

AMENDED IN SENATE FEBRUARY 23, 2011

SENATE BILL

No. 116

Introduced by Senator De León

**(Coauthors: Senators DeSaulnier, Hancock, Hernandez, Leno,
Lowenthal, Price, Steinberg, and Wolk)**

(Coauthors: Assembly Members Blumenfield and Hueso)

January 19, 2011

An act to amend Sections 23101, 25113, 25128, and 25136 of, to add Section 25128.7 to, and to repeal Section 25128.5 of, the Revenue and Taxation Code, relating to taxation, to take effect immediately, tax levy.

LEGISLATIVE COUNSEL'S DIGEST

SB 116, as amended, De León. Income taxes: single sales factor.

The Corporation Tax Law imposes taxes measured by income and, in the case of a business with income derived from or attributable to sources both within and without this state, apportions the business income between this state and other states and foreign countries in accordance with a specified 4-factor formula based on the property, payroll, and sales within and without this state, except that in the case of an apportioning trade or business that derives more than 50% of its gross business receipts from conducting one or more qualified business activities, as defined, business income is apportioned in accordance with a specified 3-factor formula. Existing law, for taxable years beginning on or after January 1, 2011, authorizes a taxpayer required to apportion its business income in accordance with the 4-factor formula to make an annual election to have that business income apportioned in accordance with a single sales factor formula.

This bill would eliminate the authorization for specified taxpayers to elect to have business income apportioned in accordance with a single

sales factor formula and instead require those taxpayers to apportion their business income in accordance with a single sales factor formula for taxable years beginning on or after January 1, 2011, and would make related changes.

This bill would constitute a change in state statute that would result in a taxpayer paying a higher tax within the meaning of Section 3 of Article XIII A of the California Constitution, and thus would require for passage the approval of $\frac{2}{3}$ of the membership of each house of the Legislature.

This bill would take effect immediately as a tax levy.

Vote: $\frac{2}{3}$. Appropriation: no. Fiscal committee: yes.

State-mandated local program: no.

The people of the State of California do enact as follows:

1 SECTION 1. Section 23101 of the Revenue and Taxation Code
2 is amended to read:

3 23101. (a) “Doing business” means actively engaging in any
4 transaction for the purpose of financial or pecuniary gain or profit.

5 (b) For taxable years beginning on or after January 1, 2011, a
6 taxpayer is doing business in this state for a taxable year if any of
7 the following conditions has been satisfied:

8 (1) The taxpayer is organized or commercially domiciled in this
9 state.

10 (2) Sales, as defined in subdivision ~~(e)~~ or (f) of Section 25120
11 as applicable for the taxable year, of the taxpayer in this state
12 exceed the lesser of five hundred thousand dollars (\$500,000) or
13 25 percent of the taxpayer’s total sales. For purposes of this
14 paragraph, sales of the taxpayer include sales by an agent or
15 independent contractor of the taxpayer. For purposes of this
16 paragraph, sales in this state shall be determined using the rules
17 for assigning sales under Section 25135 and ~~subdivision (b)~~ of
18 Section 25136 and the regulations thereunder, as modified by
19 regulations under Section 25137.

20 (3) The real property and tangible personal property of the
21 taxpayer in this state exceed the lesser of fifty thousand dollars
22 (\$50,000) or 25 percent of the taxpayer’s total real property and
23 tangible personal property. The value of real and tangible personal
24 property and the determination of whether property is in this state
25 shall be determined using the rules contained in Sections 25129

1 to 25131, inclusive, and the regulations thereunder, as modified
2 by regulation under Section 25137.

3 (4) The amount paid in this state by the taxpayer for
4 compensation, as defined in subdivision (c) of Section 25120,
5 exceeds the lesser of fifty thousand dollars (\$50,000) or 25 percent
6 of the total compensation paid by the taxpayer. Compensation in
7 this state shall be determined using the rules for assigning payroll
8 contained in Section 25133 and the regulations thereunder, as
9 modified by regulations under Section 25137.

10 (c) (1) The Franchise Tax Board shall annually revise the
11 amounts in paragraphs (2), (3), and (4) of subdivision (b) in
12 accordance with subdivision (h) of Section 17041.

13 (2) For purposes of the adjustment required by paragraph (1),
14 subdivision (h) of Section 17041 shall be applied by substituting
15 “2012” in lieu of “1988.”

16 (d) The sales, property, and payroll of the taxpayer include the
17 taxpayer’s pro rata or distributive share of pass-through entities.
18 For purposes of this subdivision, “pass-through entities” means a
19 partnership or an “S” corporation.

