

Options for Discussion for the new CCR §25128.5

- (a) Definitions. For purposes of this regulation, the following definitions are applicable:
- (1) Affiliated corporations. "Affiliated corporations" are corporations related by common ownership without regard to unity. Common ownership is as defined in California Code of Regulations section 25105.
 - (2) Apportioning trade or business. "Apportioning trade or business" means a taxpayer that is a single corporation that is subject to the tax imposed by Part 11 of the Revenue and Taxation Code and is required to file a return under Revenue and Taxation Code section 18601.
 - (3) Apportionment. "Apportionment" is the means by which the total group business income of a combined report is assigned to this state under Revenue and Taxation Code sections 25128 through 25137 and section 25141.
 - (4) Business assets. "Business assets" are assets, including intangible assets, other than stock of a member of the combined reporting group, which are used in the conduct of the business of the combined reporting group or would produce business income to the combined reporting group if the assets were sold. Business assets are valued at net book value as of the date that electing taxpayers and non-electing taxpayers or non-taxpayers become members of a new combined reporting group. A copy of the taxpayer's valuation of the business assets must be made available when required by the Franchise Tax Board. The Franchise Tax Board may, in its sole discretion, allow an alternative valuation date if it determines that an alternative date would be more appropriate.
 - (5) Business asset test. The "business asset test" is the mechanism of comparing business assets to determine if members of a combined reporting group are required to use the standard formula under Revenue and Taxation Code section 25128 or the single-sales factor formula under Revenue and Taxation Code section 25128.5 and this regulation.
 - (6) Combined reporting group. A "combined reporting group" is as defined by California Code of Regulations section 25106.5, subsection (b), paragraph (3).
 - (7) Commencement date. The "commencement date" of a single-sales factor formula election is the first day of the period for which the election is made.
 - (8) Corporation. References to "corporation" include a subchapter S corporation, any other incorporated entity, or any entity defined or treated as a corporation pursuant to Revenue and Taxation Code sections 23038 or 23038.5.
 - (9) Good cause. "Good cause" shall have the same meaning as specified in Treasury Regulation section 1.1502-75(c).

(10) Group Return. A "group return" is as defined by California Code of Regulations section 25106.5, subsection (b), paragraph (13).

(11) Net book value. "Net book value" is equal to an asset's original cost minus depreciation, depletion and amortization. Book value means the amount which an asset is carried on a balance sheet. Depreciation means the systematic write off of the cost of a tangible asset over the asset's useful life. Depletion means the systematic write off of the cost of harvesting or mining a natural resource. Amortization means the systematic write off of the cost of an intangible asset over the asset's useful life. Book value, depreciation, depletion and amortization will be reflected using United States Generally Accepted Accounting Principles (US GAAP). If any member of a combined reporting group does not maintain its books using US GAAP, the Franchise Tax Board may allow an alternative method of valuation of that member's business assets.

(12) New combined reporting group. A "new combined reporting group" is a combined reporting group that is created by a new affiliation of two or more corporations, or by the addition of one or more new members to an existing combined reporting group.

(13) Original return. The "original return" is the last return filed on or before the due date (taking extensions into account) regardless of the form on which it is filed or however it may be denominated. A return filed after the due date (taking extensions into account) regardless of the form on which it is filed or however it may be denominated may be an original return, if no other return has been filed, but it would not be a timely filed, original return.

(14) Standard formula. The "standard formula" is the three-factor method of apportionment as defined by Revenue and Taxation Code section 25128 and California Code of Regulations section 25128.

(15) Timely filed. A "timely filed" return is one filed on or before the due date (taking extensions into account).

(16) Unitary business. A "unitary business" consists of those activities required to be included in a combined report pursuant to Revenue and Taxation Code section 25101 and the published cases decided thereunder by the United States Supreme Court, the courts of this State, and the California State Board of Equalization. Activities constitute a "unitary business" if unity of ownership, unity of operation, and unity of use are present, or if the activities carried on within the state contribute to or are dependent upon the activities carried on without the state. California Code of Regulations section 25120, subsection (b), sets forth certain indicia and standards for determining whether activities constitute a single trade or business and are therefore unitary.

(b) Electing the single-sales factor formula.

(1) To make a single-sales factor formula election permitted by Revenue and Taxation Code section 25128.5, a taxpayer must make an election on a timely filed, original return

for the year of the election. In order for an election by a combined reporting group to be effective, each member of the combined reporting group that is subject to taxation under Part 11 of the Revenue and Taxation Code must affirmatively make this election.

