

AUTHOR'S COPY

LEGISLATIVE COUNSEL'S DIGEST

Bill No.

as introduced, De León.

General Subject: Income taxes: single sales factor.

The Corporation Tax Law imposes taxes measured by income and, in the case of a business with income derived from or attributable to sources both within and without this state, apportions the business income between this state and other states and foreign countries in accordance with a specified 4-factor formula based on the property, payroll, and sales within and without this state, except that in the case of an apportioning trade or business that derives more than 50% of its gross business receipts from conducting one or more qualified business activities, as defined, business income is apportioned in accordance with a specified 3-factor formula. Existing law, for taxable years beginning on or after January 1, 2011, authorizes a taxpayer required to apportion its business income in accordance with the 4-factor formula to make an annual election to have that business income apportioned in accordance with a single sales factor formula.



110240431481BILL

This bill would eliminate the authorization for specified taxpayers to elect to have business income apportioned in accordance with a single sales factor formula and instead require those taxpayers to apportion their business income in accordance with a single sales factor formula for taxable years beginning on or after January 1, 2011, and would make related changes.

This bill would constitute a change in state statute that would result in a taxpayer paying a higher tax within the meaning of Section 3 of Article XIII A of the California Constitution, and thus would require for passage the approval of $\frac{2}{3}$ of the membership of each house of the Legislature.

This bill would take effect immediately as a tax levy.

Vote: $\frac{2}{3}$. Appropriation: no. Fiscal committee: yes. State-mandated local program: no.



110240431481BILL

31481

01/13/11 11:25 AM
RN 11 02404 PAGE 1

AUTHOR'S COPY

An act to amend Sections 25113, 25128, and 25136 of, to add Section 25128.7 to, and to repeal Section 25128.5 of, the Revenue and Taxation Code, relating to taxation, to take effect immediately, tax levy.



110240431481BILL

THE PEOPLE OF THE STATE OF CALIFORNIA DO ENACT AS FOLLOWS:

SECTION 1. Section 25113 of the Revenue and Taxation Code, as added by Section 4 of Chapter 657 of the Statutes of 2003, is amended to read:

25113. (a) Except as provided in subdivision (f), for taxable years beginning on or after January 1, 2003, the election provided for in Section 25110 shall be made on an original, timely filed return for the year of the election. The election will be considered valid if both of the following conditions are satisfied:

(1) The tax is computed in a manner consistent with a water's-edge election.

(2) A written notification of election is filed with the return on a form prescribed by the Franchise Tax Board. Pursuant to regulations promulgated under this section, the Franchise Tax Board may accept the filing of other objective evidence that supports the conclusion that a water's-edge election was intended in lieu of notification on the designated form.

(b) Except as otherwise provided, a water's-edge election shall be effective only if made by every member of the self-assessed combined reporting group that is subject to taxation under this part.

(1) An election made on a group return of a self-assessed combined reporting group shall constitute an election by each taxpayer member included in that group return, unless one of those taxpayers files a separate return in which no election is made and paragraph (2) does not apply.

(2) A taxpayer that fails to make an election on its own timely filed original return shall be deemed to have elected if either of the following applies:



(A) It has a parent corporation that is an electing taxpayer that included the income and apportionment factors of the nonelecting taxpayer in the self-assessed combined reporting group reflected in the electing parent's timely filed original return, including a group return.

(B) The income and apportionment factors of the nonelecting taxpayer are reflected in the self-assessed combined reporting group of a timely filed original return of an electing taxpayer, and the notification of election filed by the electing taxpayer pursuant to paragraph (2) of subdivision (a) is signed by an officer or other authorized agent of either a parent corporation of the nonelecting taxpayer or another corporation with authority to bind the nonelecting taxpayer to an election.

(3) For purposes of this subdivision, a "parent corporation" of the taxpayer is a corporation that owns or constructively owns stock possessing more than 50 percent of the voting power of the taxpayer as determined under subdivisions (e) and (f) of Section 25105.

(4) If a corporation that is a member of a combined reporting group is not itself subject to taxation under this part in the year for which the water's-edge election is made, but subsequently becomes subject to taxation under this part, that corporation shall be deemed to have elected with the other taxpayer members of the combined reporting group.

