

## DISCUSSION TOPICS

### Franchise Tax Board Interested Parties Meeting – Sales Factor: Sales of Tangible Personal Property Regulation Section 25106.5 May 26, 2011

#### 1. BACKGROUND

Revenue & Taxation Code (RTC) section 25135 provides the sales factor numerator assignment rules for sales of tangible personal property. During 2009, the Legislature amended RTC section 25135, operative for taxable years beginning on or after January 1, 2011.

#### **RTC Section 25135 – For Taxable Years Beginning Before January 1, 2011**

Prior to the 2009 amendment, RTC section 25135, operative December 1, 2000, generally provided that sales of tangible personal property are in this state if (a) the property is delivered or shipped to a purchaser, other than the United States government, within this state regardless of the f.o.b. point or other conditions of the sale; and (b) the property is shipped from an office, store, warehouse, factory, or other place of storage in this state and (1) the purchaser is the United States government or (2) the taxpayer is not taxable in the state of the purchaser.

While the language of RTC section 25135 has remained substantially unchanged since its first enactment in 1966, the interpretation of the administrative agencies including the State Board of Equalization (SBE) and the Franchise Tax Board (FTB) has vacillated several times.

In *Appeal of Joyce, Inc.*, 66-SBE-070, November 23, 1966, the SBE held that a unitary group's sales factor numerator must exclude the group's California destination sales of tangible personal property if the individual member making the sales was not itself subject to tax in California (the *Joyce* rule).

In *Appeal of Finnigan Corporation*, 88-SBE-022, decided on August 25, 1988 (*Finnigan I*), *Appeal of Finnigan Corporation*, 88-SBE-22A, Opinion on Petition for Rehearing, decided on January 24, 1990 (*Finnigan II*), and *Appeal of The NutraSweet Co.*, 92-SBE-024, decided on October 29, 1992 (*NutraSweet*), the SBE abandoned the *Joyce* rule and required assignment to a destination state of a unitary group's sales of tangible personal property if one member of the group had taxable nexus with that destination state (the *Finnigan/NutraSweet* rule).

However, the SBE reinstated the *Joyce* rule prospectively for taxable years beginning on or after April 22, 1999, in the *Appeal of Huffly Corporation*, 99-SBE-005, decided on April 22, 1999.

For taxable years beginning on or after April 22, 1999, the FTB has applied the *Joyce* rule and required assignment of sales of tangible personal property to a jurisdiction only when

the member of a combined reporting group making the sales had established nexus with that jurisdiction.

### **RTC Section 25135 – For Taxable Years Beginning on or after January 1, 2011**

The California Legislature adopted and codified the *Finnigan/NutraSweet* rule during 2009. As amended, RTC section 25135 requires that sales of tangible personal property delivered or shipped to a purchaser in California be assigned to California if the seller or any member of the seller's combined reporting group is taxable in California. In addition, all sales of tangible personal property delivered to a state other than California are not assigned (thrown back) to California if any member of the seller's combined reporting group is taxable in that state. This amendment applies to taxable years beginning on or after January 1, 2011.

Due to the California Legislature's codification of the *Finnigan/NutraSweet* rule, it is necessary to amend existing regulations promulgated under RTC section 25106.5. Staff would like to receive input on what specific language should be changed in Regulation section 25106.5 in order to implement the legislative change to RTC section 25135 to reflect the *Finnigan/NutraSweet* rule?

## **2. STAFF'S EXPECTATIONS FOR THE MEETING**

Staff seeks to allow the public an opportunity to share ideas on the content of possible amendments to Regulation section 25106.5. Staff believes that the following core principles provide an objective basis upon which to evaluate any proposed changes to the existing Regulation section 25106.5. Among these principles are:

- (1) Equity: Are all similarly situated taxpayers being treated in a similar manner?
- (2) Administration: Is a rule as clear and simple as possible? Can taxpayers and the FTB apply a rule?
- (3) Elimination of potential disputes: Does a rule raise new concerns that could lead to new disputes?
- (4) Recordkeeping: Does a rule use existing records as much as possible to minimize the burdens of recordkeeping on taxpayers?

## **3. POSSIBLE MODEL REGULATION AND FTB NOTICE**

Regulation section 25137-14, addressing the apportionment rules for Mutual Fund Service Providers and Asset Management Service Providers, adopted during 2007, provides a sales factor assignment method similar to the *Finnigan/NutraSweet* rule. In addition, in response to the SBE's opinions in *Finnigan I* and *Finnigan II*, the FTB published FTB Notice 90-3 on June 8, 1990, to inform the public about the change in FTB's administrative practice with respect to a multi-entity apportionment formula. Both the language in Regulation section 25137-14 and the example in FTB Notice 90-3 may be considered as possible amendments for Regulation section 25106.5.

Interested parties participating in the meeting are encouraged to review the following statutes, regulations, and FTB Notice:

1. RTC section 25135 (two versions: one applicable to taxable years beginning before January 1, 2011, one applicable to taxable years beginning on or after January 1, 2011)
2. California Code of Regulations, title 18, section 25106.5
3. California Code of Regulations, title 18, section 25137-14
4. FTB Notice 90-3, June 8, 1990

Staff anticipates hosting an open discussion to address concerns presented by the public. Interested parties should discuss possible approaches to administering the new tangible personal property sales assignment rule, keeping in mind that staff's underlying objective is to eliminate disputes and create straightforward rules that may be easily applied by taxpayers and administered by the FTB.