0500 Abbreviations, Acronyms and Definitions

The following are the abbreviations, acronyms, and definitions used extensively in all phases of multistate audits. In many cases the terms are statutorily defined. You should develop a working knowledge of these terms and definitions.

Abbreviations and Acronyms:

- **AB**: Assembly Bill
- **AIS**: Audit Issue Section
- **AMT**: Alternative Minimum Tax
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- **CCR**: California Code of Regulations
- **CFC**: Controlled Foreign Corporation
- **DISC**: Domestic International Sales Corporation
- **E&P**: Earnings and Profits
- **ECI**: Effectively Connected Income
- **FMV**: Fair Market Value
- **FOB**: Free on Board
- **FSC**: Foreign Sales Corporation
- **FTB**: Franchise Tax Board
- **FTC**: Foreign Tax Credit
- **IDR**: Information Document Request
- **IRC**: Internal Revenue Code
- **IRS**: Internal Revenue Service
- **LLC**: Limited Liabilities Companies
- **LR**: Legal Ruling
- **MATM**: Multistate Audit Technique Manual
- **MAP**: Manual of Audit Procedures
- **NOL**: Net Operating Loss
- **NPA**: Notice of Proposed Assessment
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- **PL**: Public Law
- **PTI**: Previously Taxed Income
- **REIT**: Real Estate Investment Trust
- **R&TC**: Revenue and Taxation Code
- **SB**: Senate Bill
- **SBE**: State Board of Equalization

- **SEC**: Securities Exchange Commission
- **Treas. Reg.**: IRS Treasury Regulation
- **TRS**: Technical Resource Section
- **UDITPA:** Uniform Division of Income for Tax Purposes Act
- **U.S.**: United States

Definitions

The R&TC and the CCR provide definitions for many terms used in the administration of multistate tax laws. The following are some of the most relevant terms pertaining to multistate tax law.

Allocation

The assignment of nonbusiness income to a particular state. (CCR § 25121(a)(3); MATM 4000)

Apportionment

The process by which business income is divided between states by the use of an apportionment formula. (CCR § 25121(a)(2); MATM 7000)

Apportionment Formula

A formula used to calculate the amount of business income that is derived from or attributable to sources within this state. An apportionment formula can consist of a single factor (e.g., sales only) or of multiple factors (property, payroll and sales). (R&TC § 25128; MATM 7000)

Business Activity

Transactions and activity occurring in the regular course of a taxpayer's particular trade or business. (CCR § 25121(a)(4); MATM 4000)

Business Income

Income arising from transactions and activity 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 constituted integral parts of the taxpayer's regular trade or business operations. (R&TC § 25120(a); MATM 4000)

Combined Reporting Group

Those corporations whose business income and apportionment factors are permitted or required to be considered for purposes of computing the income of a California taxpayer that is derived from or attributable to sources within this state. (CCR §25106.5(b)(3); R&TC §25113(d)(1); MATM 3000)

Combined Report

The schedules attached to the tax return that calculates each taxpayer member's income from sources within this state under the combined reporting method. (CCR §25106.5(b)(1); MATM 3000) See CCR §25106.5 for additional definitions and terms pertaining to combined reports.

Commercial Domicile

The principal place from which the taxpayer directs or manages its trade or business. (R&TC § 25120(b); MATM 1500)

Compensation

Wages, salaries, commissions, and any other form of remuneration paid to employees for personal services. (R&TC §25120(c); MATM 7320)

Corporation

The term applies to all corporations, other than corporations specifically exempted by the R&TC or the California Constitution. It includes any of the entities described as a corporation in R&TC §23038, including banks.

Doing Business

Any corporation that is actively engaging in any transaction in California for the purpose of financial gain or pecuniary profit is "doing business" in this state. (R&TC §23101(a).) In addition, commencing in 2011, R&TC contains a test for doing business based upon the absolute and relative amounts of the taxpayer's property, payroll and sales that are in California. (MATM 1100)

Fiscalization

The process of placing the income and factors of unitary corporations with different accounting periods onto a common taxable year-end. (CCR §25106.5(b)(15); §25106.5(c)(5); and §25106.5-4; MATM 5200)

Foreign Corporation

Any corporation incorporated outside California. (California Corporations Code §171)