(5) A taxpayer that is engaged in more than one apportioning trade or business as defined in paragraph ~~(6)~~ (2) of subdivision ~~(d)~~ (c) of Section 25128 may make a separate election for each apportioning trade or business.



(c) A water's-edge election shall remain in effect or be terminated in accordance with this subdivision.

(1) Except as otherwise provided in this subdivision, if one or more electing taxpayer members of a combined reporting group later become disaffiliated or otherwise cease to be included in the combined reporting group, the water's-edge election shall remain in effect as to both the departing taxpayer members and any remaining taxpayer members.

(2) If an electing taxpayer and a nonelecting taxpayer become members of a new unitary affiliate group, the nonelecting taxpayer shall be deemed to have elected if the value of the total business assets of the electing taxpayer, and its component unitary group, if any, is larger than the value of the total business assets of the nonelecting taxpayer, and its component unitary group, if any. Otherwise, the water's-edge election shall be automatically terminated at the time the electing members become part of the combined report. For purposes of applying paragraphs (9) and (10), the commencement date of the deemed election shall be the same as the commencement date of the electing taxpayers.

(3) If taxpayers filing under water's-edge elections with different commencement dates become members of a new unitary affiliate group, the earliest election date shall be deemed to apply to all electing taxpayers if the total business assets of the earlier electing taxpayer, and its component unitary group, if any, is larger than the value of the total business assets of the later electing taxpayer, and its component unitary group, if any. Otherwise, the later election commencement date shall apply to all electing taxpayers.



(4) (A) If a taxpayer with an election that has been terminated under paragraph (9) or (10) becomes a member of a new unitary affiliate group that includes another electing or nonelecting taxpayer not affected by those paragraphs, any water's-edge election of the other taxpayer member, if applicable, shall terminate, and any restrictions on making a new water's-edge election, relating to an election terminated under those paragraphs, shall apply to all taxpayer members of the new unitary affiliate group if the total business assets of the taxpayer with the terminated election, and its component unitary group, if any, is larger than the other taxpayer, and its component unitary group, if any. Otherwise, paragraph (2) shall apply, if applicable. If paragraph (2) does not apply, all taxpayer members of the new unitary affiliate group will be treated as nonelecting taxpayers that are not subject to any restrictions on making a new water's-edge election.

(B) If two nonelecting taxpayers with different termination dates under paragraph (9) or (10) become members of a new unitary affiliate group, the earliest termination date shall be deemed to apply to all nonelecting taxpayers, as well as any restrictions on making a new water's-edge election relating to that termination, if the total business assets of the earlier terminating taxpayer, and its component unitary group, if any, is larger than the value of the total business assets of the later terminating taxpayer, and its component unitary group, if any. Otherwise, the later termination date, and the related restrictions on making a new water's-edge election, shall apply to all taxpayer members of the new unitary affiliate group.

(5) (A) Except as provided in subparagraph (B), if one or more electing taxpayers did not report their income and apportionment factors as members of a combined



reporting group with one or more nonelecting taxpayers, and, pursuant to a Franchise Tax Board audit determination, the nonelecting taxpayers, are properly in the same combined reporting group as the electing taxpayers, the water's-edge election of the electing taxpayers shall remain in effect and the nonelecting taxpayers shall be deemed to have made a water's-edge election. The commencement date of the deemed water's-edge election shall be the same as the commencement date of the electing taxpayers.

(B) Subparagraph (A) may not apply if the value of total business assets of the electing taxpayers does not exceed the value of total business assets of the nonelecting taxpayers. In that event, the water's-edge election of each electing taxpayer is terminated as of the date the nonelecting taxpayers are, pursuant to the audit determination described in subparagraph (A), properly included in the same combined reporting group as the electing taxpayers.

(C) For purposes of applying the business asset test of this paragraph, the term "business assets" shall have the same meaning as subparagraph (A) of paragraph (6), except that the business assets of other members of the unitary affiliate group that are not taxpayers shall not be taken into account.

(D) Notwithstanding subparagraph (A), nonelecting taxpayers may not be deemed to have made a water's-edge election if the Franchise Tax Board audit determination described in subparagraph (A) is withdrawn or otherwise overturned.