20 **SECTION 1.**

21 *SEC. 2.* Section 25113 of the Revenue and Taxation Code, as
22 added by Section 4 of Chapter 657 of the Statutes of 2003, is
23 amended to read:

24 25113. (a) Except as provided in subdivision (f), for taxable
25 years beginning on or after January 1, 2003, the election provided
26 for in Section 25110 shall be made on an original, timely filed
27 return for the year of the election. The election will be considered
28 valid if both of the following conditions are satisfied:

29 (1) The tax is computed in a manner consistent with a
30 water’s-edge election.

31 (2) A written notification of election is filed with the return on
32 a form prescribed by the Franchise Tax Board. Pursuant to
33 regulations promulgated under this section, the Franchise Tax
34 Board may accept the filing of other objective evidence that
35 supports the conclusion that a water’s-edge election was intended
36 in lieu of notification on the designated form.

37 (b) Except as otherwise provided, a water’s-edge election shall
38 be effective only if made by every member of the self-assessed
39 combined reporting group that is subject to taxation under this
40 part.

1 (1) An election made on a group return of a self-assessed
2 combined reporting group shall constitute an election by each
3 taxpayer member included in that group return, unless one of those
4 taxpayers files a separate return in which no election is made and
5 paragraph (2) does not apply.

6 (2) A taxpayer that fails to make an election on its own timely
7 filed original return shall be deemed to have elected if either of
8 the following applies:

9 (A) It has a parent corporation that is an electing taxpayer that
10 included the income and apportionment factors of the nonelecting
11 taxpayer in the self-assessed combined reporting group reflected
12 in the electing parent's timely filed original return, including a
13 group return.

14 (B) The income and apportionment factors of the nonelecting
15 taxpayer are reflected in the self-assessed combined reporting
16 group of a timely filed original return of an electing taxpayer, and
17 the notification of election filed by the electing taxpayer pursuant
18 to paragraph (2) of subdivision (a) is signed by an officer or other
19 authorized agent of either a parent corporation of the nonelecting
20 taxpayer or another corporation with authority to bind the
21 nonelecting taxpayer to an election.

22 (3) For purposes of this subdivision, a "parent corporation" of
23 the taxpayer is a corporation that owns or constructively owns
24 stock possessing more than 50 percent of the voting power of the
25 taxpayer as determined under subdivisions (e) and (f) of Section
26 25105.

27 (4) If a corporation that is a member of a combined reporting
28 group is not itself subject to taxation under this part in the year for
29 which the water's-edge election is made, but subsequently becomes
30 subject to taxation under this part, that corporation shall be deemed
31 to have elected with the other taxpayer members of the combined
32 reporting group.

33 (5) A taxpayer that is engaged in more than one apportioning
34 trade or business, as defined in paragraph (2) of subdivision ~~(e)~~
35 *(b)* of Section 25128, may make a separate election for each
36 apportioning trade or business.

37 (c) A water's-edge election shall remain in effect or be
38 terminated in accordance with this subdivision.

39 (1) Except as otherwise provided in this subdivision, if one or
40 more electing taxpayer members of a combined reporting group

1 later become disaffiliated or otherwise cease to be included in the
2 combined reporting group, the water's-edge election shall remain
3 in effect as to both the departing taxpayer members and any
4 remaining taxpayer members.

5 (2) If an electing taxpayer and a nonelecting taxpayer become
6 members of a new unitary affiliate group, the nonelecting taxpayer
7 shall be deemed to have elected if the value of the total business
8 assets of the electing taxpayer, and its component unitary group,
9 if any, is larger than the value of the total business assets of the
10 nonelecting taxpayer, and its component unitary group, if any.
11 Otherwise, the water's-edge election shall be automatically
12 terminated at the time the electing members become part of the
13 combined report. For purposes of applying paragraphs (9) and
14 (10), the commencement date of the deemed election shall be the
15 same as the commencement date of the electing taxpayers.

16 (3) If taxpayers filing under water's-edge elections with different
17 commencement dates become members of a new unitary affiliate
18 group, the earliest election date shall be deemed to apply to all
19 electing taxpayers if the total business assets of the earlier electing
20 taxpayer, and its component unitary group, if any, is larger than
21 the value of the total business assets of the later electing taxpayer,
22 and its component unitary group, if any. Otherwise, the later
23 election commencement date shall apply to all electing taxpayers.

