

NOTE: This handout is intended only for purposes of facilitating discussion at the interested parties meeting on January 11, 2016.

18 CCR 23038(b)-2 – Amendments – dft3
(15 Dec 15)

§ 23038(b)-2. Business Entities; Definitions

(a) Business entities. For purposes of this regulation and Reg. §23038(b)-3, a business entity is any entity recognized for California income and franchise tax purposes (including an entity with a single owner that may be disregarded as an entity separate from its owner under Reg. §23038(b)-3) that is not properly classified as a trust under Reg. §23038(a)(3) or otherwise subject to special treatment under the Revenue and Taxation Code. A business entity with two or more members is classified for California income and franchise tax purposes as either a corporation or a partnership. A business entity with only one owner is classified as an association taxable as a corporation or is disregarded; if the entity is disregarded, its activities are treated in the same manner as a sole proprietorship, branch, or division of the owner.

(b) Corporations. For purposes of the tax imposed under [\[Chapter 2 and\]](#)¹ Chapter 3 of the Revenue and Taxation Code (commencing with Revenue and Taxation Code section 23501), the term corporation includes--

(1) A business, ~~[delete comma]~~ entity organized under a federal or state statute, or under a statute of a federally recognized Indian tribe, if the statute describes or refers to the entity as incorporated or as a corporation, body corporate, or body politic;

(2) An association (as determined under Reg. §23038(b)-3);

(3) A business entity organized under a state statute, if the statute describes or refers to the entity as a joint-stock company or joint-stock association;

(4) ~~[reserved]~~ [\[An insurance company\]](#)²;

(5) [reserved];

(6) [reserved];

(7) A business entity that is taxable as a corporation under a provision of the Revenue and Taxation Code other than subdivision (b) of Section 23038; and

(8) Certain foreign entities--(A) In general. Except as provided in subsections (b)(8)(B) and (d) of this regulation, the following business entities formed in the following jurisdictions:

- American Samoa, Corporation
- Argentina, Sociedad Anonima
- Australia, Public Limited Company
- Austria, Aktiengesellschaft

¹ Need further discussion.

² Need further discussion.

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Barbados, Limited Company
Belgium, Societe Anonyme
Belize, Public Limited Company
Bolivia, Sociedad Anonima
Brazil, Sociedade Anonima
[Bulgaria, Aktsionerno Druzhestvo](#)

Canada, Corporation and Company
Chile, Sociedad Anonima
People's Republic of China, Gufen Youxian Gongsi
Republic of China (Taiwan), Ku-fen Yu-hsien Kung-szu
Columbia, Sociedad Anonima
Costa Rica, Sociedad Anonima
Cyprus, Public Limited Company
Czech Republic, Akciova Spolecnost

Denmark, Aktieselskab
Ecuador, Sociedad Anonima or Compania Anonima
Egypt, Sharikat Al-Mossahamah
El Salvador, Sociedad Anonima
[Estonia, Aktsiaselts](#)
[European Economic Area/European Union, Societas Europaea](#)

Finland, [Julkinen](#) Osakeyhtio/[Publikt](#) Aktiebolag
France, Societe Anonyme

Germany, Aktiengesellschaft
Greece, Anonymos Etaireia
Guam, Corporation
Guatemala, Sociedad Anonima
Guyana, Public Limited Company

Honduras, Sociedad Anonima
Hong Kong, Public Limited Company
Hungary, Reszvenytarsasag

Iceland, Hlutafelag
India, Public Limited Company
Indonesia, Perseroan Terbuka
Ireland, Public Limited Company
Israel, Public Limited Company
Italy, Societa per Azioni

Jamaica, Public Limited Company
Japan, Kabushiki Kaisha

Kazakstan, Ashyk Aktsionerlik Kogham
Republic of Korea, Chusik Hoesa

[Latvia, Akciju Sabiedriba](#)
Liberia, Corporation

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Liechtenstein, Aktiengesellschaft

