

INITIAL STATEMENT OF REASONS FOR THE
AMENDMENT OF CALIFORNIA CODE OF REGULATIONS,
TITLE 18, SECTION 25137-8, AND THE
ADOPTION OF CALIFORNIA CODE OF REGULATIONS,
TITLE 18, SECTION 25137-8.2

PUBLIC PROBLEM, ADMINISTRATIVE REQUIREMENT, OR OTHER CONDITION OR CIRCUMSTANCE THAT THE PROPOSED AMENDMENT TO REGULATION SECTION 25137-8 AND ADOPTION OF PROPOSED REGULATION SECTION 25137-8.2 ARE INTENDED TO ADDRESS

As originally presented to the Franchise Tax Board, staff proposed to amend the current regulation. Members of the Franchise Tax Board expressed concerns that amendment of the current regulation might be construed as retroactively addressing issues that were interpreted differently by staff and some members of the effected taxpayers. To address that concern staff has modified the proposed action to 1) make no changes to the current regulation other than to renumber it and limit its effective date and 2) propose the adoption of a new regulation reflecting the changes proposed to be made to the current regulation by staff and have the new regulation be effective with respect to future years.

The proposed amendments to the existing Regulation section 25137-8 renumber it as Regulation section 25137-8.1 and limit its taxable years of application.

Changes are made to current Regulation section 25137-8 in proposed Regulation section 25137-8.2 to add "Distributors" to those taxpayers subject to the regulation.

The adoption of proposed Regulation section 25137-8.2 is made to address the treatment of advertising revenue generated by film properties. Current regulation 25137-8 does not specifically address the treatment of receipts from advertising. The addition of language dealing with advertising, however, reflects the current interpretation and policy of the Franchise Tax Board with respect to such receipts. Furthermore, the treatment of advertising receipts and is consistent with Multistate Tax Commission Regulation IV.18(h) for television and radio broadcasters, with Regulation section 25137-12 for the print media industry and with similar rules adopted in at least one other state. The Franchise Tax Board's interpretation of the current regulation with respect to the treatment of advertising revenue is currently being challenged by several taxpayers. An amendment to the current regulation to reflect this policy is not being proposed so as not to preclude taxpayers contesting the Franchise Tax Board's policy from pursuing their remedies. No inference should be drawn from the fact that language addressing this issue is only included in proposed Regulation section 25137-8.2 and is not included in the proposed amendments to Regulation section 25137-8.1.

Changes are made to the current regulation which excluded news and sports filmed for telecast from the definition of films to now included them in the definition of films. This means news and sports filmed for telecast will now be included in the calculation of the

property factor as films. This change conforms California's treatment to the provision of the Multistate Tax Commission Regulation IV.18(h).

The current regulation, which will hereinafter be Regulation section 25137-8.1, is applicable to producers of commercials. Producers of commercials were removed from proposed Regulation 25137-8.2 so that the proposed regulation would conform to Regulation IV.18.(h) of the Multistate Tax Commission. Whether this elimination should be made is a question to be discussed at the hearing on the proposed amendment to the current regulation and adoption of the new regulation.

The proposed regulation 25137-8.2 modifies the current regulation by adding a sentence stating the ownership of movie theatres does not make an entity a distributor. The intent of this insertion was to make it clear that ownership of movie theatres by itself did not make an entity a distributor. At issue that may be discussed at the hearing is whether this sentence needs to be changed to make clear that a film distributor who also owns movie theatres is still a distributor for purposes of the proposed regulation.

An issue to be discussed at the hearing is whether language should be added to proposed Regulation Section 25137-8.2 to provide for the inclusion of other means of distribution of film properties.

Staff also proposes to make non-substantive changes to the proposed Regulation section 25137-8.2 as noticed to 1) reorder the definitions to place them in alphabetical order; 2) to include the various definitional provisions relating to "films" in a single paragraph and subparagraphs; 3) to re-write paragraph (c)(1)(A) to clearly differentiated the rental of studio property and equipment from short term rentals of similar equipment; and 4) to insert a general paragraph in (c)(3) so that it will contain both a subsection (A) and (B). These changes will be discussed at the hearing and staff's draft language will be made available.

