production in this state, regardless of the place of sale or to whom sold or by whom used, or the fact that the delivery may be made to points outside the state.

42012. The tax imposed by this part shall be in addition to any ad valorem taxes imposed by the state, or any of its political subdivisions, or any local business license taxes which might be incurred as a privilege of severing oil from the earth or doing business in that locality. No equipment, material, or property shall be exempt from payment of ad valorem tax by reason of the payment of the gross severance tax pursuant to this part.

42014. Two or more producers that are corporations and are owned or controlled directly or indirectly, as defined in Section 25105, by the same interests, shall be considered as a single producer for purposes of application of the tax prescribed in Section 42010.

42015. There is exempted from the imposition of the oil severance tax imposed pursuant to this part all oil owned or produced by any political subdivision of the State of California, including that political subdivision's proprietary share of oil produced under any unit, cooperative or other pooling agreement, except for oil produced from and attributed to tide and submerged lands that have been granted in trust by the State of California.

42020. The tax imposed by this part shall be due and payable to the board on a monthly basis.

42022. The board may prescribe the forms and reporting requirements as necessary to implement the tax, including but not limited to information regarding the location of the well by county, the gross amount of oil produced, the price paid therefor, the prevailing market price of oil, and the amount of tax due.

42112. In all proceedings under this chapter the board may act on behalf of the people of the State of California.

42145. The board shall enforce the provisions of this part and may prescribe, adopt, and enforce rules and regulations (including but not limited to the payment of interest, the imposition of penalties, and any other action permitted by Sections 6451 through 7176 of the Revenue and Taxation Code, or 38401 through 38901, whichever are most applicable) relating to the application, administration and enforcement of this part.

42166. All taxes, interest, penalties, and other amounts collected pursuant to this part other than that required for cost of the administration of this tax by the board shall be deposited in the General Fund.

Section 8. Section 23151 of the Revenue and Taxation Code is amended to read:

23151. (a) With the exception of banks and financial corporations, every corporation doing business within the limits of this state and not expressly exempted from taxation by the provisions of the Constitution of this state or by this part, shall annually pay to the state, for the privilege of exercising its corporate franchises within this state, a tax according to or measured by its net income, to be computed at the rate of 7.6 percent upon the basis of its net income for the next preceding income year, or if greater, the minimum tax specified in Section 23153.

(b) For calendar or fiscal years ending after June 30, 1973, the rate of tax shall be 9 percent instead of 7.6 percent as provided by subdivision (a).

(c) For calendar or fiscal years ending in 1980 to 1986, inclusive, the rate of tax shall be 9.6 percent.

(d) For calendar or fiscal years ending in 1987 to 1996, inclusive, and for any income year beginning before January 1, 1997, the tax rate shall be 9.3 percent.

(e) For any income year beginning on or after January 1, 1997, the tax rate shall be 8.84 percent. The change in rate provided in this subdivision shall be made without proration otherwise required by Section 24251.

(f) For calendar or fiscal years ending in 2006 and thereafter, the tax rate shall be 9.3 percent. The change in rate provided in this subdivision shall be made without proration otherwise required by Section 24251.

(~~f~~)(g) (1) For the first taxable year beginning on or after January 1, 2000, the tax imposed under this section shall be the sum of both of the following:

(A) A tax according to or measured by net income, to be computed at the rate of 8.84 percent upon the basis of the net income for the next preceding income year, but not less than the minimum tax specified in Section 23153.

(B) A tax according to or measured by net income, to be computed at the rate of 8.84 percent upon the basis of the net income for the first taxable year beginning on or after January 1, 2000, but not less than the minimum tax specified in Section 23153.

(2) Except as provided in paragraph (1), for taxable years beginning on or after January 1, 2000, the tax imposed under this section shall be a tax according to or measured by net income, to be computed at the rate of 8.84 percent upon the basis of the net income for that taxable year, but not less than the minimum tax specified in Section 23153.

(h)(1) For the first taxable year beginning on or after January 1, 2006, the tax imposed under this section shall be the sum of both of the following:

(A) A tax according to or measured by net income, to be computed at the rate of 9.3 percent upon the basis of the net income for the next preceding income year, but not less than the minimum tax specified in Section 23153.

