

California [Regulation 25106.5-10](#) language corresponding to MTC Finnigan model statute Section 3C.ii.(b)(1)(B & C)

(b) Determination of Income.

(1) The income of a unitary business with operations in foreign countries shall be computed in the following manner:

(A) A profit and loss statement shall be prepared for each foreign branch or corporation in the currency in which the books of account of the branch or corporation are regularly maintained.

(B) Adjustments shall be made to the profit and loss statement to conform it to the [financial] accounting principles generally accepted in the United States for the preparation of such statements except as modified by this regulation.

(C) Adjustments shall be made to the profit and loss statement to conform it to the tax accounting standards required under Division 2, Part 11 [Chapter 13] of the Revenue and Taxation Code.

(D) The profit and loss statement of each branch or corporation, whether U.S. or foreign, shall be translated into the currency in which the parent company maintains its books and records in accordance with subsection (b)(4).

(E) Business and nonbusiness income as determined under California law shall be identified and segregated. For general definition, rules and examples for determining business and nonbusiness income, see Regulation 25120.

(F) Nonbusiness income shall be allocated to a specific state pursuant to the provisions of Sections 25124 to 25127, inclusive of Division 2, Part 11 of the Revenue and Taxation Code.

(G) Business income shall be included in the combined report prepared for the unitary business and shall be apportioned on the basis of the appropriate formula for the business.

(H) Income from California sources shall be expressed in dollars in accordance with subsection (b)(4) and the taxes computed accordingly.

(2) In lieu of the procedures set forth in subsection (b)(1) and subject to the determination of the Franchise Tax Board that it reasonably reflects income, a unitary business with operations in a foreign country may determine its income on the basis of the consolidated profit and loss statement prepared for the related corporations of which the unitary business is a member which is prepared for filing with the Securities and Exchange Commission. If the business is not required to file with the Securities and Exchange Commission, the consolidated profit and loss statement prepared for reporting to shareholders and subject to review by an independent auditor may be used.

(A) Adjustments shall be made, if necessary to:

1. conform to the accounting principles generally accepted in the United States for the preparation of such statements, except as modified by this regulation;
2. conform to the tax accounting standards as required under Division 2, Part 11 of the California Revenue and Taxation Code; and
3. eliminate unrealized gain and losses resulting from the restatement or revaluation of assets or liabilities to reflect changes or fluctuations in currency values.

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[Explicates (b)(1)(B) above:]

(A) **Financial** Accounting adjustments to be made to conform profit and loss statements to those utilized in the United States -

1. Include but are not limited to the following:

a. Clear reflection of income. Any accounting practice designed for purposes other than the clear reflection on a current basis of income and expense for the taxable year shall not be given effect. For example, an adjustment shall be required where an allocation is made to an arbitrary reserve out of current income.

b. Physical assets, depreciation, etc. All physical assets, including inventory when reflected at cost, shall be taken into account at historical cost computed either for individual assets or groups of similar assets. The historical cost of such an asset shall not reflect any appreciation or depreciation in its value or in the relative value of the currency in which its cost was incurred. Depreciation, depletion, and amortization allowances shall be based on the historical cost of the underlying asset, and no effect shall be given to any such allowance determined on the basis of a factor other than historical cost.

c. Valuation of assets and liabilities. Any accounting practice which results in the systematic undervaluation of assets or overvaluation of liabilities shall not be given effect, even though expressly permitted or required under foreign law, except to the extent allowable under subsection (b)(3)(B). For example, an adjustment shall be required where inventory is written down below market value.

d. Income equalization. Income and expense shall be taken into account without regard to equalization over more than one accounting period; and any equalization reserve or similar provision affecting income or expense shall not be given effect, even though expressly permitted or required under foreign law.

2. Currency gains or losses on closed transaction are includible, but no adjustments shall be made, or otherwise reflected, for unrealized gains or losses resulting from the restatement or revaluation of assets or liabilities to reflect changes or fluctuations in currency values. A closed transaction is one where any foreign exchange position taken by a corporation has been terminated by exchanging the foreign currency for the currency in which the individual corporation maintains its books and records and normally conducts its business affairs. In the case of a borrowing in a foreign currency, the transaction shall not be deemed closed until repayment is made.

[Explicates (b)(1)(C): above]:

(B) The **tax** accounting adjustments to be made shall include, but are not limited to, the following:

1. Accounting methods. The method of accounting shall reflect the provisions of Section 24651 of the Revenue and Taxation Code and the regulations thereunder.

2. Inventories. Inventories shall be taken into account in accordance with the provisions of Sections 24701 through 24706 of the Revenue and Taxation Code and the regulations thereunder, except Regulation 24702--24706(b)(5).

3. Depreciation, depletion, and amortization. Depreciation, depletion, and amortization are to be computed in accordance with California law.

#### 4. Elections.

a. Elections required to be made for purposes of determining income under Division 2, Part 11 of the Revenue and Taxation Code of all California reporting entities shall be made in accordance with applicable provisions of such law and the regulations adopted pursuant thereto.

b. Elections required to be made for purposes of determining income under Division 2, Part 11 of the Revenue and Taxation Code for entities which are not subject to taxation by California but are required to be included in the combined report for the unitary business shall be made by agreement of all entities required to report to California in accordance with applicable provisions of such law and the regulations adopted pursuant thereto. If agreement cannot be reached, see California Code of Regulations Section 25106.5-3.

(C) No adjustment shall be required under subsections (b)(3)(A) and (b)(3)(B) unless it is material. Whether an adjustment is material depends upon the facts and circumstances of the particular case, including the amount of the adjustment, its size relative to the general level of the corporation's total assets and annual profit or loss, the consistency with which the practice has been applied, and whether the item to which the adjustment relates is of a recurring or a nonrecurring nature.

(4) For purposes of determining income, necessary translations shall be made at the following exchange rates:

(A) Depreciation, depletion, or amortization shall be translated at the appropriate exchange rate for the translation period in which the historical cost of the underlying asset was incurred.

(B) All other items shall be translated at either the end-of-year exchange rate or at the simple average exchange rate for the translation period. Income repatriated during the year shall be translated at the exchange rate at date of repatriation. It is presumed that the translation rate used in preparing the consolidated profit and loss statement for financial reporting purposes is proper absent a showing that some other method is appropriate.

A change from end-of-year rates or average rates may not be made without the permission of and on such conditions as the Franchise Tax Board may prescribe.

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