How Corporations Can Reduce Their California Taxes to Virtually Zero With the Water's Edge Election, Net Operating Losses, and Tax Credits

A Hypothetical and Simplified Example

BigTech, Inc. has $10 billion in profits (revenues minus business expenses) from companies set up around the world.

Explanation	Example
BigTech can use the **Water's Edge Election** to only count its "domestic" profits.	**"Domestic profits" = $4 billion** (BigTech actually earned $8 billion of its profits in the US, but it used various techniques to shift $4 billion of that into its foreign subsidiaries, leaving it with $4 billion in "domestic" profits and $6 billion in "foreign" profits.)
A **"sales factor"** is used to calculate profits attributable to California. (Sales factor = Sales to CA divided by total sales)	If BigTech's sales factor = 10%, its **California profits = $400 million**. ($4 billion x 10%)
If BigTech incurred losses in prior years, it can subtract those from its California profits as **"net operating loss (NOL) deductions"**.	If BigTech has $300 million in NOLs, its **California taxable income = $100 million**. ($400 million - $300 million)
California's 8.84% corporate tax rate is applied to taxable income to determine **taxes before the application of tax credits**.	**Tax due would be $8.84 million** if BigTech has no tax credits. ($100 million x 8.84%)
But if BigTech has California **tax credits** from the current and/or prior years (such as the Research and Development Credit or Film Credit), it can subtract those from its tax bill.	If BigTech has $10 million in tax credits available, this wipes out the $8.84 million tax bill and it **only pays the $800 "minimum franchise tax"**.

BigTech's final tax bill = $800

The remaining $1.16 million in tax credits can be used to offset its tax bill in future years. ($10 million - $8.84 million)