Lithuania, Akcine Bendroves

Luxembourg, Societe Anonyme

Malaysia, Berhad

Malta, ~~Partnership Anonyme~~ Public Limited Company

Mexico, Sociedad Anonima

Morocco, Societe Anonyme

Netherlands, Naamloze Vennootschap

New Zealand, Limited Company

Nicaragua, Compania Anonima

Nigeria, Public Limited Company

Northern Mariana Islands, Corporation

Norway, Allment Aksjeselskap

Pakistan, Public Limited Company

Panama, Sociedad Anonima

Paraguay, Sociedad Anonima

Peru, Sociedad Anonima

Philippines, Stock Corporation

Poland, Spolka Akcyjna

Portugal, Sociedade Anonima

Puerto Rico, Corporation

Romania, Societe pe Actiuni

Russia, Otkrytoye Aktsionerney Obshchestvo

Saudi Arabia, Sharikat Al-Mossahamah

Singapore, Public Limited Company

Slovak Republic, Akciova Spolocnost

Slovenia, Delniska Druzba.

South Africa, Public Limited Company

Spain, Sociedad Anonima

Surinam, Naamloze Vennootschap

Sweden, Publika Aktiebolag

Switzerland, Aktiengesellschaft

Thailand, Borisat Chamkad (Mahachon)

Trinidad and Tobago, ~~Public~~ Limited Company

Tunisia, Societe Anonyme

Turkey, Anonim Sirket

Ukraine, Aktsionerne Tovaristvo Vidkritogo Tipu

United Kingdom, Public Limited Company

United States Virgin Islands, Corporation

Uruguay, Sociedad Anonima

Venezuela, Sociedad Anonima or Compania Anonima

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(B) Clarification of list of corporations in paragraph subsection (b)(8)(i)(A) of this section regulation – 1. Exceptions in certain cases. The following entities will not be treated as corporations under subsection (b)(8)(A) of this regulation:

(i) With regard to Canada, any corporation or company formed under any federal or provincial law which provides that the liability of all of the members of such corporation or company will be unlimited; and a Nova Scotia Unlimited Liability Company (or any other company or corporation all of whose owners have unlimited liability pursuant to federal or provincial law).

(ii) With regard to India, a company deemed to be a public limited company solely by operation of Section 43A(1) of the Internal Revenue Code (relating to corporate ownership of the company), Section 43A(1A) of the Internal Revenue Code (relating to annual average turnover), or Section 43A(1B) of the Internal Revenue Code (relating to ownership interests in other companies) of the Companies Act, 1956 (or any combination of these), provided that the organizational documents of such deemed public limited company continue to meet the requirements of Section 3(1)(iii) of the Companies Act, 1956.

(iii) With regard to Malaysia, a Sendirian Berhad.

2. Inclusions in certain cases. With regard to Mexico, the term Sociedad Anonima includes a Sociedad Anonima that chooses to apply the variable capital provision of Mexican corporate law (Sociedad Anonima de Capital Variable).

(C) Public companies. For purposes of paragraph subsection (b)(8)(i)(A) of this section regulation, ~~With~~ with regard to Cyprus, Hong Kong, and Jamaica, ~~and~~ Trinidad and Tobago, the term ~~Public Limited Company~~ Public Limited Company includes any ~~limited company~~ limited company which ~~that~~ is not defined as a private ~~limited company~~ under the corporate laws of those jurisdictions.

In all other cases, where the term Public Limited Company is not defined, that term shall include any Limited Company defined as a public company under the corporate laws of the relevant jurisdiction.

(D) Limited companies. ~~Any reference to a limited company (whether public or private) in subsection (b)(8)(A) of this regulation~~ For purposes of this paragraph subsection (b)(8), any reference to a Limited Company includes, as the case may be, companies limited by shares and companies limited by guarantee.

(E) Multilingual countries. Different linguistic renderings of the name of an entity listed in subsection (b)(8)(A) of this regulation shall be disregarded. For example, an entity formed under the laws of Switzerland as a Societe Anonyme will be a corporation and treated in the same manner as an Aktiengesellschaft.

