

# ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: De León Analyst: Dawn Hadid Bill Number: SB 911

Related Bills: See Legislative History Telephone: 845-3391 Amended Date: August 09, 2012

Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** FTB Disclose Whether A Taxpayer Uses A Four-Factor Apportionment\Prohibit State Agencies From Contracting With Entities Using Four-Factor Apportionment

## SUMMARY

This bill would prohibit state agencies from entering into contracts with taxpayers that use the four-factor formula to compute their taxes.

This analysis only addresses the provisions of this bill that impact the department's programs and operations.

## RECOMMENDATION

No position.

## Summary of Amendments

The August 9, 2012, amendments removed the provisions related to local agency bond reports, and replaced them with the provisions discussed in this analysis. This is the department's first analysis of the bill.

## REASON FOR THE BILL

The reason for the bill is to encourage taxpayers to apportion their business income in a fair manner that will support the recovery of California's economy.

## EFFECTIVE/OPERATIVE DATE

This bill would become effective and operative January 1, 2013.

## ANALYSIS

### STATE LAW

Existing law provides authority to the Department of General Services for purchasing goods and services for state agencies.<sup>1</sup>

<sup>1</sup> Public Contract Code Sections: 10308, 10309, 10331 through 10333 and 12100 et seq. State Administrative Manual Section 3506

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Current state law prohibits the disclosure of any taxpayer information except as specifically authorized by statute. California law allows the Franchise Tax Board (FTB) to release individual tax return information to specific state agencies. Agencies must have a specific reason for requesting the information, including investigating items of income disclosed on any return or report, verifying eligibility for public assistance, locating absent parents to collect child support, or locating abducted children. For some agencies, only limited information may be released, such as the taxpayer’s social security number and address.

State law uses an apportionment formula, known as the four-factor formula, to determine the amount of “business” income attributable to California.<sup>2</sup> The apportionment formula consists of property, payroll, and sales factors. Each of these factors is a fraction: the numerator is the value of the item in California and the denominator is the value of the item everywhere. The property factor generally 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.

$$\frac{\left( \frac{\text{Property Factor}}{\text{Average California Property}} \div \frac{\text{Average Total Property}}{\text{Total Property}} \right) + \left( \frac{\text{Payroll Factor}}{\text{California Payroll}} \div \frac{\text{Total Payroll}}{\text{Total Payroll}} \right) + \left( \frac{\text{Sales Factor}}{\text{California Sales}} \div \frac{\text{Total Sales}}{\text{Total Sales}} \right)}{4} = \text{California Apportionment Factor}$$

For taxable years beginning on or after January 1, 2011, an apportioning trade or business (other than an apportioning trade or business that derives more than 50 percent of its gross business receipts from conducting a qualified business activity), is allowed to make an annual, irrevocable election to utilize a single factor, 100 percent sales (single sales factor), apportionment formula.

$$\frac{\text{California Sales}}{\text{Total Sales}} \text{ equals } \text{California apportionment factor}$$

The election must be on a timely-filed original return in the manner and form prescribed by the FTB.

**THIS BILL**

This bill would prohibit state agencies, including the FTB, from entering into contracts with taxpayers that apportion their income using the four-factor formula.

In order to verify the method of apportionment utilized by taxpayers, this bill would require the FTB to disclose to other state agencies whether the four-factor formula was used.

<sup>2</sup> “Business income attributable to California” is a taxpayer’s “business income” multiplied by its California apportionment formula. 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.

Further, this bill would specify that if the contracts are necessary to protect the health, safety, and welfare of the general public and could only be fulfilled by a taxpayer that utilizes the four-factor apportionment formula, the contract would be permitted.

The provisions of this bill would be specific to contracts for “goods and services”, relating to tangible personal property, including materials, supplies and equipment.

### IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author’s office to resolve these and other concerns that may be identified.

This bill would require the FTB to disclose the elected apportionment formula of taxpayers competing to enter into a state contract. Current law provides for disclosure of taxpayer information within the Revenue and Taxation Code, and disclosure of elected apportionment formula is not allowed. In order for the FTB to comply with the provisions of this bill, the author may wish to amend the general disclosure provisions contained in the Revenue and Taxation Code.

### **LEGISLATIVE HISTORY**

AB 1500 (Perez, 2011/12) would establish the Middle Class Scholarship Fund, require mandatory single sales factor for taxable years beginning on or after January 1, 2012, and require the FTB to report to the Department of Finance estimates of the amount of revenue associated with the change to a mandatory single sales factor apportionment formula for each fiscal year. This bill failed to pass from the Senate Floor.

SBX3 15 (Calderon, Ch. 17, Stats. 2009) allows specific entities to elect to utilize a sales only formula to apportion its income subject to franchise or income tax and modifies the rules for assigning certain receipts for inclusion in the sales factor.

SB 640 (Burton, Ch. 657, Stats. 2003) prohibits the state, absent a compelling public interest, from entering into contracts or agreements with certain publicly traded foreign (non-U.S.) corporations.

### **OTHER STATES’ INFORMATION**

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws. Research did not indicate that any of these states have enacted legislation to prevent entities that utilize a four-factor formula from entering into contracts with state agencies.

## FISCAL IMPACT

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

## ECONOMIC IMPACT

Estimated Revenue Impact of SB 911 For Contracts Entered Into On or After January 1, 2013 Assumed Enactment By September 30, 2012 (\$ in Millions)		
2012-13	2013-14	2014-15
+\$1.4	+\$6.8	+\$6.5

## SUPPORT/OPPOSITION

Support: None identified to date.

Opposition: None identified to date.

## ARGUMENTS

Proponents: Those in favor of this bill might argue the bill encourages taxpayers to utilize the single sales factor method of apportionment, thus helping the California economy.

Opponents: Those opposed to this bill might argue that the bill may penalize taxpayers who elect to use the existing lawful four-factor method of apportionment.

## LEGISLATIVE STAFF CONTACT

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