Formula Factors

Make sure to use the proper apportionment formula for each of the taxable years within your audit cycle. (R&TC §25128 and §25128.5)

For Taxable Year beginning prior to January 1, 1993 and for those taxpayers who derive more than 50 percent of their gross business receipts from conducting a "qualified business activity" described in R&TC §25128(b):

R&TC §25128 provides that all business income be apportioned to this state by use of an apportionment formula consisting of property, payroll, and sales. See MATM 7000. The U.S. Supreme Court has upheld the California use of an apportionment formula consisting of property, payroll and sales to fairly apportion the total income of a unitary business between the taxing jurisdictions. (*Container Corporation v. Franchise Tax Board* (1983) 463 U.S.159.)

R&TC §25128 sets forth the apportionment formula as a fraction, in which:

- **Property factor** is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in this state during the taxable year, and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented and used everywhere during the taxable year. (R&TC §25129; MATM 7100)
- **Payroll factor** is a fraction, the numerator of which is the total amount of compensation paid by the taxpayer in this state during the taxable year, and the

denominator of which is the total compensation paid everywhere during the taxable year. (R&TC §25132; MATM 7300)

- **Sales factor** is a fraction, the numerator of which is the total sales of the taxpayer in this state during the taxable year, and the denominator of which is the total sales of the taxpayer everywhere during the taxable year. (R&TC §25134.) For taxable years beginning on or after January 1, 1993, the sales factor is double-weighted, except as provided in R&TC §25128, subdivisions (b) and (c).

For taxable years beginning on or after January 1, 1993:

California departed from the UDITPA model which uses an equally weighted three factor (property, payroll, and sales) apportionment formula. R&TC §25128 requires an apportionment taxpayers to use the four-factor apportionment formula, which includes a double weighted sales factor to apportion their business income to California. See MATM 7005 for exceptions to the double-weighted sales factor formula.

For taxable years beginning on or after January 1, 2011:

California adopted an elective single-factor apportionment formula. (R&TC §25128.5.) Any apportioning trade or business other than those deriving more than 50 percent of their gross business receipts from conducting a "qualified business activity" described in R&TC §25128(b) may make an irrevocable annual election on an original timely filed return, to use an alternate method to apportion the income to California by multiplying the business income by a single sales factor formula. See MATM 7006.

Intrastate Apportionment

The process of determining the California income apportioned and allocated to each California taxpayer in a combined group. Each California taxpayer's share of the unitary group business income attributable to California sources is calculated by multiplying each California taxpayer's California apportionment percentage by the unitary group business income. (*Appeal of Signal Companies, Inc*., 86-SBE-194, November 11, 1986; *Appeal of First Pacific Bancorp*, 95-SBE-013, November 9, 1995; FTB Legal Ruling 95-2.) This process is necessary to determine the separate tax liability for each California taxpayer, as well as to properly compute items such as NOLs, AMT, capital gains and losses, and tax credits. Intrastate apportionment is discussed in MATM 7900.

Multistate Tax Compact, Multistate Tax Commission

The Multistate Tax Compact (MTC) is an agreement among participating states to facilitate the uniform administration of state taxes for multistate taxpayers. The MTC incorporates UDITPA, and establishes the Multistate Tax Commission. R&TC §38006 contains the complete text of the MTC. It provides that the purpose of the MTC is to:

- Facilitate proper determination of state and local tax liability of multistate taxpayers, including the equitable apportionment of tax bases and settlement of apportionment disputes.
- Promote uniformity or compatibility in significant components of tax systems.
- Facilitate taxpayer convenience and compliance in the filing of tax returns and in other phases of tax administration.
- Avoid duplicative taxation.

States join the MTC by enacting the Multistate Tax Compact. California is a member state.

Nexus

The U.S. Constitution requires a minimum connection between the interstate activities and the taxing state. Nexus refers to the connection with a state which gives the state jurisdiction to impose a tax. See MATM 1100 and 1200.

Nonbusiness Income

Nonbusiness income is all income other than business income. (R&TC §25120(d); MATM 4000)

Public Law 86-272

In general, a state has an inherent right to tax activities that have nexus to the taxing state. This right flows from the state's sovereign status. In an effort to provide clarity and limit the states' ability to tax interstate commerce, Congress enacted Public Law 86-272 (15 USC §381 et seq.; see *Wisconsin Department of Revenue v. William Wrigley, Jr., Co*. (1992) 505 U.S. 214.)

