

TITLE 18. FRANCHISE TAX BOARD

As required by Government Code section 11346.4, this is notice that a public hearing has been scheduled to be held at 1:00 p.m., February 6, 2013, at the Franchise Tax Board, 9646 Butterfield Way, Golden State Room A/B, Sacramento, California, to consider the amendment of Section 25106.5 under Title 18 of the California Code of Regulations ("Regulation"), pertaining to the assignment of sales of tangible personal property for sales factor purposes.

An employee of the Franchise Tax Board ("the Board") will conduct the hearing. Interested persons are invited to present comments, written or oral, concerning the proposed regulatory action. It is requested, but not required, that persons who make oral comments at the hearing also submit a written copy of their comments at the hearing.

Government Code section 15702, subdivision (b), provides for consideration by the three-member Franchise Tax Board of any proposed regulatory action if any person makes such request in writing.

WRITTEN COMMENT PERIOD

Written comments will be accepted until 5:00 p.m., February 6, 2013. All relevant matters presented will be considered before the proposed regulatory action is taken. Comments should be submitted to the agency officer named below.

AUTHORITY AND REFERENCE

Section 19503 of the Revenue and Taxation Code ("RTC") authorizes the Board to prescribe regulations necessary for the enforcement of Part 11 (commencing with section 23001) of the RTC. Additionally, RTC section 25106.5, subdivision (a), specifically authorizes the Board to adopt regulations as necessary or appropriate to carry out the purposes of RTC section 25106.5. The proposed regulatory action interprets, implements, and makes specific RTC section 25106.5.

INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW

Summary of Existing Laws and Regulations

Taxpayers that have business activities within and without California are required to determine the amount of income properly attributed to activities in California pursuant to the Uniform Division of Income for Tax Purposes Act ("UDITPA," RTC sections 25120 - 25141). Under UDITPA, business income is assigned to California either through the application of a four-factor (property factor, payroll factor, and double-weighted sales factor), a three-factor (property factor, payroll factor, and single-weighted sales factor), or a single sales factor (sales factor only) apportionment formula (see RTC sections 25128 and 25128.5).

The sales factor is a fraction, the numerator of which is the taxpayer's sales in California and the denominator of which is the taxpayer's sales everywhere during the taxable

year. RTC section 25135 provides the sales factor numerator assignment rules for sales receipts from sales of tangible personal property.

RTC section 25135, operative December 1, 2000, generally provided that sales receipts from sales of tangible personal property are in this state if (a) the property is delivered or shipped to a purchaser, other than the United States government, within this state regardless of the f.o.b. point or other conditions of the sale; and (b) the property is shipped from an office, store, warehouse, factory, or other place of storage in this state and (1) the purchaser is the United States government or (2) the taxpayer is not taxable in the state of the purchaser.

The Board adopted existing Regulation section 25106.5 in 2000, which required assignment of sales receipts from sales of tangible personal property to the sales factor numerator of a jurisdiction only when the member of a combined reporting group making the sales had established nexus with that jurisdiction.

In 2009, the California Legislature amended RTC section 25135. As amended, for taxable years beginning on or after January 1, 2011, RTC section 25135 requires that sales receipts from sales of tangible personal property delivered or shipped to a purchaser in California be assigned to the California sales factor numerator if the seller or any member of the seller's combined reporting group is taxable in California. In addition, all sales receipts from sales of tangible personal property delivered to a state other than California are not assigned (thrown back) to the California sales factor numerator of the seller if any member of the seller's combined reporting group is taxable in that state.

Objectives of and Anticipated Benefits from the Proposed Regulation

The 2009 amendment to RTC section 25135 changed the combined report mechanics in apportioning taxpayers' income attributable to activities in California as set forth in existing Regulation section 25106.5. The proposed amendments to existing Regulation section 25106.5 are necessary to provide guidance to implement such change in law.

Multistate taxpayers will benefit from having direction on when and how to assign sales receipts from sales of tangible personal property to the California sales factor to properly apportion income among different jurisdictions in compliance with recently amended statute. There are no benefits of the proposed regulation to the health and welfare of California residents, worker safety, and the state's environment.

Evaluation of Proposed Regulation with Respect to Existing State Regulations

The Franchise Tax Board has evaluated and determined that adoption of the proposed amendments to this regulation is not inconsistent with or incompatible with existing state regulations. There are no other comparable existing state regulations.

