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May 7, 2026

Assembly Member Buffy Wicks, Chair
Assembly Member Josh Hoover, Vice Chair
California Committee on Appropriations

Re: A.B. 1790 – COST Opposes Repeal of Water’s-Edge Election

Dear Chair Wicks, Vice Chair Hoover, and Members of the Committee on Appropriations:

On behalf of the Council On State Taxation (COST), we are writing to voice COST’s opposition to A.B. 1790.

About COST

COST is a nonprofit trade association based in Washington, DC. COST was formed in 1969 as an advisory committee to the Council of State Chambers of Commerce and today has an independent membership of approximately 500 major corporations engaged in interstate and international business. COST’s objective is to preserve and promote the equitable and nondiscriminatory state and local taxation of multijurisdictional business entities. Numerous COST members have operations in California and, in addition to the State, they would be negatively impacted by this legislation.

No State or Country Requires Worldwide Combined Reporting

No state or country in the world, including the U.S., currently mandates worldwide combined reporting,¹ and California would be an outlier if it adopted a mandatory regime. Proponents argue that worldwide combined reporting would recoup revenues allegedly lost through profit shifting by U.S.-based multinational enterprises, but that claim overlooks major international initiatives already underway to curb base erosion and profit shifting (BEPS). For more than a decade, the Organization for Economic Cooperation and Development (OECD) has led efforts to address BEPS by strengthening the coherence of international tax rules and increasing transparency. The OECD considered—but ultimately rejected—mandatory worldwide combined filing during its

¹ The only exception is Alaska for certain oil and gas companies.

BEPS deliberations, and its current Pillar One and Pillar Two proposals likewise do not contemplate worldwide combined reporting.² Adopting mandatory worldwide combined reporting would therefore make California an outlier and could undermine the State's economic competitiveness by increasing uncertainty in the corporate income tax system as companies consider where to locate or expand operations.

Mandatory Worldwide Combined Reporting Would Create Revenue Volatility

For 40 years California taxpayers have been allowed to make an election to file their corporate income taxes on a water's-edge basis. The longevity of this reporting structure allowed California to develop a reliable method for estimating revenue. This structure has provided the state with a steady and reliable revenue stream, but mandating worldwide combined reporting will increase the volatility of that revenue stream. Elimination of the Election will put California at the mercy of the global economy. The vast majority of multinational businesses operate through hundreds of subsidiaries and affiliates. Not all those entities are profitable as profitability depends not only on the nature of the business but also on the location of the business operations. Factors such as emerging economies, political unrest, and the timing of economic recoveries all have a direct impact on the profitability of multinational operations. A multinational group forced to file a worldwide combined return will generally also contain loss companies which will offset the income of the profitable group members.

Mandatory worldwide combined reporting does not only impact the computation of taxable income it also impacts the apportionment of that income. Multistate/multinational corporations are required to apportion their income to California using a single sales factor formula. The formula consists of a ratio of receipts in California to total receipts. Thus, the denominator of the formula will include the group's total worldwide receipts without regard to whether the entity generating the receipts was profitable. While mandatory worldwide combined reporting may, in some cases, potentially produce a larger amount of income prior to apportionment, California will receive a much smaller portion of that income.

Water's-edge Election is not a Corporate Loophole.

In a tax context the term "loophole" implies an exploitation of an unintended statutory ambiguity. Effectively, a loophole is an unintended gap in the statutory structure. The Election is neither a statutory ambiguity nor is it related to a gap in the tax structure. The Election California has provided for over 40 years is specifically authorized by the statute and reflects a conscious tax policy decision by the California legislature. It is important to note that the statute that authorizes the Election contains significant safeguards to address any abuse of the Election. The Election is effectively a contract between the taxpayer and the Franchise Tax Board (FTB). Under the terms of the agreement the taxpayer is bound to the Election for an 84-month period.³ In making the Election the taxpayer agrees to provide the FTB with access to key domestic individuals and documentation for purposes of evaluating and adjusting the income between

² The OECD solution to address global profit shifting is a global 15 percent minimum tax (GMT) on the income of multinational entities in every country in which they operate. The GMT is imposed on an entity-by-entity basis and does not incorporate any of the principles of combined reporting.

³ CA Rev. & Tax Code §25113

members and non-members of the water's-edge group.⁴ Additionally, the taxpayer agrees to characterize all dividends received from nonmembers as apportionable business income. A taxpayer making the election is following a clearly defined statutory scheme. There is no gap or ambiguity in that statutory scheme. Thus, it is inappropriate to label the Election as a corporate loophole.

The Inclusion of NCTI in the Tax Base Violates Key Elements of GMTs

The COST Board of Directors adopted a formal policy position opposing the taxation of foreign source income.⁵ With respect to A.B. 1790, the inclusion of 40% of NCTI in the corporate income tax base violates key elements of the emerging global consensus on global minimum taxes (GMT). Compounding the problem, the bill's failure to allow factor representation for NCTI is contrary to the State's current law that provides for factor representation of taxable foreign dividends. Additionally, there is no offsetting credit for foreign taxes. Thus, foreign-source income is taxed at the state level regardless of whether (or to what extent) the foreign-source income is taxed in the foreign country. All this raises potential double taxation issues, which creates a significant risk of litigation that could result in significant refund exposure.

Conclusion

For the forgoing reasons, A.B. 1790 represents a fundamental and unprecedented departure from long-standing California corporate tax policy. Accordingly, COST respectfully requests this Committee to reject A.B. 1790.

Respectfully,



Marilyn A. Wethekam



Dylan B. Waits

cc: COST Board of Directors
Patrick J. Reynolds, COST President & Executive Director

⁴ CA Rev. & Tax Code §25110(b)

⁵ This policy position is available at: <https://www.cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-policy-positions/20260421-fsi-policy-statement-final.pdf>.