

California's Corporation Taxes

Frequently Asked Questions



Is my corporation subject to California income tax?**Corporation Franchise Tax**

You are responsible for the corporation franchise tax if your corporation or limited liability company treated as a corporation is doing business in California. Doing business in California is defined as actively engaging in any transaction in California for the purpose of financial gain or profit. Foreign corporations that are general partners of partnerships or members of limited liability companies (treated as partnerships for tax purposes) doing business in California are also responsible for the corporation franchise tax.

Corporation Income Tax

You are responsible for the corporation income tax if your corporation or limited liability company treated as a corporation receives income from sources within California but is not doing business in California. Foreign corporations that are limited partners of partnerships doing business in California are also subject to the income tax.

Alternative Minimum Tax

You are responsible for the alternative minimum tax set forth in federal tax law as modified by California law unless you are an S corporation.

Do I have to pay a minimum franchise tax for my corporation doing business in California?

For your first taxable year:

- If your corporation incorporates or qualifies to do business in California on or after January 1, 2000, you are not subject to the minimum franchise tax. Your corporation is still liable for a franchise tax on its net income.
- If your corporation is a limited liability company treated as a corporation doing business in California, you are also not subject to the minimum franchise tax if your limited liability company was organized or registered to do business in California on or after January 1, 2000.
- If you are a foreign corporation that is not qualified to do business in California, but are doing business in the state, you are subject to the minimum franchise tax.

All other years:

Your corporation is subject to an annual \$800 minimum franchise tax if it is doing business in the state, whether your corporation is active, inactive, operating at a loss, or filing a short period return for less than 12 months.

Can I use S corporation status in California?

Yes, California has adopted most of the federal provisions for S corporations. However, if you are a federal S corporation doing business in California or having California source income, you are subject to the franchise or income tax at the corporate level in addition to the shareholder tax on the pass-through income.

What is my tax rate?

The tax rates below apply to your corporation subject to either the corporation franchise or income tax.

C corporations, other than banks and financial corporations	8.84%
C corporations that are banks or financial corporations	10.84%
S corporations, other than banks and financial corporations	1.5%
S corporations that are banks or financial corporations	3.5%

What taxes can my corporation deduct?

Under California law, you cannot take a deduction for:

- Corporation franchise or income taxes.
- Any taxes on or measured by income.

Generally, you can deduct other taxes.

What depreciation method can I use as a C corporation doing business in California?

As a C corporation doing business in California, you should be aware of some important differences that exist between federal and California laws affecting the calculation of depreciation and amortization:

- California recognizes additional first-year depreciation under California Revenue and Taxation Code section 24356, not under Internal Revenue Code section 179.
- California has not conformed to federal statutes allowing depreciation under the Modified Accelerated Cost Recovery System.
- California has adopted provisions of the federal Class Life Asset Depreciation Range System, which specifies a useful life for various types of property.
- California law does not recognize the federal provision enabling a corporation to choose a depreciation period that varies from the specified asset guideline system.

What depreciation method can I use as an S corporation doing business in California?

For assets placed into service in 1987 and after, you can use the same depreciation method you used for federal purposes, unless California law modifies it.

Beginning in 1999, California law also conforms to the applicable amount of the Internal Revenue Code section 179 deduction. However, we do not conform to federal law on the following allowances:

- The additional 30 percent first-year depreciation allowance for qualified property.
- The additional 30 percent depreciation allowance for Qualified New York Liberty Zone property added by the federal Jobs Creation and Worker Assistance Act of 2002.

My corporation earned income from sources both within and outside California, how do you determine my California tax liability?

California applies the unitary method to determine your tax liability. Under this method, all of the elements comprising your trade or business are viewed as one unitary business, whether or not the activities of your business are conducted in separate corporate forms. The business income of your unitary business is then divided and assigned to California by means of an apportionment formula. This formula takes into account your worldwide property, payroll, and sales factors. In the case of multiple C corporations, we include your business income and apportionment factors of all the C corporations in your unitary business in a combined report.

What is a combined report?

A combined report is the calculations by which multiple entities engaged in a unitary business divide and assign income on a geographic basis. In a worldwide combined report, the combined business income from worldwide members of the unitary group is divided and assigned to California using the apportionment formula. For more information get *Guide for Corporations Filing a Combined Report (FTB 1061)*.

What is the apportionment formula?

