

REVISED



Date: May 31, 2024

To: Members, Assembly Budget Committee
Members, Senate Budget Committee

From: Peter Blocker, Vice President of Policy

Subject: **OPPOSITION to RN 2406822 – May Revise Budget Trailer Bill Relating to Corporate Tax Increase on Foreign Dividends**

The California Taxpayers Association and the organizations below must respectfully oppose the May budget proposal to require certain income to be excluded from a businesses' apportionment factor when filing on a water's edge basis. This budget change directly reverses a recent Office of Tax Appeals (OTA) decision in the *Appeal of Microsoft*, which dealt specifically with the exclusion of foreign dividends in the sales factor of a water's edge filer. Numerous taxpayers are currently under audit with similar facts in this case that will be affected by this proposed change.

Taxpayers rely on the technical expertise of OTA decisions when planning their long-term tax liabilities and make important business decisions with these opinions in mind.

In 2017, the Office of Tax Appeals was created to remove political influence from the appeals process, creating an independent, objective appeals process. Due to the time it takes for an audit to make its way through the appeals process, the recent ruling was the most significant case to date decided by the OTA. The May budget revision undermines the OTA's

independence and credibility, creating a process where a taxpayer's win before the OTA can be merely undone by statutory changes.

For the following reasons, CalTax and the organizations listed below respectfully oppose the tax increase proposed in the May budget revision.

Imposes a Retroactive Tax Increase. The May Revise “clarification” of apportionment issues is more than clarification – it is a retroactive tax increase, overturning California law that has existed since the 1960s.

At issue in the *Appeal of Microsoft* was:

1. Whether dividends from foreign subsidiaries that are deducted from income pursuant to R&TC section 24411 are includable in the sales factor of a water's-edge filer.
2. Whether these dividends should be excluded from the sales factor as a “substantial and occasional sale,” pursuant to California Code of Regulations, title 18, (Regulation) section 25137(c)(1)(A).

The California Legislature previously undertook an extensive effort to redefine what is included in the sales factor and what is excluded, but it did not address or “clarify” that dividends income should be reduced by deductions for purposes of the sales factor. The Legislature cannot reasonably claim now in a “clarification” that it meant to exclude other types of income received. Section 25120 states that all gross amounts received must be included in the sales factor, which dates back to the statute's original language enacted in 1966. It is unreasonable for the current Legislature to “clarify” what was meant by the Legislature almost 60 years ago.

Further, the OTA's ruling in *Microsoft* unanimously ruled in favor of the taxpayer, following a line of important court and OTA cases that have developed California common law regarding the meaning of “gross receipts” for purposes of the sales factor (*Microsoft Corporation v. Franchise Tax Board* (2006); *Appeal of Robert Half International Inc. and Subsidiaries*, 2019-OTA-330; and *Appeal of Southern Minnesota Beet Sugar Cooperative and Subsidiary*, 2023-OTA-342).

Undermines Independence of OTA. Having the Legislature “overrule” the *Microsoft* decision by “clarifying” the meaning of statutes enacted by the Legislature decades ago undermines the rule of law and the very purpose of the OTA to interpret California tax law.

The OTA was established in 2017 as part of the Taxpayer Transparency and Fairness Act. The OTA's purpose was to provide a nonpartisan and fair adjudicatory body for taxpayers. In the declaratory statement for the legislation establishing the OTA, the Legislature remarked:

“Taxpayers deserve to have appeals considered by an independent, objective panel with sufficient expertise and a sole focus on tax issues. Any appeals forum must issue decisions in a transparent fashion, relying on well-established precedents in tax law, providing open public access and choice of representation, and building a record that both taxpayers and tax administration agencies can rely upon.”

The Legislature recognizes the importance of an independent judicial process to handle technical disputes over tax law. Overturning the decisions of OTA administrative law judges

The California Taxpayers Association is a nonpartisan, nonprofit association formed to support good tax policy, oppose unnecessary taxes and promote government efficiency. Established in 1926, CalTax is the oldest and largest group representing California taxpayers.

directly undermines the agency’s authority over tax matters and creates a chilling effect on the business community, where lawmakers could overturn any decision they see fit. Retaining the independence of the OTA as a non-political institution to dispute tax matters should be prioritized by the Legislature.

For these reasons, CalTax and the organizations listed below urge the Legislature to reject this budget item.

On behalf of...

California Taxpayers Association
Biocom California
California Association of Wine Grape Growers
California Chamber of Commerce
California Independent Petroleum Association
California Manufacturers and Technology Association
Central City Association of Los Angeles
Council on State Taxation
Microsoft
Los Angeles Area Chamber of Commerce
Orange County Taxpayers Association
Securities Industry and Financial Markets Association
Silicon Valley Leadership Group
Solano County Taxpayers Association
Valley Industry & Commerce Association
Western Electrical Contractors Association