Advocacy Points

- **Repatriation**:

  California should not include any portion of foreign earnings deemed repatriated under IRC section 965 in the state tax base.

  If and when California updates its conformity with the Internal Revenue Code ("IRC") to the current version of the IRC as amended by the Tax Cuts and Jobs Act ("TCJA"), it should exclude the deemed repatriated foreign earnings from computation of the state tax base of both world-wide and water's-edge taxpayers. The deemed repatriation of foreign earnings in IRC section 965 is a federal income tax fiction designed to aid in the transition of the federal income tax system from a "world-wide" to a "quasi-territorial" tax system. The California tax system, however, is not undergoing such a transition so the provisions serve no purpose in California and should not be followed in California.

  With respect to water's-edge filers, California currently includes a portion of the income and factors of controlled foreign corporations ("CFCs") in computing the taxable income of a California' water's-edge group. The amounts included for each CFC are proportional to the CFC's Subpart F income over its total earnings and profits. Because California has already included a portion of the income of CFCs in computing the taxable income of a California water's edge group, California should exclude foreign earnings deemed repatriated under IRC section 965 from the state tax base of the water's-edge group. Additionally, with respect to California's water's-edge filers, taxing the deemed repatriated foreign earnings would be inconsistent with California's historic policy of taxing a portion of foreign affiliates *current* income. Furthermore, California's current regime for taxing CFC income would not apply to earnings deemed repatriated under IRC section 965 because the current regime provides that a portion of current income and current apportionment factors of the CFC are included in the computation of the liability of the water's-edge group – the current regime would not account for the fact that 965 income represents earnings from the past 30 years.

  With respect to California's world-wide filers, the California system of taxation will remain a world-wide tax system, under which California already taxes the earnings of unitary foreign subsidiaries and cannot constitutionally tax the earnings of non-unitary foreign subsidiaries. Thus, the repatriation provisions should be moot with respect to California's world-wide filers.

  Thus, foreign earnings deemed repatriated under IRC section 965 should not be included in the tax base for world-wide or water's-edge filers.

- **GILTI:**

  California should not include any portion of the global intangible low-taxed income ("GILTI") included in federal taxable income under IRC section 951A in the state tax base.

  If and when California updates its conformity with the Internal Revenue Code ("IRC") to the current version of the IRC as amended by the Tax Cuts and Jobs Act ("TCJA"), it should exclude GILTI from the computation of the state tax base of both world-wide and water's-edge taxpayers.

  With respect to California's water's-edge filers, California currently includes a portion of the income of controlled foreign corporations ("CFCs") in computing the taxable income of a California' water's-edge group. The amount included for each CFC is proportional to the CFC's Subpart F income over its total earnings and profits. GILTI should be excluded from the California tax base because taxing GILTI would be inconsistent with California's historic policy of not taxing operating income of foreign subsidiaries. California's taxation of Subpart F income, which is generally passive income of the US shareholder, is fundamentally different from taxing a portion of the operating income of foreign subsidiaries. Taxation of such income would be wholly inconsistent with California's water's-edge filing regime and would make such regime a quasi-world-wide regime. Such a wholesale change to California's policy of taxing foreign income should be made by the state legislature (if at all) and not through blind conformity to the IRC.

  With respect to California world-wide filers, the GILTI provisions are moot because California already taxes the income of unitary foreign subsidiaries (and cannot constitutionally tax the earnings of non-unitary foreign subsidiaries).

  Furthermore, at the federal level, taxation of GILTI is supposed to reach only that income that is attributable to "low-tax" foreign jurisdictions; this is accomplished by use of foreign tax credits. California does not apply foreign tax credits, so conformity would result in taxing much more than income earned in low-tax jurisdictions.

- **Interest Expense Limitation:**

  California should not conform to the interest expense limitation of IRC section 163(j), as amended by the Tax Cuts and Jobs Act.

  First, the limitation provides no material benefit to the state because California already has provisions in place to address improper interest deductions, such as the potential application of transfer pricing principles. Additionally, because California is a combined return state, separate computations would be needed for each combined return that has different members than those in the federal consolidated group. The California Legislature or Franchise Tax Board will need to spend a significant amount of time drafting rules concerning a myriad of issues, including: whether carried-forward interest expense will be based on the taxpayer's apportionment in the year the interest expense is paid or in the year the interest expense is used; how to account for the carried-forward interest expense when a corporation leaves/joins a combined group; how to account for the carried-forward interest expense when there is a change of ownership in the taxpayer; and whether to suspend the income inclusion if a disallowed business expense is paid to a related party that files as part of a different filing group in the state. This can all be avoided by decoupling from IRC section 163(j).

Furthermore, the interest expense limitation has been added at the federal level as a companion to the expensing provisions; the interest expense limitations ensure that taxpayers do not get a double benefit by purchasing certain assets that are eligible for expensing by means of excessive borrowings that would result in an interest expense deduction. Therefore, to the extent California decouples from the expensing provisions, it is both logical and fair it should also decouple from the interest expense limitation.

- **Expensing:**

  California should conform to IRC section 168(k).

  The federal government has provided companies with the ability to immediately deduct the cost to purchase certain assets in an attempt to stimulate the economy and encourage companies to make capital investments. California should do the same as decoupling negatively impacts companies with a significant presence in California.

- **Capital Contributions:**

  California should conform to IRC section 118 as it was in effect prior to the Tax Cuts and Jobs Act.

  Conforming to the current version of IRC section 118 would tax corporations on contributions by governmental entities and civic groups such that state and local governmental incentives to attract and retain businesses would be taxable to the receiving corporation. If a state wants to use incentives to attract and retain businesses, imposing tax on such incentives reduces the effectiveness of such policy.

- **FDIC Premiums:**

  California should decouple from IRC section 162(r).

  This federal provision disallowing a deduction for FDIC fees was included purely as a means of raising revenue to offset other provisions that reduced the overall amount of corporate federal income taxes that will be paid to the federal government. Because taxpayers are not benefitting from an overall tax reduction in California, there is no rationale for limiting the deductibility of FDIC fees. Furthermore, this provision negatively impacts institutions with a significant presence in California.