Existing Comparable Federal Regulation

There are no Federal regulations comparable to the proposed Regulation section 25106.5 because the Federal government does not use a formulary apportionment method of apportioning income among or between countries or states.

SPECIFIC PROPOSAL

Existing Regulation section 25106.5 instructs taxpayers to determine their income attributable to California based on its own California apportionment percentage. However, under RTC section 25135, as amended in 2009, California source total group combined report business income must be determined first based on the group's California apportionment percentage. The resulting amount is then assigned to each taxpayer member through the intrastate apportionment process.

Subsection (b) of existing Regulation section 25106.5 defines terms that apply to all regulations adopted under RTC section 25106.5, which relate to California combined reporting rules. Three new definitions are added so that terms used in the proposed amendments are defined.

Proposed subsection (b)(20) defines the term "California apportionment percentage" to mean the fraction used to apportion the total group combined report business income to California.

Proposed subsection (b)(21) defines the term "intrastate apportionment" to mean the method by which the California source total group combined report business income is assigned to each of the taxpayer members of the combined reporting group.

Proposed subsection (b)(22) defines the term "intrastate apportionment percentage" to mean the percentage applied by a specific taxpayer member to the California source total group combined report business income to determine that member's share of the group's California source apportioned income.

Existing Regulation section 25106.5(c) sets forth the steps in determining California source income or loss from the business income of a combined report group. Existing subsection (c)(7) provides the detailed guidance on how to compute a taxpayer member's California source total group combined report business income based on its own California apportionment percentage, and this is where most of the amendments being proposed are located (other than those set forth above at subsections (b)(20), (b)(21), and (b)(22) to add new definitions).

Existing subsection (c)(7) will be retained, except for insertion of applicable dates of taxable years beginning on or after April 22, 1999, and before January 1, 2011, and will be renumbered to subsection (c)(7)(B).

Proposed new subsection (c)(7)(A) is added to the existing Regulation section 25106.5.

Proposed subsection (c)(7)(A)1 provides that a group's California source combined report business income is computed by multiplying the total group combined report

business income for the accounting period of the principal member by the group's California apportionment percentage.

Subsection (c)(7)(A)1.a. provides the guidance for determining the group's California apportionment percentage under the different apportionment formulas of single-sales factor, double-weighted sales factor, and single-weighted sales factor.

Subsection (c)(7)(A)1.b. provides further guidance regarding the California property factor, payroll factor, and sales factor of the combined reporting group for the application of subsection (c)(7)(A).

Proposed subsection (c)(7)(A)2. provides the intrastate apportionment method to assign the California source total group combined report business income between the taxpayer members of the group. The group's California source combined report business income is multiplied by a taxpayer member's intrastate apportionment percentage to arrive at that taxpayer member's California source combined report business income.

Subsection (c)(7)(A)2.a. provides guidance regarding each taxpayer member's California property factor, payroll factor, and sales factor.

Subsection (c)(7)(A)2.b. provides guidance on how to determine each taxpayer member's California apportionment percentage under the different apportionment formulas of single-sales factor, double-weighted sales factor, and single-weighted sales factor.

Subsection (c)(7)(A)2.c. provides the approach to determine the taxpayer member's intrastate apportionment percentage.

Subsection (c)(7)(A)2.d. provides that the taxpayer member computes its California source combined report business income by multiplying the group's California source combined report business income by its intrastate apportionment percentage.

Proposed subsection (c)(7)(A)3 provides detailed examples to illustrate the rules set forth in this subsection (c)(7)(A).

Existing Regulation section 25106.5(g) is deleted because subparagraphs (A) and (B) of Regulation section 25106.5(c)(7), as proposed, set forth the respective applicable taxable years to which the amendments and existing regulation provisions will apply, respectively.

DISCLOSURES REGARDING THE PROPOSED REGULATORY ACTION

Mandate on Local Agencies and School Districts

The Board is not aware of any mandate on local agencies or school districts that would be created by reasonable compliance with the proposed regulation.

Cost or Savings to State Agencies, Local Agencies or School Districts, and Federal Funding

It is estimated that the 2009 legislation produces a net revenue gain of about \$12 million annually to the state. The proposed amendments to Regulation section 25106.5 to implement this legislation will not have any additional fiscal impact on state government.

The Board is not aware of any cost or savings to any state agency, any cost to any local agency or school district that is required to be reimbursed under Part 7 (commencing with Section 17500) of Division 4 of Title 2 of the California Government Code, other nondiscretionary cost or savings imposed on local agencies, and the cost or savings in federal funding to the state, that will result from the proposed amendments to the regulation.