Example: Corporation P, a calendar year California taxpayer, has a subsidiary, Corporation A, who is also a calendar year California taxpayer. Corporation P and Corporation A are members of the same combined reporting group. On its separate timely filed return, Corporation P makes a single-sales factor formula election. Conversely, on its separate timely filed return, Corporation A does not make a single-sales factor formula election. As a result, neither Corporation P nor Corporation A are deemed to have made a single-sales factor formula election.

(2) An election made on a group return is an election by each taxpayer member included in that group return. However, the election made on the group return will not have any effect if a taxpayer member of the combined reporting group files a separate return in which no election is made, unless subsection (c)(3)(C) applies.

(3) Deemed Single-Sales Factor Formula or Standard Formula Elections and Non-Elections

(A) If a corporation that is a member of a combined reporting group is not itself subject to taxation under Part 11 of the Revenue and Taxation Code in the year for which the single-sales factor formula election is made, but subsequently becomes subject to taxation under Part 11 of the Revenue and Taxation Code, that corporation shall be deemed to have elected with the other taxpayer members of the combined reporting group.

(B) Corporations that are non-electing taxpayers that are subsequently found to be members of a combined reporting group as the result of a Franchise Tax Board audit determination (represented by a notice of additional tax proposed to be assessed, a notice of proposed overpayment, notice of action on a claim for refund, or a letter from the tax auditor regarding a computational effect which does not result in a current year adjustment [e.g., a computation of net operating loss carryover]) shall be deemed to have elected the single-sales factor formula if the value of the total business assets of the electing taxpayer(s) is greater than those of the non-electing taxpayer(s). The commencement date of the deemed single-sales factor formula election shall be the same as the commencement date of the electing taxpayers. If the value of total business assets of the electing taxpayers does not exceed the value of total business assets of the non-electing taxpayers, the single-sales factor formula election of each electing taxpayer is terminated as of the date the non-electing taxpayers are, pursuant to the audit determination, properly included in the same combined reporting group as the electing taxpayers. Non-electing taxpayers may not be deemed to have made a single-sales factor formula election if the Franchise Tax Board audit determination is withdrawn or otherwise overturned. For purposes of applying this paragraph, the business assets of other members of the combined reporting group that are not taxpayers shall not be taken into account.

Example: Corporation P is not a California taxpayer. It has two subsidiaries, Corporation A and Corporation B, that are California taxpayers, and another subsidiary, Corporation C, that is not a California taxpayer. Corporations P, A, and C are members of the same combined reporting group. Corporation A makes a single-sales factor formula election on its timely filed return which reflects the apportionment factors and income of Corporations P and C. Corporation B files a separate tax return as a standard formula non-electing taxpayer. Upon Franchise Tax Board audit, Corporation B is determined to be a member of the combined reporting group that includes Corporations A, P, and C. In the year of Corporation A's single-sales factor formula election, Corporation A's business assets are \$500 million and Corporation B's business assets are \$250 million. Based on the business asset test, Corporation B is deemed to have elected the single-sales factor formula, because Corporation A's business assets are greater than Corporation B's business assets. Corporations P and C's business assets are not taken into account in performing the business assets test, since neither P nor C are California taxpayers.

(C) If a taxpayer member of a combined reporting group files a separate return based on the standard formula, while other taxpayer members of the combined reporting group included in a group return file based on the single-sales factor formula, the business asset test will determine which method must be used for all taxpayer members of the combined reporting group.

Example: Corporations A, B, C, and D are California taxpayer members of a combined reporting group. Corporations A, B, and C file a group return using the single-sales factor formula. Conversely, Corporation D files a separate return using the standard formula. Pursuant to the business asset test, because the business assets of the electing Corporations A, B, and C are greater than the business assets of the non-electing Corporation D, Corporation D is deemed to have elected the single-sales factor formula.

(D) When taxpayer members of a combined reporting group file separate returns because their relative tax years end on different dates and some taxpayer members have elected the single-sales factor formula, while others have not, for purposes of conducting the business asset test, the business assets for the electing and non-electing taxpayers will be compared for each common 12-month period that occurs after January 1, 2011. Thereafter, the business assets test will be applied to the same common 12-month period.

Example: Corporations A, B, C, and D are California taxpayer members of a combined reporting group. Corporations A, B, and C are calendar year taxpayers and are included in a group return. Their return filed for taxable year ending December 31, 2011 uses the single-sales factor formula. Conversely, Corporation D has a fiscal year end on June 30th. The return Corporation D files for the year end of June 30, 2012 uses the standard formula. The first common 12 month period for all of the taxpayers begins on July 1, 2011, and ends on June 30, 2012. The business assets for the last six months of 2011 and the first six months of 2012 for electing Corporations A, B, and C are compared to the business assets of non-electing Corporation D for its taxable year ending June 30, 2012. If the business assets of electing Corporations A,

B, and C are greater than the business assets of non-electing Corporation D for the common 12 month period; then Corporation D is deemed to have elected the single-sales factor formula for apportionment. Conversely, if the business assets of non-electing Corporation D are greater than the business assets of Corporations A, B, and C for the common 12 month period, there is no single-sales factor formula election for Corporations A, B, or C. For all tax years thereafter, the business assets test will be based on a comparison of the business assets for the period encompassing Corporation D's fiscal year.