(B) A tax according to or measured by net income, to be computed at the rate of 9.3 percent upon the basis of the net income for the first taxable year beginning on or after January 1, 2006, but not less than the minimum tax specified in Section 23153.

(2) Except as provided in paragraph (1), for taxable years beginning on or after January 1, 2006, the tax imposed under this section shall be a tax according to or measured by net income, to be computed at the rate of 9.3 percent upon the basis of the net income for that taxable year, but not less than the minimum tax specified in Section 23153.

Section 9. Section 23455 of the Revenue and Taxation Code is amended to read:

23455. For purposes of this part, Section 55 of the Internal Revenue Code is modified as follows:

(a) Section 55(b)(1) of the Internal Revenue Code, relating to tentative minimum tax, is modified by requiring the tentative minimum tax for the taxable year to be imposed as follows:

(1) With respect to corporations subject to tax under Chapter 2 (commencing with Section 23101), other than banks or financial corporations, according to or measured by net income, for the privilege of doing business within this state, at a rate of 7 percent upon the basis of so much of the alternative minimum taxable income for the taxable year as exceeds the exemption amount.

(2) With respect to corporations subject to tax under Chapter 3 (commencing with Section 23501), on net income from sources within this state, at a rate of 7 percent upon the basis of so much of the alternative minimum taxable income for the taxable year as exceeds the exemption amount.

(3) With respect to organizations or trusts subject to tax under Article 2 (commencing with Section 23731) of Chapter 4, on the unrelated business income from sources within this

state, at a rate of 7 percent upon the basis of so much of the alternative taxable income for the taxable year as exceeds the exemption amount.

(4) With respect to banks subject to tax under Section 23181, according to or measured by net income, for the privilege of doing business within this state, in an amount equal to the sum of the following:

(A) At a rate of 7 percent upon the basis of so much of the alternative minimum taxable income as exceeds the exemption amount.

(B) At the rate determined under Section 23186, less the rate prescribed by Section 23151, upon the basis of net income for the taxable year.

(5) With respect to financial corporations subject to tax under Section 23183, according to or measured by net income, for the privilege of doing business within this state, in an amount equal to the sum of the following:

(A) At a rate of 7 percent upon the basis of so much of the alternative minimum taxable income as exceeds the exemption amount.

(B) At the rate determined under Section 23186, less the rate prescribed by Section 23151, upon the basis of net income for the taxable year.

(b) Section 55(b)(2) of the Internal Revenue Code, relating to the definition of alternative minimum taxable income, is modified as follows:

(1) For corporations whose net income is determined under Chapter 17 (commencing with Section 25101), alternative minimum taxable income shall be allocated and apportioned in the same manner as net income is allocated and apportioned for purposes of the regular tax.

(2) With respect to taxpayers subject to Article 4 (commencing with Section 23221) of Chapter 2, Article 4 (commencing with Section 23221) to Article 9 (commencing with Section 23361), inclusive, shall apply to the tax imposed by this section except that Section 23221 shall not apply.

(3) For purposes of computing the alternative minimum tax for taxable years in which a taxpayer commenced doing business, dissolves, withdraws, or ceases doing business, Sections 18601, 23151, 23151.1, 23151.2, 23181, 23183, 23183.1, 23183.2, 23201 to 23204, inclusive, 23222 to 23224.5, inclusive, 23282, 23332.5, and 23504 shall be applied with due regard for the rate and alternative minimum taxable income prescribed by this chapter.

(c) Section 55(c) of the Internal Revenue Code, relating to the definition of regular tax, is modified to read:

(1) For purposes of this chapter, "regular tax" means the amount of tax imposed under Chapter 2 (commencing with Section 23101) or Chapter 3 (commencing with Section 23501) or

Article 2 (commencing with Section 23731) of Chapter 4, but does not include any amount imposed under paragraph (1) of subdivision (e) of Section 24667 or paragraph (2) of subdivision (f) of Section 24667.

