



06.23.09

Information Letter 2009-01

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Regarding: Application of Excess Inclusion Rules to California Taxpayer Members of a Unitary Combined Reporting Group That Aren't REMIC Residual Interest Holders.

Dear Mr. \*\*\*\*\*:

This is in response to your inquiry of March 20, 2009 seeking guidance with respect to the above-referenced issue. The purpose of this letter is to provide that guidance.

In your request, you ask if "excess inclusion income" is assigned to all members of a unitary combined reporting group. However, a common misconception is that there is something that is known as "excess inclusion income." A review of the federal REMIC rules confirms that no such item exists. As footnote 12 of FTB Legal Ruling 2009-01 states: "[Excess Inclusion] [(EII)] is not a separate type of income, such as capital gains, but is rather a method of characterizing REMIC income. Therefore, the term 'Excess Inclusion Income' is a misnomer."

Because the issue is discussed in detail in FTB Legal Ruling 2009-01, there is no need to reiterate how the excess inclusion rules apply in a combined reporting context. However, the following example should elucidate what impact, if any, the rules have on other California taxpayer members of a unitary combined reporting group that aren't residual interest holders.

Assume the following facts:

1. There are three California taxpayer members of a unitary combined reporting group: Corp. A, Corp. B and NERI. (i.e. Non-economic residual interest holder.)
2. Corp. A's apportionable business income is \$100. Corp. B's apportionable business income is \$40.
3. The only apportionable business income/loss attributable to NERI is underlying REMIC loss of \$50.

4. Corp. A has a California apportionment factor percentage of 30%. Corp. B has a California apportionment factor percentage of 40%. NERI has a California apportionment factor percentage of 10%.
5. Based on the EI rules and California's combined report rules, NERI must report a minimal amount of California-sourced income of \$10.

Based on these assumptions, each entity's California-sourced income is calculated as follows:

	Corp. A	Corp. B	NERI	Total
Apportionable Business Income(Loss)	\$100	\$40	(\$50)	\$90
Apportionment Factor Percentage	30%	40%	10%	80%
California-Sourced Income	\$27	\$36	\$9	\$72

As the above example indicates, the \$50 loss attributable to NERI from its underlying REMIC is included in the group's apportionable business income base and spread to Corp. A and Corp. B. However, even though NERI's California-sourced income would ordinarily be \$9, due to the application of the EI rules, it must report \$10.

Assume the same facts above, except Corp. A has an apportionable business loss of \$100.

	Corp. A	Corp. B	NERI	Total
Apportionable Business Income(Loss)	(\$100)	\$40	(\$50)	(\$110)
Apportionment Factor Percentage	30%	40%	10%	80%
California-Sourced Loss	(\$33)	(\$44)	(\$11)	(\$88)

Again, the \$50 loss attributable to NERI from its underlying REMIC is included in the group's apportionable business loss base and spread to Corp. A and Corp. B. However, even though NERI's California-sourced loss would ordinarily be \$11, due to the application of the EI rules, it must report \$10 of California-sourced income.

Thereafter, Corp. A would have a NOL carryforward/carryback of \$33 and Corp. B. would have a NOL carryforward/carryback of \$44. However, because it must report \$10 of California-sourced income, NERI will have a NOL carryforward/carryback of \$21.  $((\$11) - \$10 = (\$21))$ . (NOL carrybacks are only available for years beginning on or after January 1, 2011. See California Revenue & Taxation Code section 24416(d)(2).)

Please be advised that the tax law described in this information letter is considered a well-established interpretation or principle of tax law. This letter is provided for general information only and is not to be considered "written advice from the Board" within the meaning of Section 21012 of the Revenue and Taxation Code.

Sincerely,

Craig Swieso  
Tax Counsel IV