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*** ******* ******
*** *********, ** **********

Chief Counsel Ruling 2012-03

Subject: Chief Counsel Ruling Request for **********, ********, **********

Dear **********:

This is in response to your Chief Counsel Ruling Request of June 22, 2012 wherein you seek guidance with respect to the operation of Revenue and Taxation Code sections 23101, 25122 and 25135.[1]

FACTS

The facts as represented by the taxpayer and upon which this ruling is expressly conditioned, are as follows:

******** is a worldwide ******* of ********* *****and other ********* products (*e.g.*, *********) and is domiciled in California. ********* represents it is unitary with its subsidiaries, ******** ********* *** ("**********") and ******* ********** ("*******"). *********, ********, and ******, along with other unitary subsidiaries of **********, will file a California franchise tax return based on a combined report for the taxable year beginning January 1, 2011.

********** is a ********** of ***** and other ********** for use on various ******* (*e.g.*, ***** and ** **** ******, etc.). ******** develops, markets and sells tangible personal property ("TPP") in the form of packaged ***** *****. ********* ships the packaged ***** from California to retail customers located in all 50 states and multiple foreign jurisdictions. *********'* activities to ****** and ***** its **** **** and other ********** products are largely performed in California. Except for a few other states where ********* has employees engaged in development activities, ********* activities outside of California are protected from domestic state taxation under

[1] Unless otherwise specified, "Section" or "§" references are to the California Revenue and Taxation Code currently in effect and "Regulation Section" or "Regulation §" references are to the applicable California regulations promulgated thereunder.

Public Law 86-272 ("P.L. 86-272").[2] ********'* sales exceed $500,000 in certain states and foreign jurisdictions, based on representations from **********'* books and records using the customer's ship-to address.

******* is a ********** of ***** ********** **** **** and other ******** offerings, primarily in the ***** ***** ***** ******* **** category. ***** develops, markets and sells other–than–TPP ***** and ******* to individual customers in the form of ********* ******** and ***** ***** **** **********.[3] Similar to *******, ********'* activities in ******** and ******** it's ****** ***** ***** and other ******** offerings are predominantly performed in California. *******'* customers are located in all 50 states and multiple foreign jurisdictions. ********'* activities involving ***** ******** and ***** ********** are not protected by P.L. 86-272. ******** represents that its other–than–TPP sales would exceed $500,000 in certain states and foreign jurisdictions under Section 25136(b) and Regulation Section 25136-2, based on ********'* books and records, using the location of each individual customer's billing address.

For taxable year 2011, but for the effect of the rulings requested below, ********** is uncertain as to whether it would have California throwback sales when calculating its California sales factor under Section 25135 due to the shipment of TPP from California to customers in certain jurisdictions where ********** would otherwise not be taxable.

The Chief Counsel Ruling requested by ********** is based on a tax position for which ********** has not yet filed its 2011 tax return, and the issue is not currently pending audit, protest, appeal, or litigation.

ISSUES

1. For the 2011 and future taxable years, should ******* throw back foreign TPP sales to the California sales factor numerator where ******** has more than $500,000 of TPP sales in a foreign jurisdiction, or should the sales not be thrown back because ******** would be taxable in such foreign jurisdiction under Section 25122?

2. Should ********* throw back domestic TPP sales to the California sales factor numerator where (i) ****** is taxable in a state under the standard set forth in Section 25122 because ******** has more than $500,000 in sales in such state, and (ii) in accordance with Section 25135(b) for taxable years beginning on or after January 1, 2011, ******* and ********* are members of the same combined reporting group?

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[2] Pub. L. No. 86-272, 73 Stat. 555 (1959), 15 U.S.C. § 381.

[3] This ruling does not address whether in fact sales of ********** and ********* ********** are other–than–TPP, but is based upon *******'* representation that these sales are sales of other–than-TPP.