(2) The tax specified in paragraph (1) shall be the amount determined prior to reduction by any credits against the tax.

(d) The rate of 7 percent prescribed in subdivision (a) shall be 6.65 percent for any taxable year beginning on or after January 1, 1997. The change in rate provided in this subdivision shall be made without proration otherwise required by Section 24251.

(e) The rate of 7 percent prescribed in subdivision (a) shall be 7 percent for any taxable year beginning on or after January 1, 2006. The change in rate provided in this subdivision shall be made without proration otherwise required by Section 24251.

Section 10. Section 23036.2 is added to the Revenue and Taxation Code, to read:

23036.2. (a) Notwithstanding any other provision of law, and except as provided in subdivision (c), the aggregate amount of all credits that contain a carryover provision (including both credits carried forward from prior years and credits allowed in the current taxable year) may not reduce the "tax" for the taxable year (after reduction by credits that do not contain a carryover provision) by more than 50 percent.

(b) The carryover period for any credit limited by operation of subdivision (a) shall be extended by two years.

(c) This section does not apply to Section 23610.5, relating to low-income housing.

(d) This section shall be operative for taxable years beginning on or after January 1, 2006.

Section 11. Section 23802 of the Revenue and Taxation Code is amended to read:

23802. (a) Section 1363(a) of the Internal Revenue Code, relating to the taxability of an "S" corporation, does not apply.

(b) Corporations that are "S" corporations under this chapter shall continue to be subject to the taxes imposed under Chapter 2 (commencing with Section 23101) and Chapter 3 (commencing with Section 23501), except as follows:

(1) ~~The~~ (A) *For taxable years beginning before January 1, 2006, the tax imposed under Section 23151 or 23501 shall be imposed at a rate of 1 1/2 percent rather than the rate specified in those sections.*

(B) For taxable years beginning on or after January 1, 2006, the tax imposed under Section 23151 or 23501 shall be imposed at the following rates rather than the rate specified in those sections:

(i) For that portion of taxable income that is one hundred thousand dollars (\$100,000) or less, the tax rate is 1.5 percent.

(ii) For that portion of taxable income that is over one hundred thousand dollars (\$100,000) but not over one million dollars (\$1,000,000), the tax rate is 2 percent of the excess over one hundred thousand dollars (\$100,000).

(iii) For that portion of taxable income that is over one million dollars (\$1,000,000), the tax rate is 2.5 percent of the excess over one million dollars (\$1,000,000).

(2) In the case of an “S” corporation that is also a financial corporation, the rate of tax specified in paragraph (1) shall be increased by the excess of the rate imposed under Section 23183 over the rate imposed under Section 23151.

(c) An “S” corporation shall be subject to the minimum franchise tax imposed under Section 23153.

(d)(1) For purposes of subdivision (b), an “S” corporation shall be allowed a deduction under Section 24416 or 24416.1 (relating to net operating loss deductions), but only with respect to losses incurred during periods in which the corporation is an “S” corporation for purposes of this part.

(2) Section 1371(b) of the Internal Revenue Code, relating to denial of carryovers between “C” years and “S” years, shall apply for purposes of the tax imposed under subdivision (b), except as provided in paragraph (1).

(3) The provisions of this subdivision do not affect the amount of any item of income or loss computed in accordance with the provisions of Section 1366 of the Internal Revenue Code, relating to pass-thru of items to shareholders.

(4) For purposes of subdivision (b) of Section 17276, relating to limitations on loss carryovers, losses passed through to shareholders of an “S” corporation, to the extent otherwise allowable without application of that subdivision, shall be fully included in the net operating loss of that shareholder and then that subdivision shall be applied to the entire net operating loss.

(e) For purposes of computing the taxes specified in subdivision (b), an “S” corporation shall be allowed a deduction from income for built-in gains and passive investment income for which a tax has been imposed under this part in accordance with the provisions of Section 1374 of the Internal Revenue Code, relating to tax imposed on certain built-in gains, or Section 1375 of the Internal Revenue Code, relating to tax imposed on passive investment income.