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(b)(9) Business entities with multiple charters. (i) (A) An entity created or organized under the laws of more than one jurisdiction if the rules of this section regulation would treat it as a corporation with reference to any one of the jurisdictions in which it is created or organized. Such an entity may elect its classification under Treas. Reg. § 301.7701-3, subject to the limitations of those provisions, only if it is created or organized in each jurisdiction in a manner that meets the definition of an eligible entity in § 301.7701-3(a) Reg. § 23038(b)-3(a). The determination of a business entity's corporate or non-corporate classification is made independently from the determination of whether the entity is domestic or foreign. See § 301.7701-5 Reg. § 23038(b)-4 for the rules that determine whether a business entity is domestic or foreign.

(ii) (B) Examples. The following examples illustrate the rule of this paragraph subsection (b)(9):

Example 1. (i) Facts. X is an entity with a single owner organized under the laws of Country A as an entity that is listed in paragraph subsection (b)(8)(i)(A) of this section regulation. Under the rules of this section regulation, such an entity is a corporation for Federal California income and franchise tax purposes and under § 301.7701-3(a) Reg. § 23038(b)-3(a) is unable to elect its classification. Several years after its formation, X files a certificate of domestication in State B as a limited liability company (LLC). Under the laws of State B, X is considered to be created or organized in State B as an LLC upon the filing of the certificate of domestication and is therefore subject to the laws of State B. Under the rules of this section regulation and § 301.7701-3 Reg. § 23038(b)-3, an LLC with a single owner organized only in State B is disregarded as an entity separate from its owner for Federal California income and franchise tax purposes (absent an election to be treated as an association). Neither Country A nor State B law requires X to terminate its charter in Country A as a result of the domestication, and in fact X does not terminate its Country A charter. Consequently, X is now organized in more than one jurisdiction.

(ii) Result. X remains organized under the laws of Country A as an entity that is listed in paragraph subsection (b)(8)(i)(A) of this section regulation, and as such, it is an entity that is treated as a corporation under the rules of this section regulation. Therefore, X is a corporation for Federal California income and franchise tax purposes because the rules of this section regulation would treat X as a corporation with reference to one of the jurisdictions in which it is created or organized. Because X is organized in Country A in a manner that does not meet the definition of an eligible entity in § 301.7701-3(a) Reg. § 23038(b)-3(a), it is unable to elect its classification.

Example 2. (i) Facts. Y is an entity that is incorporated under the laws of State A and has two shareholders. Under the rules of this section regulation, an entity incorporated under the laws of State A is a corporation for Federal California income and franchise tax purposes and under § 301.7701-3(a) Reg. § 23038(b)-3(a) is unable to elect its classification. Several years after its formation, Y files a certificate of continuance in Country B as an unlimited company. Under the laws of Country B, upon filing a certificate of continuance, Y is treated as organized in Country B. Under the rules of this section regulation and § 301.7701-3 Reg. § 23038(b)-3, an unlimited company organized only in Country B that has more than one owner is treated as a partnership for Federal California income and franchise tax purposes (absent an election to be treated as an association). Neither State A nor Country B law requires Y to terminate its charter in State A as a result of the continuance, and in fact Y does not terminate its State A charter. Consequently, Y is now organized in more than one jurisdiction.

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(ii) Result. Y remains organized in State A as a corporation, an entity that is treated as a corporation under the rules of this section regulation. Therefore, Y is a corporation for Federal California income and franchise tax purposes because the rules of this section regulation would treat Y as a corporation with reference to one of the jurisdictions in which it is created or organized. Because Y is organized in State A in a manner that does not meet the definition of an eligible entity in ~~§ 301.7701-3(a)~~ Reg. § 23038(b)-3(a), it is unable to elect its classification.

