Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	De Leon	Analyst:	Gail Hall	Bill Number:	AB 1935
Related Bills:	See Legislative History	Telephone:	845-6111	Introduced Date:	February 17, 2010
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Business Income Apportionment/Single Sales Factor

SUMMARY

This bill would remove the election provision from the sales-only formula that may be utilized to determine business income derived from within and without California.

PURPOSE OF THE BILL

According to author's staff, this bill would save the state millions annually through repeal of the tax law that incentivizes California businesses to move operations out-of-state.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately, and would be specifically operative for taxable years beginning on or after January 1, 2011.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

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

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.

Board Position:			Department Director	Date
_______ S	_______ NA	_______ NP		
_______ SA	_______ O	_______ NAR	Selvi Stanislaus	04/16/10
_______ N	_______ OUA	___X___ PENDING		

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. For most taxpayers, the sales factor is double-weighted.

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

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

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 of an apportioning trade or business that derive more than 50 percent of its 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, all members of the apportioning trade or business use the same weighting, regardless of whether the particular entity was involved in a qualified business activity.

State law permits a departure from the standard apportionment provisions only in limited and specific cases[1], 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[2].

For taxable years beginning on or after January 1, 2011, state law allows an apportioning trade or business to make an annual, irrevocable election to utilize a single factor, 100 percent sales (single sales factor) apportionment formula instead of the three factor, double-weighted sales apportionment formula. Qualified business activities (described above) are specifically prohibited from electing a single sales factor apportionment formula. The election must be made on a timely filed original return in the manner and form prescribed by the Franchise Tax Board.

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

THIS BILL

This bill would remove the elective language for the single sales factor formula and require each apportioning trade or business, except for those that derive more than 50 percent of their gross receipts from conducting a "qualified business activity," to apportion business income by using the single sales factor formula.

LEGISLATIVE HISTORY

SBX3 15 (Calderon, Stats. 2010, 3rd Ex. Sess. 2009, Ch. 17) and ABX3 15 (Krekorian, Stats. 2010, 3rd Ex. Sess. 2009, Ch. 10) enacted a provision that allows certain apportioning trades or businesses to make an annual, irrevocable election on a timely filed original return to utilize a single factor, 100 percent sales apportionment formula instead of the three factor, double-weighted sales apportionment formula. Apportioning trades or businesses that derive more than 50 percent of their gross business receipts from conducting one or more qualified business activities (agricultural, extractive, savings and loan, and banking or financial business) are specifically prohibited from electing a single factor, 100 percent sales apportionment formula.

PROGRAM BACKGROUND

FISCAL IMPACT

This provision would not significantly impact the department's costs.

ECONOMIC IMPACT

Estimated Revenue Impact of AB1935 Operative for Tax Years Beginning On or After January 1, 2011 Assumed Enactment Date before June 30, 2010 ($ In Millions)			
2010/11	2011/12	2012/13	2013/14
$135	$450	$600	$550

LEGISLATIVE STAFF CONTACT

Legislative Analyst
Gail Hall
(916) 845-6111
gail.hall@ftb.ca.gov

Revenue Manager
Monica Trefz
(916) 845-4002
monica.trefz@ftb.ca.gov

Legislative Director
Brian Putler
(916) 845-6333
brian.putler@ftb.ca.gov