24 (4) (A) If a taxpayer with an election that has been terminated
25 under paragraph (9) or (10) becomes a member of a new unitary
26 affiliate group that includes another electing or nonelecting
27 taxpayer not affected by those paragraphs, any water's-edge
28 election of the other taxpayer member, if applicable, shall
29 terminate, and any restrictions on making a new water's-edge
30 election, relating to an election terminated under those paragraphs,
31 shall apply to all taxpayer members of the new unitary affiliate
32 group if the total business assets of the taxpayer with the terminated
33 election, and its component unitary group, if any, is larger than
34 the other taxpayer, and its component unitary group, if any.
35 Otherwise, paragraph (2) shall apply, if applicable. If paragraph
36 (2) does not apply, all taxpayer members of the new unitary affiliate
37 group will be treated as nonelecting taxpayers that are not subject
38 to any restrictions on making a new water's-edge election.

39 (B) If two nonelecting taxpayers with different termination dates
40 under paragraph (9) or (10) become members of a new unitary

1 affiliate group, the earliest termination date shall be deemed to
2 apply to all nonelecting taxpayers, as well as any restrictions on
3 making a new water's-edge election relating to that termination,
4 if the total business assets of the earlier terminating taxpayer, and
5 its component unitary group, if any, is larger than the value of the
6 total business assets of the later terminating taxpayer, and its
7 component unitary group, if any. Otherwise, the later termination
8 date, and the related restrictions on making a new water's-edge
9 election, shall apply to all taxpayer members of the new unitary
10 affiliate group.

11 (5) (A) Except as provided in subparagraph (B), if one or more
12 electing taxpayers did not report their income and apportionment
13 factors as members of a combined reporting group with one or
14 more nonelecting taxpayers, and, pursuant to a Franchise Tax
15 Board audit determination, the nonelecting taxpayers, are properly
16 in the same combined reporting group as the electing taxpayers,
17 the water's-edge election of the electing taxpayers shall remain in
18 effect and the nonelecting taxpayers shall be deemed to have made
19 a water's-edge election. The commencement date of the deemed
20 water's-edge election shall be the same as the commencement date
21 of the electing taxpayers.

22 (B) Subparagraph (A) may not apply if the value of total
23 business assets of the electing taxpayers does not exceed the value
24 of total business assets of the nonelecting taxpayers. In that event,
25 the water's-edge election of each electing taxpayer is terminated
26 as of the date the nonelecting taxpayers are, pursuant to the audit
27 determination described in subparagraph (A), properly included
28 in the same combined reporting group as the electing taxpayers.

29 (C) For purposes of applying the business asset test of this
30 paragraph, the term "business assets" shall have the same meaning
31 as subparagraph (A) of paragraph (6), except that the business
32 assets of other members of the unitary affiliate group that are not
33 taxpayers shall not be taken into account.

34 (D) Notwithstanding subparagraph (A), nonelecting taxpayers
35 may not be deemed to have made a water's-edge election if the
36 Franchise Tax Board audit determination described in subparagraph
37 (A) is withdrawn or otherwise overturned.

38 (6) For purposes of paragraphs (2) to (5), inclusive, the following
39 shall apply:

1 (A) “Business assets” are assets, including intangible assets,
2 other than stock of a member of the unitary affiliate group, which
3 are used in the conduct of the business of the unitary affiliate group
4 or would produce business income to the unitary affiliate group,
5 if an election were not in place, if the assets were sold. Business
6 assets shall be valued at net book value.

7 (B) The phrase “unitary affiliate group” refers to all of those
8 corporations that would constitute a unitary group if a water’s-edge
9 election were not made.

10 (C) The phrase “new unitary affiliate group” refers to a unitary
11 affiliate group that is created by a new affiliation of two or more
12 corporations, or by the addition of one or more new members to
13 an existing unitary affiliate group.

14 (D) The phrase “component unitary group” means that portion
15 of a group of corporations that have become members of a new
16 unitary affiliate group that were members of their own respective
17 unitary affiliate group prior to entering the new unitary affiliate
18 group, disregarding any corporations that did not become part of
19 the new unitary group.

20 (7) In the application of paragraphs (2) to (4), inclusive, a series
21 of acquisitions as steps of a single transaction shall be aggregated
22 as a single change of membership.

23 (8) In the event of a merger or consolidation, the water’s-edge
24 status and election commencement date or termination date of the
25 surviving corporation shall be consistent with the result that would
26 have been obtained under paragraphs (2) to (4), inclusive, if the
27 surviving corporation had acquired the stock of the transferor
28 corporation.