Example 3. (i) Facts. Z is an entity that has more than one owner and that is recognized under the laws of Country A as an unlimited company organized in Country A. Z is organized in Country A in a manner that meets the definition of an eligible entity in ~~§ 301.7701-3(a)~~ Reg. § 23038(b)-3(a). Under the rules of this section regulation and ~~§ 301.7701-3~~ Reg. § 23038(b)-3, an unlimited company organized only in Country A with more than one owner is treated as a partnership for Federal California income and franchise tax purposes (absent an election to be treated as an association). At the time Z was formed, it was also organized as a private limited company under the laws of Country B. Z is organized in Country B in a manner that meets the definition of an eligible entity in ~~§ 301.7701-3(a)~~ Reg. § 23038(b)-3(a). Under the rules of this section regulation and ~~§ 301.7701-3~~ Reg. § 23038(b)-3, a private limited company organized only in Country B is treated as a corporation for Federal California income and franchise tax purposes (absent an election to be treated as a partnership). Thus, Z is organized in more than one jurisdiction. Z has not made any entity classification elections under ~~§ 301.7701-3~~ Reg. § 23038(b)-3.

(ii) Result. Z is organized in Country B as a private limited company, an entity that is treated (absent an election to the contrary) as a corporation under the rules of this section regulation. However, because Z is organized in each jurisdiction in a manner that meets the definition of an eligible entity in ~~§ 301.7701-3(a)~~ Reg. § 23038(b)-3(a), it may elect its classification under ~~§ 301.7701-3~~ Reg. § 23038(b)-3, subject to the limitations of those provisions.

Example 4. (i) Facts. P is an entity with more than one owner organized in Country A as a general partnership. Under the rules of this section regulation and ~~§ 301.7701-3~~ Reg. § 23038(b)-3, an eligible entity with more than one owner in Country A is treated as a partnership for Federal California income and franchise tax purposes (absent an election to be treated as an association). P files a certificate of continuance in Country B as an unlimited company. Under the rules of this section regulation and ~~§ 301.7701-3~~ Reg. § 23038(b)-3, an unlimited company in Country B with more than one owner is treated as a partnership for Federal California income and franchise tax purposes (absent an election to be treated as an association). P is not required under either the laws of Country A or Country B to terminate the general partnership in Country A, and in fact P does not terminate its Country A partnership. P is now organized in more than one jurisdiction. P has not made any entity classification elections under ~~§ 301.7701-3~~ Reg. § 23038(b)-3.

(ii) Result. P's organization in both Country A and Country B would result in P being classified as a partnership. Therefore, since the rules of this section regulation would not treat P as a corporation with reference to any jurisdiction in which it is created or organized, it is not a corporation for Federal California income and franchise tax purposes.

(c) Other business entities. (1) For California income and franchise tax purposes, the term partnership means a business entity that is not a corporation under subsection (b) of this regulation and that has at least two members.

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(2) Wholly owned entities -- (A) In general. Except as otherwise provided in this paragraph (c), Aa business entity that has a single owner and is not a corporation under subsection (b) of this regulation is disregarded as an entity separate from its owner for purposes of Part 10 (Personal Income Tax Law commencing with Revenue and Taxation Code section 17001), Part 10.2 (Administration of Franchise and Income Tax Law commencing with Revenue and Taxation Code section 18401), and Part 11 (Corporation Tax Law commencing with Revenue and Taxation Code section 23001), subject to certain statutory provisions which recognize the existence of otherwise disregarded entities for certain purposes including the tax and fee of a limited liability company under Revenue and Taxation Code sections 17941 and 17942, the return filing requirements of a limited liability company under Revenue and Taxation Code section 18633.5, and the credit limitations of a disregarded entity under Revenue and Taxation Code sections 17039 and 23036.

(B) Special rule for certain business entities. If the single owner of a business entity is a bank (as defined in Revenue and Taxation Code section 23039), then the special rules applicable to banks will continue to apply to the single owner as if the wholly owned entity were a separate entity. For this purpose, the special rules applicable to banks under the Internal Revenue Code do not include the rules under sections 864(c)- and 882(c)- and 884 of the Internal Revenue Code.

(iii) (C) Tax liabilities of certain disregarded entities -- (A) (i) In general. An entity that is disregarded as separate from its owner for any purpose under this section regulation is treated as an entity separate from its owner for purposes of--

(1) Federal California income and franchise tax liabilities of the entity with respect to any taxable period for which the entity was not disregarded;

(2) Federal California income and franchise tax liabilities of any other entity for which the entity is liable; and

(3) Refunds or credits of Federal California income and franchise tax.