(f) For purposes of computing taxes imposed under this part, as provided in subdivision (b):

(1) An “S” corporation shall compute its deductions for amortization and depreciation in accordance with the provisions of Part 10 (commencing with Section 17001) of Division 2.

(2) Section 465 of the Internal Revenue Code, relating to limitation of deductions to the amount at risk, shall be applied in the same manner as in the case of an individual.

(3)(A) Section 469 of the Internal Revenue Code, relating to limitations on passive activity losses and credits, shall be applied in the same manner as in the case of an individual. For purposes of the tax imposed under Section 23151 or 23501, as modified by this section, material participation shall be determined in accordance with Section 469(h) of the Internal Revenue Code, relating to certain closely held “C” corporations and personal service corporations.

(B) For purposes of this paragraph, the “adjusted gross income” of the “S” corporation shall be equal to its “net income,” as determined under Section 24341 with the modifications required by this subdivision, except that no deduction shall be allowed for contributions allowed by Section 24357.

(4) The exclusion provided under Section 18152.5 may not be allowed to an “S” corporation.

(5) The deduction for bad debts under paragraph (2) of subdivision (a) of Section 24348 may not be allowed to an “S” corporation.

(g)(1) The provisions of Section 1363(d) of the Internal Revenue Code, relating to recapture of LIFO benefits, shall be modified for purposes of this part to refer to Section 19101 in lieu of Section 6601 of the Internal Revenue Code.

(2) For purposes of Section 19023, relating to the definition of “estimated tax,” and Section 19142, relating to an addition to tax for underpayment of estimated tax, the tax imposed pursuant to this subdivision is not a tax imposed by this part.

Section 12. Section 17260.5 is added to the Revenue and Taxation Code, to read:

17260.5 (a) The provisions of Section 263(i) of the Internal Revenue Code, relating to special rules for intangible drilling and development costs, shall apply for all purposes under this part and shall apply to all such costs paid or incurred with respect to oil, gas, or geothermal wells located within and without the United States.

(b) The provisions of Section 263(c) of the Internal Revenue code shall have no force or effect for any purpose under this part.

(c) The provisions of this section shall apply to costs paid or incurred on or after January 1, 2006.

Section 13. Section 24423 of the Revenue and Taxation Code is hereby repealed.

~~24423. (a) Notwithstanding Section 24422, regulations shall be prescribed by the Franchise Tax Board under this part corresponding to the regulations which granted the option to deduct as expenses intangible drilling and development costs in the case of oil and gas wells and which were recognized and approved by the Congress in House Concurrent Resolution 50, Seventy/ninth Congress:~~

~~(b) The provisions of Section 263(I) of the Internal Revenue Code, relating to special rules for intangible drilling and development costs incurred outside the United States, shall apply to costs paid or incurred after December 31, 1986.~~

Section 14. Section 24423 of the Revenue and Taxation Code is added to read:

24423. (a) Notwithstanding Section 24422 the provisions of Section 263(I) of the Internal Revenue Code, relating to special rules for intangible drilling and development costs, shall apply for all purposes under this part and shall apply to all such costs paid or incurred with respect to oil, gas, or geothermal wells located within and without the United States.

(b) The provisions of Section 263(c) of the Internal Revenue Code shall have no force or effect for any purpose under this part.

(c) The provisions of this section shall apply to costs paid or incurred on or after January 1, 2006.

Section 15. Section 25128 of the Revenue and Taxation Code is amended to read:

25128. (a) All business income shall be apportioned to this state by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor.

(b) This section shall apply to income years beginning on or after January 1, 2006.

Section 16. Section 25110 of the Revenue and Taxation Code is amended to read:

25110. (a) Notwithstanding Section 25101, a qualified taxpayer, as defined in paragraph (2) of subdivision (b), that is subject to the tax imposed under this part, may elect to determine its income derived from or attributable to sources within this state pursuant to a water's-edge election in accordance with the provisions of this part, as modified by this article. A taxpayer that makes a water's-edge election shall take into account the income and apportionment factors of the following affiliated entities only:

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

(2) 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 United States is 20 percent or more.