(4) Election following forced de-combination

(A) A taxpayer that is subsequently found to not be a member of the combined reporting group pursuant to a Franchise Tax Board audit determination (represented by a notice of additional tax proposed to be assessed, a notice of proposed overpayment, notice of action on a claim for refund, or a letter from the tax auditor regarding a computational effect which does not result in a current year adjustment [e.g., a computation of net operating loss carryover]) may elect to use the single-sales factor formula on an amended return that will be treated as an original return for the purpose of the single-sales factor formula election. The election should ordinarily be made during the course of the audit examination so that the results of that election can be reflected in the applicable notices related to the examination. Except for claims for refund, this election after de-combination must be made no later than 60 days after the date of the applicable notice. This election may be made for each taxable year beginning with the year of de-combination through 60 days after the date of the applicable notice. The Franchise Tax Board may extend such 60-day period for good cause, not to exceed 180 days. In the case of a claim for refund for the entity that was erroneously included in the combined reporting group, a request for the single-sales factor formula election must be made in the claim itself or presented before issuance of the notice of action on the claim. Information to substantiate the effect of the election shall be provided to the Franchise Tax Board within a reasonable time after an election under this subsection is made.

Example: Corporations A, B, and C are included in a group return for calendar Years 1, 2, 3, 4, 5, and 6 that makes a single-sales factor formula election. On June 15 of Year 7 the Franchise Tax Board determines that Corporation C was erroneously included in the combined report for every year. Corporation C must make the single-sales factor formula election for Years 1, 2, 3, 4, 5, and 6 by August 15 of Year 7. Thereafter, Corporation C may make the single-sales factor formula election on its timely filed original returns.

(5) A taxpayer that is engaged in more than one apportioning trade or business as defined in Revenue and Taxation Code section 25128, subdivision (d)(6), may make a separate election for each apportioning trade or business.

(6) Validity of Election. An election under this regulation will be considered valid if the following conditions are satisfied:

(A) The tax is computed in a manner consistent with the single-sales factor formula election, and

(B) A written notification of election is filed with the return on Part B of schedule R-1 of form 100 (S Corporations file a form 100S, and water's edge corporations file a form 100W).

(7) Time for making the election.

(A) The election must be made on a timely filed, original return.

Example: Corporation P is not a California taxpayer, but it has three subsidiaries, Corporations A, B, and C that are taxpayers and are part of its unitary business. No single-sales factor formula election is filed prior to the due date (taking extensions into account) for filing a return. After the due date (taking extensions into account), a delinquent original California return is filed with a single-sales factor formula election by Corporation P, stating that it now believes it had nexus in California. Because the election was not made on a timely filed, original return, there is no valid election.

(B) Timely filings which only supplement a previously filed return, or correct mathematical or other errors, shall be considered as incorporating the previously filed return, to the extent not inconsistent, and shall be treated as the original return for purposes of making a single-sales factor formula election. Any timely filings that clearly reflect an intent to withdraw an election made on a previously filed return shall be treated as an original return.

Example 1: Corporation A is a calendar year taxpayer. Its return is due March 15. But if it files its return on or before October 15, an extension is automatically granted to October 15. If it fails to file a return by October 15, no extension exists. Under the paperless extension process, the return is timely if it is filed on or before October 15. Corporation A files its original return on October 15 of the year. The original return is timely filed, and any single-sales factor formula election contained therein shall be effective for the year for which the return is filed.

Example 2: Same facts as Example 1 except that Corporation A files its original return on May 15 of the year. The original return is timely filed, and any single-sales factor formula election contained therein shall be effective for the year for which the return is filed.

Example 3: Same facts as Example 2 except that Corporation A files a second return on October 15. Under this regulation, Corporation A's original return was filed on October 15. The single-sales factor formula election must be made by that time. If Corporation A's May 15th filing makes a single-sales factor formula election, and the election is withdrawn in the October 15th filing, the election made on May 15th has no effect. If Corporation A's May 15th filing makes a single-sales factor formula election and the October 15th filing is silent as to the single-sales factor formula election but the calculation of the tax due on the return is consistent with making a single-sales factor formula election, then the single-sales factor formula election made in the May 15th filing is incorporated into the October 15th filing, which will be

considered as the original return. If Corporation A's May 15th filing does not make a single-sales factor formula election, but a single-sales factor formula election is made on the October 15th filing, Corporation A has made a single-sales factor formula election and the October 15th filing is the original return.