(B) (ii) Examples. The following examples illustrate the application of paragraph subsection (c)(2)(iii)(A)(C)(i) of this section regulation:

Example 1.

In 2006, X, a domestic corporation that reports its taxes on a calendar year basis, merges into Z, a domestic LLC wholly owned by Y that is disregarded as an entity separate from Y, in a state law merger. X was not a member of a consolidated group at any time during its taxable year ending in December 2005. Under the applicable state law, Z is the successor to X and is liable for all of X's debts. In 2009, the Internal Revenue Service (IRS) seeks to extend the period of limitations on assessment for X's 2005 taxable year. Because Z is the successor to X and is liable for X's 2005 taxes that remain unpaid, Z is the proper party to sign the consent to extend the period of limitations.

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Example 2.

The facts are the same as in Example 1, except that in 2007, the IRS determines that X miscalculated and underreported its income tax liability for 2005. Because Z is the successor to X and is liable for X's 2005 taxes that remain unpaid, the deficiency may be assessed against Z and, in the event that Z fails to pay the liability after notice and demand, a general tax lien will arise against all of Z's property and rights to property.

(d) Special rule for certain foreign business entities--(1) In general. Except as provided in subsection (d)(3) of this regulation, a foreign business entity described in subsection (b)(8)(A) of this regulation will not be treated as a corporation under subsection (b)(8)(A) of this regulation if-

(A) The entity was in existence on May 8, 1996;

(B) The entity's classification was relevant (as defined in Reg. §23038(b)-3(d)) on May 8, 1996;

(C) No person (including the entity) for whom the entity's classification was relevant on May 8, 1996, treats the entity as a corporation for purposes of filing such person's California income tax returns, information returns, and withholding documents for the taxable year including May 8, 1996;

(D) Any change in the entity's claimed classification within the sixty months prior to May 8, 1996, occurred solely as a result of a change in the organizational documents of the entity, and the entity and all members of the entity recognized the California income tax consequences of any change in the entity's classification within the sixty months prior to May 8, 1996;

(E) A reasonable basis (within the meaning of Section 6662 of the Internal Revenue Code) existed on May 8, 1996, for treating the entity as other than a corporation; and

(F) Neither the entity nor any member was notified in writing on or before May 8, 1996, that the classification of the entity was under examination (in which case the entity's classification will be determined in the examination).

(2) Binding contract rule. If a foreign business entity described in subsection (b)(8)(A) of this regulation is formed after May 8, 1996, pursuant to a written binding contract (including an accepted bid to develop a project) in effect on May 8, 1996, and at all times thereafter, in which the parties agreed to engage (directly or indirectly) in an active and substantial business operation in the jurisdiction in which the entity is formed, subsection (d)(1) of this regulation will be applied to that entity by substituting the date of the entity's formation for May 8, 1996.

(3) Termination of grandfather status--(A) In general. An entity that is not treated as a corporation under subsection (b)(8)(A) of this regulation by reason of subsection (d)(1) or (d)(2) of this regulation will be treated permanently as a corporation under subsection (b)(8)(A) of this regulation from the earliest of:

1. The effective date of an election to be treated as an association under Reg. §23038(b)-3;

2. A termination of the partnership under Section 708(b)(1)(B) of the Internal Revenue Code (regarding sale or exchange of 50 percent or more of the total interest in an entity's capital or profits within a twelve month period); or

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3. A division of the partnership under Section 708(b)(2)(B) of the Internal Revenue Code.

~~(D) 4. The date any person or persons, who were not owners of the entity as of November 29, 1999, own in the aggregate a 50 percent or greater interest in the entity.~~

(B) Special rule for certain entities. For purposes of subsection (d)(2) of this regulation, subsection (d)(3)(A)2. of this regulation shall not apply if the sale or exchange of interest in the entity is to a related person (within the meaning of Sections 267(b) and 707(b) of the Internal Revenue Code) and occurs no later than twelve months after the date of the formation of the entity.