(3)(A) Corporations that are incorporated in the United States, excluding corporations making an election pursuant to Sections 931 to 936, inclusive, of the Internal Revenue Code, of which more than 50 percent of their voting stock is owned or controlled directly or indirectly by the same interests.

(B) An inverted domestic corporation.

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

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

(6) Any affiliated corporation which is a "controlled foreign corporation," as defined in Section 957 of the Internal Revenue Code, if all or part of the income of that affiliate is defined in Section 952 of Subpart F of the Internal Revenue Code ("Subpart F income"). The income and apportionment factors of any affiliate to be included under this paragraph shall be determined by multiplying the income and apportionment factors of that affiliate without application of this paragraph by a fraction (not to exceed one), the numerator of which is the "Subpart F income" of that corporation for that taxable year and the denominator of which is the "earnings and profits" of that corporation for that taxable year, as defined in Section 964 of the Internal Revenue Code.

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

(B) The income and factors of a corporation that is not described in paragraphs (1) to (3), inclusive, and paragraph (5) and that is an electing taxpayer under this subdivision shall be taken into account in determining its income only to the extent set forth in paragraph (4).

(b) For purposes of this article and Section 24411:

(1)(A) An “affiliated corporation” means a corporation that is a member of a commonly controlled group as defined in Section 25105.

(B) An “inverted domestic corporation” means a foreign incorporated entity, as defined in clause (iii) of subparagraph (C), if all of the following apply:

(i) Either subclause (I) or (II) applies:

(I) The foreign incorporated entity acquires, directly or indirectly, substantially all of the properties held, directly or indirectly, by a domestic corporation or substantially all of the properties constituting a trade or business of a domestic partnership or a related foreign partnership, and immediately after the acquisition, either:

(aa) In the case of a domestic corporation, more than 50 percent of the stock, by vote or value, of the foreign incorporated entity is held by former shareholders of the domestic corporation by reason of holding stock in the domestic corporation.

(ab) In the case of a domestic partnership, more than 50 percent of the stock, by vote or value, of the foreign incorporated entity is held by former partners of the domestic partnership or related foreign partnership by reason of holding a capital or profits interest in the domestic partnership or related foreign partnership.

(II) The foreign incorporated entity acquires, directly or indirectly, substantially all of the properties held, directly or indirectly, by a domestic corporation or substantially all of the properties constituting a trade or business of a domestic partnership or a related foreign partnership, and more than 50 percent of the stock, by vote or value, of the foreign incorporated entity is held by domestic shareholders.

(ii) Immediately after the acquisition described in clause (i), the properties acquired constitute at least 80 percent of the assets of the foreign incorporated entity.

(C)(i) In applying subparagraph (B), the following rules apply:

(I) There shall not be taken into account, in determining ownership for purposes of subclause (I) of clause (i) of subparagraph (B), either of the following:

(aa) Stock held by members of the expanded affiliated group that includes the foreign incorporated entity.

(ab) Stock of that foreign incorporated entity that is sold in a public offering related to the acquisition described in subparagraph (B).

(II) If a foreign incorporated entity acquires, directly or indirectly, substantially all of the property of a domestic corporation or partnership during a four-year period and the ownership requirements of clause (i) of subparagraph (B) are met within two years from the date of that acquisition, then that acquisition shall be treated as having been made pursuant to a plan.

(III) The transfer of property or liabilities, including by contribution or distribution shall be disregarded if the transfers are part of a plan, a principal purpose of which is to avoid the purposes of this section.

(IV) For purposes of applying subparagraph (B) to the acquisition of a domestic partnership, all domestic partnerships that are under common control within the meaning of Section 482 of the Internal Revenue Code shall, except as otherwise provided in regulations prescribed by the Franchise Tax Board, be treated as one partnership.

(V) The Franchise Tax Board may prescribe those regulations as may be necessary to do both of the following:

(aa) Treat warrants, options, contracts to acquire stock, convertible debt instruments, and other similar interest or intangibles as stock.

(ab) Treat stock as not stock.

