**Franchise Tax Board**

# ANALYSIS OF AMENDED BILL

| | | | | | |
|---|---|---|---|---|---|
| Author: | Villines & Ma | Analyst: | Gail Hall | Bill Number: | AB 2114 |
| Related Bills: | See Legislative History | Telephone: | 845-6111 | Amended Date: | July 2, 2008 |
| | | Attorney: | Patrick Kusiak | Sponsor: | |

**SUBJECT**: DOF, FTB, and LAO Conduct Study Of impact Of Change In Apportionment Of Income Of Trades Or Businesses That Would Modify Sales Factor to Retain & Attract Businesses To & Create New Jobs in California.

## SUMMARY

This bill would require certain agencies to conduct a study on the impact of changing the rule for assigning income to California for purposes of the franchise tax.

## SUMMARY OF AMENDMENTS

The July 2, 2008, amendments added the Franchise Tax Board (FTB) as one of the three state agencies required to participate in the study described in the SUMMARY section above. The department's analysis of the bill as amended May 1, 2008, no longer applies.

## PURPOSE OF THE BILL

The author's office has indicated the purpose of the bill is to study options to modify the method used to assign sales to California in a manner that would retain and attract businesses to and create new jobs in California.

## EFFECTIVE/OPERATIVE DATE

This bill would be effective and operative on January 1, 2009.

## POSITION

Pending.

## ANALYSIS

FEDERAL/STATE LAW

The federal method of taxing corporations doing business within and without a state is different from the California method; therefore, federal law is inapplicable.

| Board Position: | | | Department Director | Date |
|---|---|---|---|---|
| _______ S | _______ NA | _______ NP | | |
| _______ SA | _______ O | _______ NAR | Selvi Stanislaus | 7/15/08 |
| _______ N | _______ OUA | ___X___ PENDING | | |

California has adopted the Uniform Division of Income for Tax Purposes Act, (UDITPA), with certain modifications, to determine how much of an apportioning taxpayer's total income, which is earned from activities both inside and outside of California, is attributed to California and subject to California franchise or income tax. UDITPA uses an apportionment formula to determine the amount of "business" income attributable to California[1].

The apportionment formula consists of property, payroll, and sales factors. Each of these factors is a fraction the numerator of which is the value of the item in California and the denominator of which is the value of the item everywhere. The property factor includes tangible property owned or rented during the taxable year; the payroll factor includes all forms of compensation paid to employees; and the sales factor generally includes all gross receipts from the sale of tangible and intangible property and is double-weighted.

The calculation of the apportionment formula and California business income is illustrated below.

$$\frac{\dfrac{\textbf{Average CA Property}}{\text{Average Total Property Everywhere}} + \dfrac{\textbf{CA Payroll}}{\text{Total Payroll Everywhere}} + \left(2 \times \dfrac{\textbf{CA Sales}}{\text{Total Sales Everywhere}}\right)}{4} = \text{California Apportionment Percentage}$$

X Total Business Income
= California Business Income

For taxable years beginning on or after January 1, 1993, the apportionment formula for most taxpayers has been a three-factor apportionment formula consisting of property, payroll, and double-weighted sales (three-factor, double-weighted sales). An exception to this rule exists for taxpayers that derive more than 50% of their gross business receipts from conducting a "qualified business activity." These taxpayers are required to use a three-factor, single-weighted sales, apportionment formula. For this purpose, a qualified business activity is defined as an agricultural, extractive, savings and loan, and banking or financial business activity. In addition, current law requires that once a determination has been made that the apportioning trade or business is involved in a qualified business activity, the entire apportioning trade or business uses the same weighting, regardless of whether the particular entity was involved in a qualified business activity.

[1] "Business income attributable to California" is a taxpayer's "business income" multiplied by its California apportionment formula. Revenue and Taxation Code (R&TC) section 25120(a) defines "business income" as income arising from transactions and activities in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations."

State law permits a departure from the standard apportionment provisions only in limited and specific cases[2], and recognizes that the standard apportionment provisions are not appropriate when applied to certain industries and types of transactions, in which case special apportionment provisions exist for those situations[3].

THIS BILL

This bill would require the Department of Finance, FTB, and Legislative Analyst's Office to conduct a study on a modification to the computation of the sales factor that would be best suited to retain and attract businesses to, and create new jobs in, California.

## FISCAL IMPACT

Assuming the Department's role in participating in this study would be that of providing franchise/income tax data, it is estimated that any workload increases to the Department staff created by this bill would be absorbable.

## ECONOMIC IMPACT

FTB's participation in the study discussed in this analysis would not impact the state income tax revenue.

## LEGISLATIVE STAFF CONTACT

| | | |
|---|---|---|
| Legislative Analyst | Revenue Manager | Legislative Director |
| Gail Hall | Rebecca Schlussler | Brian Putler |
| (916) 845-6111 | (916) 845-5986 | (916) 845-6333 |
| gail.hall@ftb.ca.gov | rebecca.schlussler@ftb.ca.gov | brian.putler@ftb.ca.gov |

[2] R&TC section 25137.
[3] California Code of Regulations (CCR), title 18, Section 25137.