



State of California  
**Franchise Tax Board**

04.17.08

To: Interested Parties

Results of Interested Parties Meeting Held on March 25, 2008 – Revisions to Regulation Section 25114 (Water's-Edge Audits)

Dear Interested Parties,

A meeting was held at the Franchise Tax Board's (FTB) Central Office on March 25, 2008 to receive input regarding revisions to California Code of Regulations (CCR), title 18, section 25114, which addresses audits of returns filed using the water's-edge methodology. The Franchise Tax Board greatly appreciates the comments and questions received from the meeting's participants.

The revisions to CCR section 25114 are necessitated by the enactment of Senate Bill 788, Stats. 2007, ch. 07306, which amended and added provisions to California Revenue and Taxation Code (CRTC) section 25114. Pursuant to the prior version of CRTC section 25114(a), the FTB was required to examine the returns filed by taxpayers using the water's-edge method to determine that the proper methodology rules were being followed. Such examinations were required irrespective of the "potential net revenue benefit to the state". Pursuant to the amended version of CRTC section 25114(a), the FTB shall examine all returns, but it is no longer required to conduct an examination of every return to determine whether the water's-edge methodology is being satisfied.

Senate Bill 788 additionally added CRTC section 25114(c). This subdivision provides that an examination of a return filed using the water's edge method will be considered to have commenced once the taxpayer has been initially contacted by the FTB about the examination. Other than the revision to CRTC section 25114(a) and the addition of CRTC section 25114(c), Senate Bill 788 left the remaining provisions of CRTC 25114 intact.

As a result of the discussion that occurred at the meeting, it was determined that additional input should be requested with respect to the following issues:

1. A definition of the term "examine" as it is used in the revised version of CRTC section 25114(a).
2. A definition of the term "examination" as it is used in CRTC section 25114(c).
3. Elimination of the last sentence in existing CCR section 25114(a)(1), which states: "A detailed audit shall be conducted regardless of the fact that there may be no potential tax change or that the potential adjustment to tax shall be less than the cost of the audit".
4. Revise existing CCR section 25114(a)(2) to indicate that only those audits conducted pursuant to CRTC section 25114 that involve transfer pricing issues are required to adhere to the principles and procedures followed by the Internal Revenue Service in conducting examinations under Internal Revenue Code section 482.

Any interested parties should please submit any additional input by May 6, 2008 at the following address:

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Sincerely,

Craig Swieso  
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