(ii) Notwithstanding subparagraph (A), for purposes of subparagraph (B) the term "expanded affiliated group" means an affiliated group as defined in Section 1504(a) of the Internal Revenue Code, without regard to Section 1504(b)(3) of the Internal Revenue Code, except that Section 1504 of the Internal Revenue Code shall be applied by substituting "more than 50 percent" for "at least 80 percent" each place it appears.

(iii) The term "foreign incorporated entity" means any entity that is treated as a foreign corporation for purposes of the Internal Revenue Code.

(iv)(I) Except as provided in subclause (II), the terms "person," "domestic," and "foreign" have the meanings given those terms by paragraphs (1), (4), and (5), respectively, of Section 7701(a) of the Internal Revenue Code.

(II) For purposes of this article and the application of provisions of the Internal Revenue Code applicable for purposes of this article, including Subpart F of the Internal Revenue Code, a foreign incorporated entity that is an inverted domestic corporation shall be treated as a domestic corporation.

(v) For purposes of this section, indirect acquisition of property includes the acquisition of stock of the owner of that property.

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

(A) Files with the state tax return on which the water's-edge election is made a consent to the taking of depositions at the time and place most reasonably convenient to all parties from key domestic corporate individuals and to the acceptance of subpoenas duces tecum requiring reasonable production of documents to the Franchise Tax Board as provided in Section 19504 or by the State Board of Equalization as provided in Title 18, California Code of Regulations, Section 5005, or by the courts of this state as provided in Chapter 2 (commencing with

Section 1985) of Title 3 of Part 4 of, and Section 2025 of, the Code of Civil Procedure. The consent relates to issues of jurisdiction and service and does not waive any defenses a taxpayer may otherwise have. The consent shall remain in effect so long as the water's-edge election is in effect and shall be limited to providing that information necessary to review or to adjust income or deductions in a manner authorized under Sections 482, 861, Subpart F of Part III of Subchapter N, or similar provisions of the Internal Revenue Code, together with the regulations adopted pursuant to those provisions, and for the conduct of an investigation with respect to any unitary business in which the taxpayer may be involved.

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

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

(ii) Any corporation that is either a significant source of supply for the unitary business or a significant purchaser of the output of the unitary business, or that sells a significant part of its output or obtains a significant part of its raw materials or input from the unitary business. "Significant," as used in this subparagraph, means an amount of 15 percent or more of either input or output.

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

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

Sales shall be considered to be made to a state only if the corporation making the sale may otherwise be subject to a tax on or measured by net income under the Constitution or laws of the United States, and shall not include sales made to a corporation whose income and apportionment factors are taken into account pursuant to subdivision (a) in determining the amount of income of the taxpayer derived from or attributable to sources within this state.

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

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

(d) The amendments made to this section by the act adding this subdivision apply as follows:

(1) To a taxpayer that is required to file on a water's-edge basis in its first taxable year beginning on or after January 1, 2006, pursuant to a water's-edge election in accordance with the provisions of this part, as modified by this article, made on or after January 1, 2006.

(2) To a taxpayer that is required to file on a water's-edge basis pursuant to a water's-edge election in accordance with the provisions of this part, as modified by this article, made in a year prior to January 1, 2006, under Section 25111, in its first taxable year beginning on or after January 1 of the year immediately succeeding the expiration of the term of the water's-edge election in effect on January 1, 2006.

Section 17. Section 9082.8 is hereby added to the Elections Code to read:

9082.8 The State Controller, in consultation with the Department of Finance and the Legislative Analyst's Office, shall prepare a budget summary explaining how state funds are raised and spent, not to exceed two printed pages, which shall be published in the state ballot pamphlet sent to voters in every statewide election. The cost of preparing the summary shall be paid for out of funds transferred to the Economic Recovery Tax Relief Fund pursuant to Section 7.5 of Article XVI of the California Constitution.

Section 18. The statutory provision of this Act may be amended to carry out its purpose and intent by statutes requiring a 2/3 vote for enactment.

Section 19. If any provision of this act or the application thereof to any person or circumstances is held invalid, that invalidity shall not affect other provisions or applications of the act which can be given effect without the invalid provision or application, and to this end the provisions of this Act are severable.