29 (9) A water’s-edge election may be terminated without the
30 consent of the Franchise Tax Board after it has been in effect for
31 at least 84 months. The termination shall be made on an original,
32 timely filed return for the first year in which the water’s-edge
33 election is to be terminated. To be effective, the termination shall
34 be made by every taxpayer that is a member of the water’s-edge
35 group in the same manner as the election provided under
36 subdivisions (a) and (b).

37 (10) A water’s-edge election may be terminated before the
38 84-month period described in paragraph (9) has elapsed, but only
39 with the consent of the Franchise Tax Board. A request for

1 termination shall be made at the time and in the manner specified
2 by the Franchise Tax Board.

3 (A) The request may be granted for good cause. For purposes
4 of this section, good cause shall have the same meaning as specified
5 in Treasury Regulations Section 1.1502-75(c).

6 (B) The Franchise Tax Board shall consent to a termination
7 requested by all members of a water's-edge group, if the purpose
8 of the request is to permit the state to contract with an expatriate
9 corporation, or its subsidiary, pursuant to paragraph (2) of
10 subdivision (b) of Section 10286 of the Public Contract Code. A
11 water's-edge election terminated pursuant to this subparagraph
12 shall, however, be effective for the year in which the expatriate
13 corporation, or its subsidiary, enters into the contract with the state.

14 (11) Except for deemed elections as provided in paragraphs (2),
15 (4), and (5), if a water's-edge election is terminated under
16 paragraph (9) or (10), another election may not be made under this
17 section for any taxable year that begins within the 84-month period
18 following the last day of the election period that was terminated.
19 The Franchise Tax Board may waive the application of this
20 prohibition period for good cause.

21 (12) A water's-edge election shall remain in effect until
22 terminated.

23 (d) For purposes of this section, the following shall apply:

24 (1) A "combined reporting group" means those corporations
25 whose income and apportionment factors are properly considered
26 pursuant to this chapter in computing the income of the individual
27 taxpayer that is derived from or attributable to sources within this
28 state, taking into account a valid water's-edge election.

29 (2) A "group return" refers to the single return which taxpayer
30 members of a combined reporting group may elect by contract to
31 file, in the form and manner prescribed by the Franchise Tax Board,
32 in lieu of filing their own respective returns.

33 (3) A "self-assessed combined reporting group" means that
34 group of corporations whose income and apportionment factors
35 are reflected in a combined report prepared pursuant to this chapter
36 in a timely filed return, taking into account the effects of a
37 purported water's-edge election, whether or not the membership
38 of the corporations in that combined report was correctly
39 determined.

1 (e) The Franchise Tax Board may prescribe any regulations as
2 may be necessary or appropriate to carry out the purposes of this
3 section.

4 (f) To the extent that a taxpayer would have been required to
5 file on a water's-edge basis in its first taxable year beginning on
6 or after January 1, 2003, pursuant to a water's-edge election made
7 in a prior year under Section 25111, the terms of Section 25111
8 may not apply and the election shall be deemed to have been made
9 under the terms of this section. However, the commencement date
10 of the election made in a prior year under Section 25111 shall
11 continue to be treated as the commencement date of the
12 water's-edge election period for purposes of applying this section.

13 ~~SEC. 2.~~

14 *SEC. 3.* Section 25128 of the Revenue and Taxation Code is
15 amended to read:

16 ~~25128. (a) Notwithstanding Section 38006, all business income~~
17 ~~shall be apportioned to this state by multiplying the business~~
18 ~~income by a fraction, the numerator of which is the property factor~~
19 ~~plus the payroll factor plus twice the sales factor, and the~~
20 ~~denominator of which is four, except as provided in subdivision~~
21 ~~(b).~~

22 ~~(b)~~

23 *25128. (a)* If an apportioning trade or business derives more
24 than 50 percent of its "gross business receipts" from conducting
25 one or more qualified business activities, *as defined in subdivision*
26 *(b)*, all business income of the apportioning trade or business shall
27 be apportioned to this state by multiplying business income by a
28 fraction, the numerator of which is the property factor plus the
29 payroll factor plus the sales factor, and the denominator of which
30 is three.

31 ~~(e)~~

32 *(b)* For purposes of this section:

33 (1) "Agricultural business activity" means any activity relating
34 to any stock, dairy, poultry, fruit, furbearing animal, or truck farm,
35 plantation, ranch, nursery, or range. "Agricultural business activity"
36 also includes any activity relating to cultivating the soil or raising
37 or harvesting any agricultural or horticultural commodity,
38 including, but not limited to, the raising, shearing, feeding, caring
39 for, training, or management of animals on a farm as well as the
40 handling, drying, packing, grading, or storing on a farm of any

1 agricultural or horticultural commodity in its unmanufactured state,
2 but only if the owner, tenant, or operator of the farm regularly
3 produces more than one-half of the commodity so treated.

