

CALIFORNIA FRANCHISE TAX BOARD

Internal Procedures Manual
Water's Edge Manual

Rev.: September 2001

EXHIBIT 15B-1 GLOSSARY

Adjusted taxable income = taxable income + net interest expense + NOL deduction + depreciation, amortization, and depletion.

Disallowed interest expense: The amount disallowed is the lesser of excess interest expense or disqualified interest.

Disallowed interest expense carryforward: Interest expense disallowed is carried forward to the subsequent year and treated as disqualified interest in the subsequent year. A deduction for this interest is allowed to the extent excess limitation is present.

Disqualified guarantee: A guarantee by a related person who is exempt from taxation or is a foreign person. (The term does not include a subsidiary in which the taxpayer owns at least 80% of the voting power.)

Disqualified interest: Interest paid or accrued by the taxpayer to a related person if the related person is not subject to tax on the interest income or interest paid to an unrelated person if there is a disqualified guarantee and no gross basis tax is imposed on that interest. (It includes the disqualified interest disallowed in the previous year.)

Excess interest expense = Net interest - ([50% x adjusted taxable income] + excess limitation carryforward). This amount can not be less than zero.

Excess limitation = (50% x adjusted taxable income) - net interest

Excess limitation carryforward: The excess limitation that is carried forward to the subsequent year. This amount is taken into account in computing "excess interest expense" by adding it to "50% of adjusted taxable income". The excess limitation carryforward is reduced in the year it is generated to the extent any disallowed interest carryforward is allowed as a deduction in that year.

Excess limitation carryforward = (50% x adjusted taxable income) - net interest expense + excess limitation carryforward to this year (provided its not more than 3 years old) - disallowed interest expense carryforward allowed as a deduction this year.

Net interest expense = total interest expense - total interest income

Related person: An affiliated corporation where there is more than a 50% ownership interest.

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