Economic Impact on Business and the Ability of California Businesses to Compete

The Board is not aware of any significant statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states.

Potential Cost Impact on Private Persons or Businesses

The Board has made an initial determination that the adoption of the proposed amendments to the regulation will not result in costs incurred by private persons or businesses for reasonable compliance with the proposed action.

Effect on Jobs and Business in California

The Board is required to assess any impact the regulations may have on the creation or elimination of jobs in the State of California, the creation of new businesses, the elimination of existing businesses, and the expansion of businesses currently operating in the state.

Since the 2009 legislation is estimated to raise net private-sector costs, it is expected to result in net job losses in the long run. However, the proposed amendments to Regulation section 25106.5 to implement this legislation would not have any additional impact on the number of jobs or businesses created or eliminated, or on the expansion of business currently doing business within the state, beyond that resulting from the 2009 legislative change.

Impact on Small Business

The Board has made an initial determination that the adoption of the proposed regulation will not affect small businesses as generally multi-state corporations are not considered small businesses and this proposed regulation will apply only to multi-state corporations.

Impact on Housing Costs

The Board is not aware of any significant effect on housing costs that will be incurred by reasonable compliance with the proposed amendments to the regulation.

RESULTS OF THE ECONOMIC IMPACT ANALYSIS

Pursuant to Government Code section 11346.3, subdivision (b), the Franchise Tax Board has determined in the economic impact analysis that there are no effects on the creation or elimination of jobs in the state, no effect on the creation of new businesses or elimination or expansion of existing businesses within the state and that the proposed regulation will benefit taxpayers by providing direction on how to comply with a statute that now prescribes use of the *Finnigan* method of assigning receipts from sales of tangible personal property.

Benefits of the regulation to the health and welfare of California residents, worker safety, and the state's environment: None.

CONSIDERATION OF ALTERNATIVES

In accordance with Government Code section 11346.5, subdivision (a)(13), the Franchise Tax Board must determine that no reasonable alternative considered by the Board or that has otherwise been identified and brought to its attention would be more effective in carrying out the purpose of the proposed amendments to the existing regulation or would be as effective and less burdensome to affected private persons than the proposed regulatory action, or would be more cost-effective to affected private persons and equally effective in implementing the statutory policy or other provision of law.

AVAILABILITY OF STATEMENT OF REASONS AND TEXT OF PROPOSED REGULATIONS

An initial statement of reasons has been prepared setting forth the facts upon which the proposed regulatory action is based. The statement includes the specific purpose of the proposed regulatory action and the factual basis for determining that the proposed regulatory action is necessary.

The express terms of the proposed text of the regulation, the initial statement of reasons and the rulemaking file are prepared and available upon request from the agency contact person named in this notice. When the final statement of reasons is available, it can be obtained by contacting the agency officer named below, or by accessing the Franchise Tax Board's website at www.ftb.ca.gov/.

CHANGE OR MODIFICATION OF ACTIONS

The proposed regulatory action may be adopted after consideration of any comments received during the comment period.

The regulation may also be adopted with modifications if the changes are nonsubstantial or the resulting regulation is sufficiently related to the text made available to the public so that the public was adequately placed on notice that the regulation as modified could result from that originally proposed. The text of the regulation as modified will be made available to the public at least 15 days prior to the date on which the regulation is adopted. Requests for copies of any modified regulation should be sent to the attention of the agency officer named below.

ADDITIONAL COMMENTS

If you plan on attending or making an oral presentation at the regulation hearing, please contact the agency officer named below.

The hearing room is accessible to persons with physical disabilities. Any person planning to attend the hearing who is in need of a language interpreter or sign language assistance should contact the officer named below at least two weeks prior to the hearing so that the services of an interpreter may be arranged.

CONTACT

All inquiries concerning this notice or the hearing should be directed to Colleen Berwick at Franchise Tax Board, Legal Division, P.O. Box 1720, Rancho Cordova, CA 95741-1720; Telephone (916) 845-3306; Fax (916) 845-3648; E-Mail: Colleen.Berwick@ftb.ca.gov. In addition, all questions on the substance of the proposed regulation can be directed to John Su; Telephone (213) 897-5222; E-Mail: John.Su@ftb.ca.gov. This notice, the initial statement of reasons and express terms of the proposed regulation are also available at the Franchise Tax Board's website at www.ftb.ca.gov.