

Legal Division Guidance 2012-03-02

(Large Corporate Understatement Penalty – Single Sales Factor Elections)

Q: Can a taxpayer make a valid single sales factor (SSF) election and also report tax computed without the election in order to avoid the large corporate understatement penalty (LCUP) in the event the taxpayer is later determined to be ineligible to use the SSF formula?

A: No. Both the SSF election and the tax for measuring the LCUP understatement are reported on the last return filed on or before the extended due date of the return. Therefore, a taxpayer cannot, for the same taxable year, make the SSF election and report tax based on income apportioned using the three-factor formula.

Revenue and Taxation Code (RTC) section 25128.5, which allows certain taxpayers to make a single sales factor election, requires that the election be made "on a timely filed, original return." The applicable regulation defines the term "original return" as "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." (Emphasis added.) (Cal. Code Regs., tit. 18, § 25128.5, sub. (a)(20).) Thus, the election can only be made on the last return filed on or before the extended due date, even if made on an amended return form.

RTC section 19138(b) provides that the large corporate understatement penalty is an amount equal to 20 percent of any understatement of tax. The term "understatement of tax" is defined as the amount of tax imposed under the Corporation Tax Law (Part 11 of the RTC) that is in excess of the "tax shown on an original return or shown on an amended return filed on or before the original or extended due date of the return." (Emphasis added.) In other words, the penalty base is normally the tax reported on an original return. If a second original return or an amended return is filed before the extended due date, the penalty base is instead the amount shown on that superseding return. Thus, the base for measuring any future understatement of tax is the tax shown on the last return filed on or before the extended due date, even if made on an amended return form.

A taxpayer cannot, therefore, determine its apportioned income for the same taxable year under both the SSF formula election and the three-factor formula in order to avoid the LCUP in the event the taxpayer is later determined to be ineligible to use the SSF formula.

Furthermore, in the context of the cure provision relating to the 2003 – 2007 taxable years, [FTB Notice 2009-03](#) stated "...to be valid and effective to increase the penalty base as provided under section 19138, subdivision (b), an amended return must represent an honest and reasonable attempt to satisfy the requirements of the tax law..." with sufficient detail to identify the items on the return. In addition, [LCUP FAQ 23](#) provided that the amended return must be based on the best information available at the time the return is filed and that "tax deposits" without a complete amended return would not increase the base amount against which future understatements of tax are measured under RTC section 19138. These criteria are equally applicable to original returns in order to avoid the LCUP.

Finally, RTC section 19138(g) provides that the LCUP will not be imposed to the extent that the understatement of tax is attributable to the taxpayer's reasonable reliance on a legal

ruling by the Chief Counsel of the Franchise Tax Board, for example, on the characterization of gross business receipts for computing the percentages of activities conducted. See [FTB Notice 2009-08](#), Franchise Tax Board Ruling Guidelines.