HOLDINGS

1. ********** should not throw back foreign TPP sales to the California sales factor numerator where ********** has more than $500,000 of TPP sales in a foreign jurisdiction because it would be taxable in such foreign jurisdiction under Section 25122.

2. ********** should not throw back domestic TPP sales to the California sales factor numerator where ***** has more than $500,000 in sales in a state. Throwback is not required in accordance with Section 25135(b) for taxable years beginning on or after January 1, 2011 because ******** is taxable in such state under Section 25122, and ******** and ******** are members of the same combined reporting group.

DISCUSSION

1) ********** is not required to throw back foreign TPP sales to the California sales factor numerator where ******* has more than $500,000 of TPP sales in a foreign jurisdiction because it would be taxable in such foreign jurisdiction under Section 25122.

Section 25134 defines the sales factor as a fraction where the numerator is the total sales of the taxpayer in California during the taxable year, and the denominator is the total sales of the taxpayer everywhere during the taxable year.

Section 25135 provides rules for determining the portion of sales included in the numerator of the California sales factor. Section 25135(a)(2) provides that sales are attributed to California if the property is shipped from California and either (A) the sales are made to the United States government or (B) the taxpayer is not taxable in the state of the purchaser.

Section 25122 provides rules for determining whether a taxpayer is taxable in the state of the purchaser for purposes of allocation and apportionment:

> For purposes of allocation and apportionment of income under this act, a taxpayer is taxable in another state if (a) in that state it is subject 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, or (b) that state has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the state does or does not.

Regulation Section 25122(c) provides that when applying Section 25122(b), the determination of whether a taxpayer is taxable in a foreign jurisdiction shall be made by determining whether the taxpayer's activity in the foreign jurisdiction would be sufficient to give the state jurisdiction to impose a net income tax, by reason of such business activity, under the Constitution and statutes of the United States:

> When a State has jurisdiction to Subject a Taxpayer to a Net Income Tax. The second test, that of Section 25122(b), applies if the taxpayer's business

> activity is sufficient to give the state jurisdiction to impose a net income tax by reason of such business activity under the Constitution and statutes of the United States. Jurisdiction to tax is not present where the state is prohibited from imposing the tax by reason of the provisions of Public Law 86-272, 15 U.S.C.A. ss 381-385. In the case of any "state" as defined in Section 25120(f), other than a state of the United States or political subdivision of such state, the determination of whether such "state" has jurisdiction to subject the taxpayer to a net income tax shall be made as though the jurisdictional standards applicable to a state of the United States applied in that " state." If jurisdiction is otherwise present, such "state" is not considered as without jurisdiction by reason of the provisions of a treaty between that state and the United States."

Section 23151 requires that every corporation doing business within the limits of this state and not expressly exempted from taxation by the provisions of the Constitution of this state shall annually pay to the state, for the privilege of exercising its franchise within this state, a tax according to or measured by its net income.

"Doing business" is defined under Section 23101(a) as "actively engaging in any transaction for the purpose of financial or pecuniary gain or profit." In addition, for taxable years beginning on or after January 1, 2011, a corporation is doing business in California if any of the conditions under Section 23101(b) are met.[4]

Pursuant to Section 23101(b)(2), for taxable years beginning on or after January 1, 2011, a corporation is "doing business" in California if its sales exceed the lesser of five hundred thousand dollars ($500,000) or 25 percent of the taxpayer's total sales.[5] In determining California sales, Section 23101(b)(2) requires that the sales be assigned in accordance with Sections 25135 and 25136(b). Just as an entity would be taxable in California for years beginning on or after January 1, 2011 by virtue of having sales of over $500,000 in this state, ********** is considered to be taxable in foreign jurisdictions under Section 25122 where ********'* sales exceed $500,000 as a result of ********* satisfying one of the conditions under Section 23101(b)(2). By having more than $500,000 in sales in a foreign jurisdiction, ******** meets the jurisdictional standard applicable to a state of the United States applied in that foreign jurisdiction.

