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7000 APPORTIONMENT FORMULA

Apportionment is the process by which business income is divided between taxing jurisdictions. The apportionment formula calculates the percentage of the property, payroll and sales of the unitary business, which are attributable to California. The total business income of the unitary business is multiplied by this percentage to derive the amount of business income apportioned to this state.

For purposes of the apportionment formula, the property factor generally includes all real and tangible personal property owned or rented and used by the taxpayer during the taxable year, and the payroll factor includes all forms of compensation paid to employees. These factors are intended to reflect the capital investment and labor activities that generate income. The sales factor generally includes all gross receipts from the sale of tangible and intangible property, and is intended to recognize the contribution of the market state towards the production of income.

Taxable Years Prior to January 1, 1993

Prior to 1993, California followed the model UDITPA formula (see MATM 0500). This was a three-factor formula that gave equal weight to the property, payroll and sales of the business. This formula operated as follows:

$$\frac{\boxed{\begin{array}{c}\textbf{Property Factor}\\ \frac{\text{Average California Property}}{\text{Average Total Property}}\end{array}} + \boxed{\begin{array}{c}\textbf{Payroll Factor}\\ \frac{\text{California Payroll}}{\text{Total Payroll}}\end{array}} + \boxed{\begin{array}{c}\textbf{Sales Factor}\\ \frac{\text{California Sales}}{\text{Total Sales}}\end{array}}}{3} = \boxed{\begin{array}{c}\textbf{California}\\ \textbf{Apportionment Factor}\end{array}}$$

Taxable Years Beginning on or after January 1, 1993 and before January 1, 2011

For taxable years beginning on or after January 1, 1993 and before January 1, 2011, the apportionment formula was modified to double-weight the sales factor. The apportionment formula is computed as follows:

$$\frac{\underset{\text{Property Factor}}{\frac{\text{Average California Property}}{\text{Average Total Property}}} + \underset{\text{Payroll Factor}}{\frac{\text{California Payroll}}{\text{Total Payroll}}} + \left(2 \text{ X } \underset{\text{Sales Factor}}{\frac{\text{California Sales}}{\text{Total Sales}}}\right)}{4} = \text{California Apportionment Factor}$$

There are certain classes of taxpayers, such as those in extractive, agricultural, savings and loan, and bank and financial industries, for whom the double-weighted sales factor does not apply. Those taxpayers will continue to use a three factor formula using single-weighted sales. For a discussion of these exceptions, see MATM 7005.

Taxable Years Beginning On or After January 1, 2011 and before January 1, 2013

For taxable years beginning on or after January 1, 2011, and before January 1, 2013, California allowed an apportioning trade or business to make an annual, irrevocable election to use a single-sales factor formula, to apportion business income to California. The election was required to be made on an original timely filed return and those making the election were required to use market assignment for sales factor purposes for receipts from sales of other than tangible personal property. See MATM 7005 to see taxpayers that were not allowed to make this election.

Taxable years beginning on or after January 1, 2013

For taxable years beginning on or after January 1, 2013, California requires an apportioning trade or business to use a single-sales factor formula to apportion business income to California. See MATM 7005 for exceptions. For sellers of other than tangible personal property, California requires the use of market assignment to assign receipts from sales of services, use of intangibles and rental, lease and licensing of real and tangible personal property, See FAQ regarding Single-Sales Factor and Assignment of Sales (Sales Factor).

The above formulas calculate the amount of business income of the unitary group that is apportioned to and taxed by California. The calculation of each taxpayer corporation's relative share of the California income is covered in MATM 7900 (Intrastate Apportionment).

For certain industries and types of transactions that do not lend themselves to apportionment under the standard rules, CCR section 25137 sets forth special apportionment formulas and procedures which then become standard apportionment for a taxpayer if they are found to apply. These special rules are discussed in MATM 7700 – MATM 7820 along with other procedures that have been developed for dealing with some of the more common apportionment problems.