(6) For purposes of paragraphs (2) to (5), inclusive, the following shall apply:

(A) "Business assets" are assets, including intangible assets, other than stock of a member of the unitary affiliate group, which are used in the conduct of the business



of the unitary affiliate group or would produce business income to the unitary affiliate group, if an election were not in place, if the assets were sold. Business assets shall be valued at net book value.

(B) The phrase “unitary affiliate group” refers to all of those corporations that would constitute a unitary group if a water’s-edge election were not made.

(C) The phrase “new unitary affiliate group” refers to a unitary affiliate group that is created by a new affiliation of two or more corporations, or by the addition of one or more new members to an existing unitary affiliate group.

(D) The phrase “component unitary group” means that portion of a group of corporations that have become members of a new unitary affiliate group that were members of their own respective unitary affiliate group prior to entering the new unitary affiliate group, disregarding any corporations that did not become part of the new unitary group.

(7) In the application of paragraphs (2) to (4), inclusive, a series of acquisitions as steps of a single transaction shall be aggregated as a single change of membership.

(8) In the event of a merger or consolidation, the water’s-edge status and election commencement date or termination date of the surviving corporation shall be consistent with the result that would have been obtained under paragraphs (2) to (4), inclusive, if the surviving corporation had acquired the stock of the transferor corporation.

(9) A water’s-edge election may be terminated without the consent of the Franchise Tax Board after it has been in effect for at least 84 months. The termination shall be made on an original, timely filed return for the first year in which the water’s-edge election is to be terminated. To be effective, the termination shall be made



by every taxpayer that is a member of the water's-edge group in the same manner as the election provided under subdivisions (a) and (b).

(10) A water's-edge election may be terminated before the 84-month period described in paragraph (9) has elapsed, but only with the consent of the Franchise Tax Board. A request for termination shall be made at the time and in the manner specified by the Franchise Tax Board.

(A) The request may be granted for good cause. For purposes of this section, good cause shall have the same meaning as specified in Treasury Regulations Section 1.1502-75(c).

(B) The Franchise Tax Board shall consent to a termination requested by all members of a water's-edge group, if the purpose of the request is to permit the state to contract with an expatriate corporation, or its subsidiary, pursuant to paragraph (2) of subdivision (b) of Section 10286 of the Public Contract Code. A water's-edge election terminated pursuant to this subparagraph shall, however, be effective for the year in which the expatriate corporation, or its subsidiary, enters into the contract with the state.

(11) Except for deemed elections as provided in paragraphs (2), (4), and (5), if a water's-edge election is terminated under paragraph (9) or (10), another election may not be made under this section for any taxable year that begins within the 84-month period following the last day of the election period that was terminated. The Franchise Tax Board may waive the application of this prohibition period for good cause.

(12) A water's-edge election shall remain in effect until terminated.

(d) For purposes of this section, the following shall apply:



(1) A “combined reporting group” means those corporations whose income and apportionment factors are properly considered pursuant to this chapter in computing the income of the individual taxpayer that is derived from or attributable to sources within this state, taking into account a valid water’s-edge election.

(2) A “group return” refers to the single return which taxpayer members of a combined reporting group may elect by contract to file, in the form and manner prescribed by the Franchise Tax Board, in lieu of filing their own respective returns.

(3) A “self-assessed combined reporting group” means that group of corporations whose income and apportionment factors are reflected in a combined report prepared pursuant to this chapter in a timely filed return, taking into account the effects of a purported water’s-edge election, whether or not the membership of the corporations in that combined report was correctly determined.

(e) The Franchise Tax Board may prescribe any regulations as may be necessary or appropriate to carry out the purposes of this section.

(f) To the extent that a taxpayer would have been required to file on a water’s-edge basis in its first taxable year beginning on or after January 1, 2003, pursuant to a water’s-edge election made in a prior year under Section 25111, the terms of Section 25111 may not apply and the election shall be deemed to have been made under the terms of this section. However, the commencement date of the election made in a prior year under Section 25111 shall continue to be treated as the commencement date of the water’s-edge election period for purposes of applying this section.

