

CALTAX EDITORIAL: PROPOSITION 39 PROPONENTS IGNORE TAX EFFECTS OF 'THROWBACK SALES' THAT COULD MEAN HIGHER TAXES FOR SOME CALIFORNIA EMPLOYERS

Billionaire hedge-fund manager Tom Steyer and his merry band of Proposition 39 proponents are running commercials touting the proposed "single sales factor" corporate tax apportionment formula (that increases taxes by nearly \$1 billion, according to their estimate) by saying it will close a "loophole" on "out-of-state" corporations.

It is generally known that not all out-of-state corporations will be negatively impacted by a single sales factor apportionment formula, and that some California-domiciled companies could be hit with higher taxes if Proposition 39 is approved by voters next month. Many "out-of-state" corporations have factories and substantial payroll in California, and they benefit from a single sales factor because they have a greater percentage of out-of-state sales than their percentage of out-of-state property and payroll. Conversely, some California-domiciled companies will be hurt by the single sales formula because they have a larger percentage of sales in California than the percentage of property and payroll in the state.

However, because of an obscure and illogical provision of California tax law, an even larger number of California corporations could see their taxes increased by Proposition 39's single sales factor provisions. Section 25135 of the Revenue and Taxation Code provides that goods shipped from California to the U.S. government, and to buyers in other states where the company is not taxable, must be counted as California sales. This is just the opposite of the general rule that counts sales into California as California sales for the sales factor.

This "throwback sales" rule is an anachronism dating back to the 1960s. The argument made for the rule: since, under the destination rule that normally is used to assign sales, some out-of-state sales are assigned to destination states in which the taxpayer is not subject to tax, California should grab them, because all sales should be sourced somewhere.

However, if all other out-of-state sales are excluded from the California sales factor, it is illogical to count sales in another state that are not subject to apportionment in that state as sales in California.

What this means is that in addition to sales into California counting as part of the California sales factor, these out-of-state sales also will be used to determine the California sales factor. For example, a California-domiciled corporation may have 75 percent of its property and payroll in California and only 50 percent of its sales in California. A company like this benefits from the single sales factor. However, if more than half of the out-of-state sales are sales in states where the California corporation is not taxable, combined with sales to the U.S. government, this California company will find itself paying higher taxes if Proposition 39 passes.

Proponents of Proposition 39 need to level with California voters. They need to tell them that because of the "throwback sales" rule, millions and possibly billions of dollars' worth of out-of-state sales will be counted as California sales, and could result in California-domiciled corporations paying higher taxes.

This is just the opposite of the rhetoric used by proponents to imply that Proposition 39 will encourage businesses to locate in California. For California companies required to throwback their sales to California, Proposition 39 encourages the movement of business activities out of state.