Section 101(a) of PL 86-272 prohibits a state from taxing the income of a corporation whose only business activities within the state consist of "solicitation of orders" for tangible goods, provided that the orders are sent outside the State for approval and the goods are delivered from out-of-state.

By its terms, the application of PL 86-272 is very limited.

- It only applies to the solicitation of tangible personal property. Anything other than solicitation of tangible personal property (e.g., solicitation of sales of services and intangibles) will cause a loss of federal immunity. If immunity is lost, then even the taxpayer's activities that, standing alone, would not have exceeded the protections of Public Law 86-272 will now become subject to tax.
- Prohibits only taxes measured by income. It does not prohibit California's annual minimum franchise tax.
- Does not apply to foreign commerce.

See MATM 1200 - MATM 1240.

Sales

All gross receipts of the taxpayer not allocated under R&TC §§25123 through 25127 as nonbusiness income. (R&TC §25120; MATM 7510)

Depending on the years in your audit cycle, you need to consider the definition of "sales" in computing the sales factor. See R&TC §25120 subdivisions (e) and (f); MATM 7510)

State

Any state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States, and any foreign country or political subdivision thereof. (R&TC §25120(f))

Taxable in Another State

For purposes of apportionment and allocation of income, the taxpayer can be considered to be taxable in another state if either of two conditions exist:

- The state subjects the taxpayer to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax.

- The state has jurisdiction to subject the taxpayer to a net income tax regardless of whether the state actually imposes such a tax upon the taxpayer (R&TC §25122)

A taxpayer is not taxable in another state with respect to a particular trade or business merely because the taxpayer conducts activities in such other state pertaining to the production of nonbusiness income or business activities relating to another separate trade or business. (CCR §25122(a); MATM 1200)

Taxpayer

Any person or bank subject to the tax imposed under Chapter 2 (Corporation Franchise Tax), Chapter 2.5 (Alternative Minimum Tax), or Chapter 3 (Corporation Income Tax) of the Bank and Corporation Tax Law. (R&TC §23037; CCR §25121(a)(1).) The term "person" includes any association, corporation, business trust, or organization or any kind. It also includes trustee, trustee in bankruptcy, receiver, executor, administrator, or assignee. (R&TC §23037)

Throwback Sales

When a corporation ships tangible personal property from an office, store, warehouse, factory, or other place of storage in a state where a corporation is taxable to a purchaser in a state where the corporation is not taxable, those sales are assigned to the state from which the goods were shipped (the state of origin). (R&TC §25135(b); MATM 7530.) The sales reassigned to the state of origin from the destination state are referred to as throwback sales. If the taxpayer is not taxable in the state from which the property was shipped, the double throwback rule is applicable. See MATM 7532.

Uniform Division of Income for Tax Purposes Act (UDITPA)

The National Conference of Commissioners on Uniform State Laws drafted UDITPA to provide rules for the allocation and apportionment of income of multistate businesses. Once the tax base (e.g., net income) has been defined by a state, UDITPA operates:

- To define business and nonbusiness income.
- To define the apportionment formula which is used to apportion business income.
- To provide specific rules for the allocation of nonbusiness income.

California adopted UDITPA with some modifications in 1966 with the enactment of R&TC §§25120 through 25139. Those modifications are:

- California applies UDITPA rules to banks, financial corporations and public utilities.
- Section 6 of UDITPA (R&TC §25125), dealing with the allocation of capital gains and losses was amended in 1988 to add rules for allocation of gain or loss from the sale of a partnership interest. (MATM 4040.)
- In 1993, California departed from the equally weighted three-factor formula used in the model UDITPA by instituting a double-weighted sales factor. (R&TC §25128; MATM 7500.)
- In 2011, California adopted an elective single sales factor apportionment formula. See MATM 7006.

Unitary Method of Taxation

The unitary method of taxation is not a tax. It is a method by which the business income of a unitary business is apportioned among the taxing jurisdictions in which it operates. See MATM 3000.

NOTE: ((* * *)) = Indicates confidential and/or proprietary information that has been deleted.

Revised: December 2013