SEC. 2. Section 25128 of the Revenue and Taxation Code is amended to read:



25128. (a) Notwithstanding Section 38006, all business income shall be apportioned to this state by multiplying the business income by a fraction, the numerator of which is the property factor plus the payroll factor plus twice the sales factor, and the denominator of which is four, except as provided in subdivision (b) or (e).

(b) If an apportioning trade or business derives more than 50 percent of its "gross business receipts" from conducting one or more qualified business activities, all business income of the apportioning trade or business shall be apportioned to this state by multiplying business income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three.

(c) For purposes of this section, a ~~"qualified business activity"~~ means the following:

(1) "Agricultural business activity" means any activity relating to any stock, dairy, poultry, fruit, furbearing animal, or truck farm, plantation, ranch, nursery, or range. "Agricultural business activity" also includes any activity relating to cultivating the soil or raising or harvesting any agricultural or horticultural commodity, including, but not limited to, the raising, shearing, feeding, caring for, training, or management of animals on a farm as well as the handling, drying, packing, grading, or storing on a farm of any agricultural or horticultural commodity in its unmanufactured state, but only if the owner, tenant, or operator of the farm regularly produces more than one-half of the commodity so treated.

(2) "Apportioning trade or business" means a distinct trade or business whose business income is required to be apportioned under Sections 25101 and 25120, limited,



if applicable, by Section 25110, using the same denominator for each of the applicable payroll, property, and sales factors.

(3) "Banking or financial business activity" means any activity attributable to dealings in money or moneyed capital in substantial competition with the business of national banks.

(4) "Extractive business activity" means any activity relating to the production, refining, or processing of oil, natural gas, or mineral ore.

(5) "Gross business receipts" means gross receipts described in subdivision (e) or (f) of Section 25120 (other than gross receipts from sales or other transactions within an apportioning trade or business between members of a group of corporations whose income and apportionment factors are required to be included in a combined report under Section 25101, limited, if applicable, by Section 25110), whether or not the receipts are excluded from the sales factor by operation of Section 25137.

(6) "Qualified business activity" means any of the following:

(+)

(A) An agricultural business activity.

(-)

(B) An extractive business activity.

(-)

(C) A savings and loan activity.

(+)

(D) A banking or financial business activity.



(7) "Savings and loan activity" means any activity performed by savings and loan associations or savings banks which have been chartered by federal or state law.

(d) For purposes of this section:

(1) "Gross business receipts" means gross receipts described in subdivision (e) or (f) of Section 25120 (other than gross receipts from sales or other transactions within an apportioning trade or business between members of a group of corporations whose income and apportionment factors are required to be included in a combined report under Section 25101, limited, if applicable, by Section 25110), whether or not the receipts are excluded from the sales factor by operation of Section 25137.

(2) "Agricultural business activity" means activities relating to any stock, dairy, poultry, fruit, furbearing animal, or truck farm, plantation, ranch, nursery, or range. "Agricultural business activity" also includes activities relating to cultivating the soil or raising or harvesting any agricultural or horticultural commodity, including, but not limited to, the raising, shearing, feeding, caring for, training, or management of animals on a farm as well as the handling, drying, packing, grading, or storing on a farm any agricultural or horticultural commodity in its unmanufactured state, but only if the owner, tenant, or operator of the farm regularly produces more than one-half of the commodity so treated.

(3) "Extractive business activity" means activities relating to the production, refining, or processing of oil, natural gas, or mineral ore.

(4) "Savings and loan activity" means any activities performed by savings and loan associations or savings banks which have been chartered by federal or state law.



~~(5) "Banking or financial business activity" means activities attributable to dealings in money or moneyed capital in substantial competition with the business of national banks.~~

~~(6) "Apportioning trade or business" means a distinct trade or business whose business income is required to be apportioned under Sections 25101 and 25120, limited, if applicable, by Section 25110, using the same denominator for each of the applicable payroll, property, and sales factors.~~

~~(7) Paragraph (4)~~

(d) Subparagraph (D) of paragraph (6) of subdivision (c) shall apply only if the Franchise Tax Board adopts the Proposed Multistate Tax Commission Formula for the Uniform Apportionment of Net Income from Financial Institutions, or its substantial equivalent, and shall become operative upon the same operative date as the adopted formula.