4 (2) “Apportioning trade or business” means a distinct trade or
5 business whose business income is required to be apportioned
6 under Sections 25101 and 25120, limited, if applicable, by Section
7 25110, using the same denominator for each of the applicable
8 payroll, property, and sales factors.

9 (3) “Banking or financial business activity” means any activity
10 attributable to dealings in money or moneyed capital in substantial
11 competition with the business of national banks.

12 (4) “Extractive business activity” means any activity relating
13 to the production, refining, or processing of oil, natural gas, or
14 mineral ore.

15 (5) “Gross business receipts” means gross receipts described in
16 subdivision ~~(e)~~ or (f) of Section 25120 (other than gross receipts
17 from sales or other transactions within an apportioning trade or
18 business between members of a group of corporations whose
19 income and apportionment factors are required to be included in
20 a combined report under Section 25101, limited, if applicable, by
21 Section 25110), whether or not the receipts are excluded from the
22 sales factor by operation of Section 25137.

23 (6) “Qualified business activity” means any of the following:

24 (A) An agricultural business activity.

25 (B) An extractive business activity.

26 (C) A savings and loan activity.

27 (D) A banking or financial business activity.

28 (7) “Savings and loan activity” means any activity performed
29 by savings and loan associations or savings banks which have been
30 chartered by federal or state law.

31 ~~(d) Subparagraph (D) of paragraph (6) of subdivision (e) shall~~
32 ~~apply only if the Franchise Tax Board adopts the Proposed~~
33 ~~Multistate Tax Commission Formula for the Uniform~~
34 ~~Apportionment of Net Income from Financial Institutions, or its~~
35 ~~substantial equivalent, and shall become operative upon the same~~
36 ~~operative date as the adopted formula.~~

37 (e)

38 (c) In any case where the income and apportionment factors of
39 two or more savings associations or corporations are required to

1 be included in a combined report under Section 25101, limited, if
2 applicable, by Section 25110, both of the following shall apply:

3 (1) The application of the more than 50 percent test of
4 subdivision ~~(b)~~ (a) shall be made with respect to the “gross business
5 receipts” of the entire apportioning trade or business of the group.

6 (2) The entire business income of the group shall be apportioned
7 in accordance with either subdivision ~~(a)~~ or ~~(b)~~, or subdivision ~~(b)~~
8 of this section or Section 25128.7, as applicable.

9 (d) The amendments made to this section by the act adding this
10 subdivision, shall apply to taxable years beginning on or after
11 January 1, 2011.

12 ~~SEC. 3.~~

13 SEC. 4. Section 25128.5 of the Revenue and Taxation Code is
14 repealed.

15 ~~SEC. 4.~~

16 SEC. 5. Section 25128.7 is added to the Revenue and Taxation
17 Code, to read:

18 25128.7. (a) Notwithstanding Section 38006, for taxable years
19 beginning on or after January 1, 2011, any apportioning trade or
20 business, other than an apportioning trade or business described
21 in subdivision (b) of Section 25128, shall apportion its business
22 income in accordance with this section, and not in accordance with
23 Section 25128.

24 (b) Notwithstanding Section 38006, for taxable years beginning
25 on or after January 1, 2011, all business income of an apportioning
26 trade or business described in subdivision (a) shall be apportioned
27 to this state by multiplying the business income by the sales factor.

28 (c) The Franchise Tax Board may issue regulations necessary
29 or appropriate regarding the administration of this section.

30 ~~SEC. 5.~~

31 SEC. 6. Section 25136 of the Revenue and Taxation Code is
32 amended to read:

33 25136. (a) For taxable years beginning on or after January 1,
34 2011:

35 (1) Sales from services are in this state to the extent the
36 purchaser of the service received the benefit of the service in this
37 state.

38 (2) Sales from intangible property are in this state to the extent
39 the property is used in this state. In the case of marketable
40 securities, sales are in this state if the customer is in this state.

1 (3) Sales from the sale, lease, rental, or licensing of real property
2 are in this state if the real property is located in this state.

3 (4) Sales from the rental, lease, or licensing of tangible personal
4 property are in this state if the property is located in this state.

5 (b) The Franchise Tax Board may prescribe those regulations
6 as necessary or appropriate to carry out the purposes of subdivision
7 (a).

8 ~~SEC. 6.~~

9 *SEC. 7.* This act provides for a tax levy within the meaning of
10 Article IV of the Constitution and shall go into immediate effect.