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12.23.2020

Chief Counsel Ruling 2020 - 01

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 *** ***** *

RE: Chief Counsel Ruling Request for ***** and *****

Dear *** *****,

This letter is in response to your Chief Counsel Ruling ("CCR") request dated ***** **, *****. In the request, you ask for the Franchise Tax Board's ("FTB") guidance as to the assignment of sales of tangible personal property for California franchise and income tax purposes.

FACTS

***** ("*****"), headquartered in ***** , is in the business of wholesaling and distributing tangible personal property (interchangeable with "products") throughout the nation from various distribution centers in several states. ***** or its wholly-owned affiliates operate the distribution centers. For example, one such affiliate is ***** ("*****"), which operates from distribution centers in ***** , ***** , and ***** . ***** and its affiliates (collectively, the "*****") file a combined report in California pursuant to Revenue and Taxation Code section 25105, subdivision (a).

In the effort to expand its distribution activities in ***** and other states, the ***** ***** intends to implement a new distribution model under which a consolidation warehouse¹ will be built in ***** . At this consolidation warehouse, ***** will receive and process products for resale to customers in Arizona, California, Colorado, Kansas, Montana, Nebraska, Nevada, New Mexico, Oklahoma, Texas, and Wyoming, among

¹ For purposes of this CCR, the term "consolidation warehouse" includes what is defined as a "redistribution center," at which full truck loads or less than full truck loads (but still large, bulk orders) of products purchased from suppliers are delivered. The products are then sold (or redistributed) in smaller quantities to customers. However, rather than transporting those smaller quantity products in less-than truck loads to customers (which means a higher cost of the products), those smaller quantities are consolidated with other smaller quantities, resulting in full or near-full truck loads being delivered to operating divisions.

others. In more detail, ***** will purchase quantities of products from suppliers, to be delivered at the consolidation warehouse, based on Economic Order Quantity, a tool that determines the volume and frequency of orders required to satisfy a given level of demand while minimizing cost per order, without having purchase orders from its customers.

The new distribution model will impact the way ***** has previously done business with its suppliers. For example, one of the suppliers from which ***** purchases products is ***** and its affiliates (collectively, the "*****"). Under the new model, the ***** will transport via common carrier its products to ***** consolidation warehouse in *****. Upon shipment, title and risk of loss will pass from the ***** to *****.

***** will sell a portion of the products from its consolidation warehouse in ***** to ***** in California. Title of the products will transfer to ***** either upon receipt at ***** locations in California when transported by ***** own trucks (f.o.b. destination), or at ***** consolidation warehouse in Texas when shipped by a common carrier (f.o.b. shipping). ***** will subsequently resell those products from its California facilities to unaffiliated wholesalers, United States military accounts, retailers in California, or to unaffiliated wholesalers and retailers outside of California.

ISSUE

For taxable years beginning on January 1, 2020, and onward, whether receipts generated from sales of tangible personal property by ***** in ***** to its affiliate, ***** in California, both of which are members of the same combined reporting group, are includable in the ***** apportionable income and apportionment factor during the year of sale between such entities.

HOLDING

For taxable years beginning on January 1, 2020, and onward, receipts generated from sales of tangible personal property by ***** in ***** to its affiliate, ***** in California, both of which are members of the same combined reporting group, are not taken into account in the ***** apportionable income and apportionment factor during the year of sale between such members pursuant to California Code of Regulations, title 18, section 25106.5-1.

DISCUSSION

Corporations doing business in California are subject to a corporation franchise or income tax based on net income.² Income is apportioned using a single sales factor formula.³ The sales factor is a fraction, the numerator of which is the total sales in California during the

² Revenue and Taxation Code section 23151.

³ Revenue and Taxation Code section 25128.7.

taxable year, and the denominator of which is the total sales everywhere during the taxable year.⁴

Income from intercompany transactions, generally defined as transactions between corporations that are members of the same combined reporting group immediately after such transactions, is deferred for tax purposes.⁵ Additionally, sales attributable to intercompany items are not included in the property-transferring member's sales factor either in the year of the transaction or in the year(s) in which such intercompany items are taken into account.⁶ And, the property-receiving member will recognize gross receipts in the year in which the property is sold outside of the combined reporting group for sales factor purposes.⁷

As applied to the facts, the sales between ***** and ***** ***** constitute intercompany transactions because both entities are members of the same combined reporting group after the sales transactions. Therefore, receipts arising from these intercompany transactions are excluded from the ***** ***** total current apportionable income and from the sales factor during the year of transaction between ***** and ***** *****. Moreover, these sales are not recognized for combined reporting purposes until the products are sold to a party outside of the ***** ***** *****.

CONCLUSION

Receipts generated from sales of tangible personal property from ***** to its affiliate, ***** ***** in California, which are members of the same combined reporting group, constitute intercompany sales, and are excluded from both the ***** ***** ***** current apportionable income and sales factor during the year of transaction between ***** and ***** *****.

Please be advised that the tax consequences expressed in this CCR are applicable only to the named taxpayers and are based upon and limited to the facts you 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 FTB'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

⁴ Revenue and Taxation Code section 25134.

⁵ California Code of Regulations, title 18, section 25106.5-1(a) and (b)(1)(A).

⁶ California Code of Regulations, title 18, section 25106.5-1(a)(5)(A)1.

⁷ California Code of Regulations, title 18, section 25106.5-1(a)(5)(A)2.

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,

Laura Taing
Tax Counsel