~~(8)~~

(e) In any case where the income and apportionment factors of two or more savings associations or corporations are required to be included in a combined report under Section 25101, limited, if applicable, by Section 25110, both of the following shall apply:

~~(A)~~

(1) The application of the more than 50 percent test of subdivision (b) shall be made with respect to the "gross business receipts" of the entire apportioning trade or business of the group.

~~(B)~~



(2) The entire business income of the group shall be apportioned in accordance with either subdivision (a) or (b), or subdivision (b) of Section ~~25128.5~~ 25128.7, as applicable.

SEC. 3. Section 25128.5 of the Revenue and Taxation Code is repealed.

~~25128.5. (a) Notwithstanding Section 38006, for taxable years beginning on or after January 1, 2011, any apportioning trade or business, other than an apportioning trade or business described in subdivision (b) of Section 25128, may make an irrevocable annual election on an original timely filed return, in the manner and form prescribed by the Franchise Tax Board to apportion its income in accordance with this section, and not in accordance with Section 25128.~~

~~(b) Notwithstanding Section 38006, for taxable years beginning on or after January 1, 2011, all business income of an apportioning trade or business making an election described in subdivision (a) shall be apportioned to this state by multiplying the business income by the sales factor.~~

~~(c) The Franchise Tax Board is authorized to issue regulations necessary or appropriate regarding the making of an election under this section, including regulations that are consistent with rules prescribed for making an election under Section 25113.~~

SEC. 4. Section 25128.7 is added to the Revenue and Taxation Code, to read:

25128.7. (a) Notwithstanding Section 38006, for taxable years beginning on or after January 1, 2011, any apportioning trade or business, other than an apportioning trade or business described in subdivision (b) of Section 25128, shall apportion its business income in accordance with this section, and not in accordance with Section 25128.



(b) Notwithstanding Section 38006, for taxable years beginning on or after January 1, 2011, all business income of an apportioning trade or business described in subdivision (a) shall be apportioned to this state by multiplying the business income by the sales factor.

(c) The Franchise Tax Board may issue regulations necessary or appropriate regarding the administration of this section.

SEC. 5. Section 25136 of the Revenue and Taxation Code is amended to read:

~~25136. (a) For taxable years beginning before January 1, 2011, and for taxable years beginning on or after January 1, 2011, for which Section 25128.5 is operative and an election under subdivision (a) of Section 25128.5 has not been made, sales, other than sales of tangible personal property, are in this state if:~~

~~(1) The income-producing activity is performed in this state; or~~

~~(2) The income-producing activity is performed both in and outside this state and a greater proportion of the income-producing activity is performed in this state than in any other state, based on costs of performance.~~

~~(3) This subdivision shall apply, and subdivision (b) shall not apply, for any taxable year beginning on or after January 1, 2011, for which Section 25128.5 is not operative for any taxpayer subject to the tax imposed under this part.~~

~~(b)~~

25136. (a) For taxable years beginning on or after January 1, 2011:

(1) Sales from services are in this state to the extent the purchaser of the service received the benefit of the service in this state.



(2) Sales from intangible property are in this state to the extent the property is used in this state. In the case of marketable securities, sales are in this state if the customer is in this state.

(3) Sales from the sale, lease, rental, or licensing of real property are in this state if the real property is located in this state.

(4) Sales from the rental, lease, or licensing of tangible personal property are in this state if the property is located in this state.

~~(5) (A) If Section 25128.5 is operative, then this subdivision shall apply in lieu of subdivision (a) for any taxable year for which an election has been made under subdivision (a) of Section 25128.5.~~

~~(B) If Section 25128.5 is not operative, then this subdivision shall not apply and subdivision (a) shall apply for any taxpayer subject to the tax imposed under this part.~~

~~(C) Notwithstanding subparagraphs (A) or (B), this subdivision shall apply for purposes of paragraph (2) of subdivision (b) of Section 23101.~~

(e)

(b) The Franchise Tax Board may prescribe those regulations as necessary or appropriate to carry out the purposes of subdivision ~~(b)~~ (a).

SEC. 6. This act provides for a tax levy within the meaning of Article IV of the Constitution and shall go into immediate effect.