Furthermore, because *********'* sales are in a foreign jurisdiction, i.e., not in interstate commerce, P.L. 86-272 would not protect ********** from being taxable in a foreign jurisdiction. (*Appeal of Dresser Industries, Inc.*, Cal. St. Bd. of Equal. (June 28, 1982)

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[4] It is important to note that a taxpayer may still be "doing business" in California under Section 23101(a) even if none of the conditions of Section 23101(b) are met.

[5] This ruling does not address whether a corporation is taxable in California prior to January 1, 2011 if one of the conditions under Section 23101(b) were met; it addresses only facts and statutory law applicable for the 2011 taxable year and forward. This ruling does not address the taxable or taxability standards under Regulation Section 25122 prior to January 1, 2011.

("*Dresser I*"); *Appeal of Dresser Industries, Inc.*, Cal. St. Bd. of Equal. (Oct. 26, 1983)("*Dresser II*").)

Accordingly, for taxable years beginning on or after January 1, 2011, when **********'* sales exceed $500,000 in a foreign jurisdiction, ********** is taxable, as defined under section 25122, in that foreign jurisdiction. ********** is not required to throw back those sales to California under Section 25135(a)(2).

2) ********** is not required to throw back domestic TPP sales to California when ******** is taxable in a state under Section 25122.

Section 25135(b) provides that for taxable years beginning on or after January 1, 2011, all sales of a combined group are included in the sales factor numerator if any member of the group is taxable in California. Likewise, sales of TPP that are shipped from California to another state are excluded from the California sales factor numerator if any member of the group is taxable in the state to which the goods are shipped.

Therefore, if any member of the ********* combined reporting group is taxable, within the meaning of Section 25122, in a state where ******* ships TPP, ******** is not required to throw those sales back to California for the purpose of calculating its California sales factor.

Pursuant to Sections 23101 and 25122, for taxable years beginning on or after January 1, 2011, ******** is considered taxable in a state when its sales assignable to that state exceed $500,000. As determined in Ruling #1, for years beginning on or after January 1, 2011, a taxpayer is taxable in California, and hence would also be taxable in another jurisdiction, when its activities in that jurisdiction exceed any of the conditions in Section 23101(b).

In determining the $500,000 sales threshold for purposes of Section 23101(b), Section 23101(b)(2) specifies that for sales of other–than–TPP, the assignment rules contained in Section 25136(b) shall be used. Section 25136(b) provides rules used to assign sales of other–than–TPP. Here, the taxpayer represents that using the rules contained in Section 25136(b) and Regulation 25136-2, its sales of other–than–TPP are properly assigned to states other than California, based on its own analysis of its books and records. Assuming this is true, ******* is considered taxable for purposes of Section 25122 in those states where it has greater than $500,000 in sales.

Because ****** is taxable in the other states and its activities are not protected under P.L. 86-272[6], and because ******* and ********* are members of the same combined reporting group, pursuant to Section 25135(b)(2), ********* is not required to throw back interstate sales to its California sales factor numerator.

Please be advised that the tax consequences expressed in this Chief Counsel Ruling are applicable only to the named taxpayers and are based upon and limited to the facts you

[6] P.L. 86-272 does not apply to sales of other than TPP. See 15 U.S.C. 381(a)(1).

have submitted. In the event of a change in relevant legislation or judicial or administrative case law, a change in federal interpretation of federal law in cases where our opinion is based upon such an interpretation, or a change in the material facts or circumstances relating to your request upon which this opinion is based, this opinion may no longer be applicable. It is your responsibility to be aware of these changes, should they occur.

This letter is a legal ruling by the Franchise Tax Board's Chief Counsel within the meaning of paragraph (1) of subdivision (a) of section 21012 of the Revenue and Taxation Code. Please attach a copy of this letter and your request to the appropriate return(s) (if any) when filed or in response to any notices or inquiries which might be issued.

Very truly yours,

Ted Tourian
Tax Counsel