Example 4: Corporation B, a calendar year taxpayer, files a return on February 15. Corporation B's return is treated as being filed on March 15, which is the date the election is considered to have been made. Any return filed after March 15 (the due date of the return) will be considered an amended return.

Example 5: Corporation C, a calendar year taxpayer, has a due date for its return of March 15. It files a return on February 15 and files a second return on March 10. The return filed on March 10 is treated as the original return for the year. The election to file on a single-sales factor formula basis must be made on the March 10 filing to be effective. If Corporation C's February 15 filing makes a single-sales factor formula election and the March 10 filing uses the standard formula and does not make an election, the election made on the February 15 return has no effect. If Corporation C's February 15th filing did not make a single-sales factor formula election and a single-sales factor formula election is made on the March 10th filing, Corporation C has made a single-sales factor formula election.

(c) Miscellaneous Provisions.

(1) Affiliated corporations not engaged in the same unitary business. A group of affiliated corporations that are engaged in more than one unitary business may make a single-sales factor formula election with respect to one or more of the businesses, but need not elect for all of its businesses.

Example: Corporations A and B are California taxpayers and are affiliated with each other and with Corporations C, D, E, F, G, H, and I. Corporations A, C, D, and G are engaged in one unitary business, Group X. Corporations B, E, F, H, and I are engaged in another separate unitary business, Group Y. Since both Corporations A and B are California taxpayers, either may elect to file on a single-sales factor formula basis with their respective unitary group. It is not necessary for both Corporations A and B to make the same election, even though they are members of the same group of affiliated corporations. Corporation A, filing a group return for Group X, may make a single-sales factor formula election for Group X. Corporation B, filing a group return for Group Y, is not required to make a single-sales factor formula election.

(2) Partnerships. Corporations that elect single-sales factor formula apportionment must use the single-sales factor formula for distributive share items of income from unitary and nonunitary partnerships.

Example 1. Corporation A is a taxpayer. Corporation A and B are members of a combined reporting group. Corporation A owns 50 percent of the unitary Partnership Y. Accordingly, 50 percent of Partnership Y's income and factors are included in Corporation A and Corporation B's combined report. Corporation A makes a single-sales factor formula election. Corporation A's California-sourced share of income from its combined reporting

group which reflects its distributive share of Partnership Y's income and factors is determined using the single-sales factor formula.

Example 2. Same facts as Example 1 except that Corporation A owns 50 percent of the nonunitary Partnership Z instead of a 50 percent interest in Partnership Y. Pursuant to California Code of Regulations section 25137-1, subsection (g), Corporation A's distributive share of Partnership Z's income and factors are treated as a separate trade or business. Corporation A makes a single-sales factor formula election. Corporation A's California-sourced share of income from its combined reporting group is calculated using the single-sales factor formula. Accordingly, Corporation A's distributive share of income and factors from Partnership Z are also determined using the single-sales factor formula.

(3) Changes in affiliation. Elections are made at the end of each taxable year when changes in affiliation are known. When a corporation is acquired by a combined reporting group and becomes unitary mid-year, the taxpayer members of the combined reporting group have the option of electing to use the single-sales factor formula at the end of that taxable year. The income and factors of the acquired entity are not included in the combined report for the portion of the year before acquisition, and the acquired entity must file a return reflecting its income from California sources and has the option of making its own election for that time period, consistent with this regulation. When a combined reporting group sells a corporation, at the end of the year the taxpayer members of the combined reporting group have the option of making a single-sales factor formula election for the group. The combined reporting group does not include the income and factors of the divested entity for the time period after the sale. The divested entity must file its own tax return for the portion of the year after the sale and has the option to make its own single-sales factor formula election for that portion of the year.

Example 1. Corporation X and its unitary subsidiaries are members of a combined reporting group, Group W, which files on a calendar year basis. Corporation X is a member of Group W from January 1 to June 15 of Year 1. The group return filed by Group W includes Corporation X's income and factors for January 1 through June 14 of Year 1. Group W's taxpayers do not elect to use the single-sales factor formula. Corporation X may make its own single-sales factor formula election for the period starting June 15 through December 31 of Year 1.

Example 2. Corporation A and its unitary subsidiaries B and C are calendar year taxpayers and members of a combined reporting group, Group R. Corporation A acquires Corporation X on June 15 of Year 1. For Year 1, a group return is filed on behalf of the members of Group R with a single-sales factor formula election. The single-sales factor formula election applies to Corporation X for June 15 through December 31 of Year 1.

(d) This regulation shall be applicable to taxable years beginning on or after January 1, 2011.