In situations where application of the standard formula unfairly represents the extent of the taxpayer's California business activities, the taxpayer may request permission for, or FTB may require, use of another method for allocating and apportioning its income. Such other methods may include, but are not limited to, separate accounting, exclusion of one of the factors, or the inclusion of an additional factor. The authority for use of a special apportionment method is found in R&TC § 25137 and CCR § 25137. You should consult with your supervisor if you come across a case that may require alternative apportionment.

7005 EXCEPTIONS TO THE DOUBLE-WEIGHTED SALES FACTOR FORMULA

For taxable years beginning on or after January 1, 1993 and before January 1, 2011, R&TC § 25128 requires apportioning taxpayers to use the four-factor apportionment formula, which includes a double-weighted sales factor to apportion business income to California. However, if the taxpayer derives more than 50 percent of its gross business receipts from one or more “qualified business activities,” the applicable formula is a three-factor formula consisting of the sum of the property factor, the payroll factor, and the sales factor, divided by three.

For taxable years beginning on or after January 1, 2011 and before January 1, 2013, R&TC Section 25128.5 allows taxpayers to elect to use a single-sales factor formula to apportion business income to California instead of the four-factor formula with double-weighted sales. However, if the taxpayer derives more than 50 percent of its gross business receipts from one or more "qualified business activities", the taxpayer is not allowed to make this election. Those taxpayers continue to use the three-factor formula using single-weighted sales.

For taxable years beginning on or after January 1, 2013, R&TC Section 25128.7 requires taxpayers to use a single-sales factor formula to apportion business income to California. However, if the taxpayer derives more than 50 percent of its gross business receipts from one or more "qualified business activities", the taxpayer must use the three-factor formula using single-weighted sales.

The qualified business activities that give rise to subject to the special three-factor formula are “agricultural business activity”, “extractive business activity”, “savings and loan activity”, and “banking or financial business activity”. (R&TC § 25128(c).)

R&TC § 25128(d) defines each of the qualified business activities.

The "more than 50 percent" test for determining whether a taxpayer is subject to the three-factor formula applies to the combined gross business receipts of the unitary group and includes the aggregation of all types of qualified business activities. Once it is determined that a combined unitary group has more than 50 percent of its gross business receipts from one or more qualified business activities, the entire business income of the group must be apportioned using a single-weighted sales factor formula (R&TC § 25128(d)(8)). This distinction is important because even though individual members of the group may not be involved in qualified business activities, they will be subject to the single-weighted sales factor if the group as a whole meets the test.

See MATM 7500 "Definition of Sales" for more details on gross business receipts.

7006 ELECTION OF SINGLE-SALES FACTOR APPORTIONMENT OF BUSINESS INCOME

For taxable years beginning on or after January 1, 2011, California adopted an elective single-sales factor apportionment formula requiring market-assignment for those electing. Any apportioning trade or businesses other than those deriving more than 50 percent of their gross business receipts from conducting one or more a "qualified business activities" described in R&TC §25128(b) was allowed to make an irrevocable annual election on an original timely filed return, to use a single-sales factor formula (R&TC § 25128.5).

For businesses that elected to use a single-sales factor apportionment formula, all business income was apportioned to California by multiplying the business income by a single-sales factor instead of the four-factor formula based on property, payroll, and double weighted sales (R&TC § 25128.5(b)).

Businesses that derived more than 50 percent of their gross business receipts from agriculture, extractive business, savings and loans, or bank and financial activities were required to continue to use the three-factor apportionment formula (R&TC § 25128.5(a)). The exceptions to the general rule of double weighting the sales factor are covered in MATM 7005.

In determining whether the receipts from sales of services and intangibles were required to be included in a taxpayer's California sales factor numerator, taxpayers:

- Used market assignment if the taxpayer elected to use the single sales factor formula (R&TC § 25136(b)).
- Used an income producing activity/greater cost of performance method if the taxpayer did not elect to use the single-sales factor formula election (R&TC § 25136(a)).

Market Assignment and Income Producing Activity/Cost of Performance Assignment are explained in further detail under MATM 7500 Income from Intangibles.

For taxable year beginning on or after January 1, 2013, this election is no longer available.

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