Once you establish your unitary combined reporting group, the combined business income is apportioned to California by a mathematical formula. The formula is based on the three primary contributions to income earned by your unitary business: property, payroll and sales (which is generally counted twice.) The formula works as follows:

Property Factor or percentage = $\frac{\text{California Property/Property Everywhere}}{\text{California Property/Property Everywhere} + \text{California Payroll/Payroll Everywhere} + \text{California Sales/Sales Everywhere} \times 2}$

Payroll Factor or percentage = $\frac{\text{California Payroll/Payroll Everywhere}}{\text{California Property/Property Everywhere} + \text{California Payroll/Payroll Everywhere} + \text{California Sales/Sales Everywhere} \times 2}$

Sales Factor or percentage = $\frac{\text{California Sales/Sales Everywhere} \times 2}{\text{California Property/Property Everywhere} + \text{California Payroll/Payroll Everywhere} + \text{California Sales/Sales Everywhere} \times 2}$

Percentage of Business Income to be Apportioned to California = $\frac{\text{Property Percentage} + \text{Payroll Percentage} + \text{Sales Percentage} \times 2}{4}$

NOTE: If your corporation receives more than 50 percent of its gross business receipts from agricultural, extractive, savings and loan, banking or financial activities, you should not multiply your sales factor by 2 and your denominator should be 3, instead of 4, in the above formula to determine your income apportionable to the state.

For more information, refer to California Revenue and Taxation Code section 25128(c).

If the standard apportionment formula does not fairly represent your business activities in this state, you can petition in advance for modification of the standard apportionment formula. For more information regarding the apportionment formula, see the Unitary and Water's-Edge Reporting section of the most commonly used Franchise Tax Board booklets. Forms and publications relating to corporations are listed on the last page of this publication.

What if my corporation makes a water's-edge election?

If you make a water's-edge election, only the income and apportionment factors of your corporation and members of its water's-edge group are included in a combined report. The effect of this election is generally to exclude the income and apportionment factors of foreign incorporated entities from the combined report. You make this election by contract with the Franchise Tax Board for 84 months.

NOTE: For more information, refer to *Form 100W Booklet (Water's-Edge Booklet)*.

How do you compute the California net operating loss deduction?

For taxable years beginning in 2002 and 2003, California suspended the net operating loss deduction. You can continue to compute and carryover a net operating loss during the suspension period. The net operating loss suspension rules do not affect the deduction for disaster losses.

NOTE: For more information regarding the net operating loss suspension, refer to *Form 3805Q (Net Operating Loss Computation and Net Operating Loss and Disaster Loss Limitations – Corporations form)*.

Generally, the California net operating loss is computed in the same manner as the federal net operating loss, except that for California:

- You can only carryover a net operating loss to future years. You cannot carryback a net operating loss.
- Your carryover period is 5 years for net operating losses generated in taxable years beginning before January 1, 2000, and your carryover period is 10 years for net

operating losses generated in taxable years beginning on or after January 1, 2000. These rules don't apply to disaster losses and enterprise zone, Local Agency Military Base Recovery Act and Los Angeles Revitalization Zone net operating losses, which can carryover for 15 years.

- Your carryover deductions vary from 50 to 100 percent. For taxable years beginning on or after January 1, 2004, you can carry forward 100 percent of the net operating loss.

Do you authorize limited liability companies and recognize out-of-state limited liability companies doing business in California?

California law authorizes the formation of limited liability companies and recognizes out-of-state limited liability companies doing business in California and registered with the Secretary of State. In general, the taxation of a limited liability company by California depends upon its election to be taxed as a corporation, partnership, or disregarded entity for federal tax purposes.

Is your classification of an eligible business entity the same as federal classification?

California law conforms to the federal rules, also known as "check-the-box" regulations, for the classification of business entities. The classification of an eligible business entity for purposes of California income and franchise tax is the same as the classification of the entity for federal tax purposes. If you elect to change the classification of your eligible business entity for federal purposes, it is also applicable for California purposes. Except for certain entities (i.e., business trusts and single member entities that filed as partnerships) in existence prior to January 1, 1997, there is no separate California election regarding the classification of your entity for tax purposes.

Do you have a program to waive taxes and penalties for my out-of-state non-filing corporation if I agree to file?

California has adopted a Voluntary Disclosure Program to encourage out-of-state corporations and qualified S corporation shareholders to disclose their tax liabilities if they owe California taxes or have an unfulfilled tax return filing requirement. If you participate in the Voluntary Disclosure Program, you are only required to file returns for the six tax years ending immediately prior to the date you sign the agreement. We will waive penalties associated with the return filing.

For more information refer to *Guidelines For Voluntary Disclosure Agreements publication (FTB 1071)*.

Can my California corporation claim any significant credits?