~~(e) Effective/applicability date. The rules of this regulation are effective for taxable or income years commencing on or after January 1, 1997. (1) Except as otherwise provided in this paragraph subsection (e), the rules of this section regulation apply as of January 1, 1997, except that paragraph subsection (b)(6) of this section regulation applies on or after January 14, 2002, to a business entity wholly owned by a foreign government regardless of any prior entity classification, and paragraph subsection (c)(2)(B) of this section regulation applies to taxable years beginning after January 12, 2001.~~

~~The reference to the Finnish, Maltese, and Norwegian entities in paragraph subsection (b)(8)(i)(A) of this section regulation is applicable on November 29, 1999.~~

~~The reference to the Trinidadian entity in paragraph subsection (b)(8)(i)(A) of this section regulation applies to entities formed on or after November 29, 1999.~~

~~Any Maltese or Norwegian entity that becomes an eligible entity as a result of paragraph subsection (b)(8)(i)(A) of this section regulation in effect on November 29, 1999, may elect by February 14, 2000, to be classified for Federal tax purposes as an entity other than a corporation retroactive to any period from and including January 1, 1997.~~

~~Any Finnish entity that becomes an eligible entity as a result of paragraph subsection (b)(8)(i)(A) of this section regulation in effect on November 29, 1999, may elect by February 14, 2000, to be classified for Federal tax purposes as an entity other than a corporation retroactive to any period from and including September 1, 1997.~~

~~However, paragraph subsection (d)(3)(i)(D)(A)4. of this section regulation applies on or after October 22, 2003.~~

~~(2) Paragraph Subsection (c)(2)(iii)(C) of this section regulation applies on and after September 14, 2009. For rules that apply before September 14, 2009, see 26 CFR part 301, revised as of April 1, 2009.³~~

~~(3)(i)(A) General rule. Except as provided in paragraph subsection (e)(3)(i)(B) of this section regulation, the rules of paragraph subsection (b)(9) of this section regulation apply as of August 12, 2004, to all business entities existing on or after that date.~~

³ In the second sentence, do we leave the reference to the federal regulations or refer to a California equivalent? 26 CFR part 301 is entitled "Procedure And Administration." It includes, but is not limited to the check-the-box regulations (301.7701-1 to 301.7701-3). The California equivalent may be Subchapter 1 entitled "General Provisions And Definitions." However, the federal part appears to include many more sub-parts than the California Subchapter.

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~~(ii)(B)~~ Transition rule. For business entities created or organized under the laws of more than one jurisdiction as of August 12, 2004, the rules of ~~paragraph subsection (b)(9) of this section regulation~~ apply as of May 1, 2006. These entities, however, may rely on the rules of ~~paragraph subsection (b)(9) of this section regulation~~ as of August 12, 2004.

~~(4)~~ The reference to the Estonian, Latvian, Liechtenstein, Lithuanian, and Slovenian entities in ~~paragraph subsection (b)(8)(i)(A) of this section regulation~~ applies to such entities formed on or after October 7, 2004, and to any such entity formed before such date from the date any person or persons, who were not owners of the entity as of October 7, 2004, own in the aggregate a 50 percent or greater interest in the entity.

The reference to the European Economic Area/European Union entity in ~~paragraph subsection (b)(8)(i)(A) of this section regulation~~ applies to such entities formed on or after October 8, 2004.

~~(7)~~ (5) The reference to the Bulgarian entity in ~~paragraph subsection (b)(8)(i)(A) of this section regulation~~ applies to such entities formed on or after January 1, 2007, and to any such entity formed before such date from the date that, in the aggregate, a 50 percent or more interest in such entity is owned by any person or persons who were not owners of the entity as of January 1, 2007. For purposes of the preceding sentence, the term interest means--

~~(i)(A)~~ In the case of a partnership, a capital or profits interest; and

~~(ii)(B)~~ In the case of a corporation, an equity interest measured by vote or value.