SPECIFIC PURPOSE OF THE REGULATIONS

The proposed amendments to the existing regulation are necessary to limit its application to specified taxable years.

The adoption of the new regulation specifically identifies "distributors" as a part of the industry covered by this regulation. In addition, the proposed new regulation provides clarity as to the assignment of advertising revenue generated in conjunction with films in release, an issue not specifically listed in current Regulation section 25137-8.

NECESSITY

The existing regulation, which was adopted in 1982, no longer reflects the industry as it exists today. Because of changes in which the industry is organized and operates there is a need to update the rules to reflect these changes. In addition the existing regulation is not consistent with rules adopted in other states for the same industry, with Regulation section 25137-12 for the print media industry, nor with the Multistate Tax Commission Regulation IV.18(h) for television and radio broadcasters. Because there is a lack of consistency in

these rules for the assignment of income members of the industry may be subject to duplicative tax burdens or they may be able to avoid state taxes. Having a uniform set of rules adopted by a number of states addresses this problem.

The proposed amendment to renumber the existing regulation is necessary because changes which are not specifically provided for in the current regulation, but which reflect current department practice accepted by most members of the industry, that would be accomplished by amendment might be viewed as substantive. By amending the current regulation by re-denominating it and limiting the years for which its effective the respective positions of the department and taxpayers will not be effected.

Adopting a new regulation is proposed because changes are being made to the existing regulation to reflect current department practice, but which might be viewed as substantive. The changes are made by adopting a new regulation so as not to raise inferences about changes arising from amending the existing regulation.

The industry covered by the proposed regulation has changed in that the number of independent distribution companies has increased and there is a greater separation of production and distribution. Because the assignment of the income of independent distribution companies presents problems similar to those involved with producers and companies which both produced and distributed films and similar properties the same rules should apply to independent distributors. Including distributors in the class covered by the regulation accomplishes this purpose.

The changes are being proposed in the new regulation because they will make California's regulation consistent with a similar regulation adopted by the Multistate Tax Commission, Multistate Tax Commission Regulation IV.18(h), and adopted by other states. The Multistate Tax Commission is the administrator body of the Multistate Tax Compact of which California is a member. One of the goals of the compact is to promote uniformity in state tax practices with respect to the division of the corporate income tax base so there will be neither duplicative taxation nor under taxation of corporate income. Because California's rules are similar or identical to the rules of other states these goals are achieved.

These changes are being proposed because California adopted a regulation, 25137-12 for the print media which was adopted subsequent to the current regulation 25137-8 and which provides rules for the assignment of revenue from advertising. The proposed regulation contains rules for the assignment of sales from advertising because it is similar to the advertising revenue received by the print media and the similar type of revenue should be assigned in the same basic manner.

TECHNICAL, THEORETICAL, AND/OR EMPIRICAL STUDIES, REPORTS, OR DOCUMENTS

The Franchise Tax Board examined and considered the history of Regulation section 25137-8, including public hearing documents, Regulation section 25137-12, and the Multistate Tax Commission's Regulation IV.18(h) . The Franchise Tax Board did not rely upon any other technical, theoretical, or empirical studies, reports or documents in proposing the adoption of these amendments to Regulation section 25137-8 of the California Code of Regulations.

ALTERNATIVES TO THE PROPOSED REGULATORY ACTION THAT WOULD LESSEN ANY ADVERSE IMPACT ON AFFECTED PRIVATE PERSONS OR SMALL BUSINESS

The Franchise Tax Board has determined that there are no alternatives which would be more effective in carrying out the purpose of the proposed amendments to Regulation section 25137-8, and the adoption of Regulation section 25137-8.2, or would be as effective and less burdensome to affected private persons or small business than the proposed amendments. In addition, the proposed amendments pertain to corporate taxpayers and therefore do not affect private individuals.

ADVERSE ECONOMIC IMPACT ON BUSINESS

The Franchise Tax Board has determined that the proposed amendments to Regulation section 25137-8 and the adoption of Regulation section 25137-8.2 of the California Code of Regulations will not have a significant overall economic impact on business.