If you qualify, your corporation can claim a variety of tax credits to reduce California tax, including those listed below. Your corporation cannot reduce the tax below the minimum franchise tax. With certain exceptions, you can carry forward California credits until exhausted. If your corporation is an S corporation, it can pass through most credits to its shareholders.

A C corporation's credits may be limited by alternative minimum tax. For more information see *Schedule P, Alternative Minimum Tax and Credit Limitations – Corporations*.

Manufacturers' Investment Credit

You can claim this credit if you are a manufacturer (Standard Industrial Classification codes 2011 to 3999) or a taxpayer with activities related to computer programming or computer software design (Standard Industrial Classification code 7371 to 7373) that purchases qualified property placed in service in California after January 1, 1994. Qualified property for codes 7371 to 7373 must be placed in service on or after January 1, 1998.

The amount of the credit is 6 percent of the cost of the qualified property. For more information, refer to *Frequently Asked Questions about California's Manufacturers' Investment Credit (FTB 1113)*.

Research Credit

You can claim this credit for costs attributable to research activities conducted in California. For more information, refer to *Form 3523 (Research Credit)* or *Research and Development Credit: Frequently Asked Questions (FTB 1082)*.

Enterprise Zones, Local Agency Military Base Recovery Areas, Manufacturing Enhancement Areas or Targeted Tax Areas

If you are a corporation operating in an enterprise zone, Local Agency Military Base Recovery Area, Manufacturing Enhancement Area, or Targeted Tax Area, you may be eligible for a hiring credit that you can claim for a portion of wages you paid to qualified employees.

You may also be eligible for:

- A sales or use tax credit that you can claim for the sales or use tax you paid to purchase qualified property.
- A special net operating loss carryover provision.
- A deduction for a portion of the cost of qualified property.

For more information see *Guidelines for Businesses Claiming Economic Development Area Tax Incentives (FTB 1158)*.

Employer Child Care Credit Program

If you are an employer, you can claim a credit, not to exceed \$50,000, equal to 30 percent of the costs for establishing a child care program or constructing a childcare facility for use primarily for your employees' children or tenants' employees' children. For more information, see *Form 3501 (Employer Child Care Program/Contribution Credit)*.

Employer Child Care Contribution Credit

If you are an employer, you can claim a credit, not to exceed \$360 per dependent, equal to 30 percent of your contribution to a qualified childcare plan made on behalf of any dependents, under age 12, of your California employees.

Commonly used Franchise Tax Board booklets, forms, and publications relating to corporations

General Interest

- Form 100 Booklet California Corporation Franchise or Income Tax Return
- Form 100S Booklet S Corporation Tax Booklet
- Form 568 Limited Liability Company Return of Income
- FTB 1038 Instructions for Corporations Requesting a Tax Clearance Certificate

- FTB 1060 Guide for Corporations Starting a Business in California
- FTB 1071 Guidelines for Voluntary Disclosure Agreement
- FTB 1113 Frequently Asked Questions about California's Manufacturers' Investment Credit
- Form 3535 Manufacturers' Investment Credit
- FTB 3805Q Net Operating Loss Computation and Net Operating Loss and Disaster Loss Limitations-Corporations
- FTB 3817 Electronic Funds Transfer Program

Worldwide and Water's-Edge Combined Reporting

- Form 100W Booklet Water's-Edge Booklet
- Schedule R Apportionment and Allocation of Income and Instructions
- FTB 1061 Guidelines for Corporations Filing a Combined Report
- FTB 1063 Guide for Corporations That May Be Subject to the Provisions of the California Bank and Corporation Tax Law

Economic Development Areas

- FTB 1158 Guidelines for Businesses Claiming Economic Development Area Tax Incentives
- Form 3805Z Booklet Enterprise Zone Deduction and Credit Summary
- Form 3807 Booklet Local Agency Military Base Recovery Area Deduction and Credit Summary
- Form 3808 Booklet Manufacturing Enhancement Area Business Booklet
- Form 3809 Booklet Targeted Tax Area Business Booklet

Need Franchise Tax Board forms or publications?

You can get our forms and publications from our Website at: www.ftb.ca.gov

If you wish to order by mail, please write to:

**Tax Forms Request Unit
PO Box 307
Rancho Cordova CA 95741-0307**

If you have further questions or wish to order by phone, please contact us

Within the U.S., call (800) 852-5711
Outside the U.S., call (not toll-free) (916) 845-6500

Assistance for persons with disabilities: We comply with the Americans with Disabilities Act. Persons with hearing or speech impairments, please call TTY/TDD (800) 822-6268.

Or you can write to:

**Franchise Tax Board
PO Box 942857
Sacramento CA 94257-0540**