

DISCUSSION TOPICS

Franchise Tax Board Interested Parties Meeting - Regulation Section 25137-11, Relating to Trucking Companies July 17, 2008

1. BACKGROUND

Due to the mobile nature of the trucking industry, it is often difficult to isolate and measure the level of California activity in comparison to the level of activity everywhere in order to assign property, payroll, and sales to this state. For this reason, the Franchise Tax Board (FTB) promulgated California Code of Regulations (CCR), title 18, section 25137-11, to calculate the property, payroll, and sales factors of trucking companies. This regulation provides an efficient way for trucking companies to calculate their apportionment factors, as mileage is routinely recorded, and hence, it provides a readily available measure of business activity both within and without California. The rules for determining the apportionment factors for the trucking industry, pursuant to CCR section 25137-11, have generally been derived from, and are parallel to, the trucking regulation promulgated by the Multi-State Tax Commission.

The apportionment formula found in CCR section 25137-11 uses an interstate ratio to apportion property, payroll, and sales related to the transport of goods between states. Shipments that are driven only inside of California are assigned to the California numerator of the property, payroll, and sales factors. The interstate ratio for hauls crossing state lines is miles driven inside of California divided by total miles. In this way, property, payroll, and sales are assigned in proportion to the miles driven within California.

An issue arose recently concerning the definition of "trucking company" in CCR section 25137-11(b)(1). This definition states that "trucking company means a motor common carrier, a motor contract carrier, or an express carrier which primarily transports tangible personal property of others by motor vehicle for compensation." The question was whether the definition of "trucking company" encompassed a unitary group of corporations that operated as a trucking company. In Appeal of Swift Transportation Co., Inc. (Swift Transportation), No. 266318, the State Board of Equalization (SBE) upheld, in an unpublished decision, the position of the FTB that the definition of "trucking company" in CCR section 25137-11 applied to a unitary trucking group organized into several corporations. A petition for rehearing has been filed by the appellant but has not yet been acted upon by the Board of Equalization.

Although the SBE decision in Swift Transportation upheld the department's position, parties in other cases cannot cite it as authority because it is an unpublished decision. Thus, the case raises the issue of whether CCR section 25137-11(b)(1) should be clarified by amendment.

A second area of possible review and amendment concerns CCR section 25137-11, subsection (a)(2). This subsection addresses situations where a taxpayer or an affiliate of a taxpayer that is not a trucking company conducts trucking activities. In such situations, the regulation states that where the apportionment factors "directly related to such activities are separately identified" then they will be assigned using the interstate ratio. The term "trucking activities" may need further clarification because it is not defined in the regulation.

A third area of possible review and amendment concerns whether freight forwarding activities should be included in the trucking regulation. Freight forwarding companies are those that arrange for the shipment of goods by air, sea, rail or truck common carriers, and receive fees for their services. Currently, freight forwarding activities are not directly addressed in CCR section 25137-11. The FTB's practice has been to treat freight forwarding as a service when the freight forwarder does not provide trailers but only arranges for transportation. Since the income producing activities in those instances are generally divided equally between the points where the shipments originate and terminate, the FTB has assigned 50 percent of the revenue to the point of origin and 50 percent to the point of destination under the authority of Revenue & Taxation Code (RTC) section 25137. If the freight forwarder provides the trailers, then the FTB uses a mileage ratio and applies the apportionment rules for trucking, sea, air, or rail transportation, whichever is applicable, to the property, payroll, and sales related to this activity. If a freight forwarder does not qualify as a trucking company under the regulation, the interstate ratio may still be applied under the authority of RTC section 25137 where necessary to fairly reflect the business activities of the freight forwarder. The department would like to hear from interested parties as to whether freight forwarding should be addressed in CCR section 25137-11 and, if so, what method of apportionment for such activities should be utilized.

A fourth area of possible review and amendment concerns the hiring by trucking companies of transportation from independent contractors. In some instances independent contractors provide both tractors and trailers, while in other instances the trucking companies provide trailers and the independent contractor provides tractors. In still other situations, trucking companies provide both tractors and trailers and the independent contractor simply drives. These situations are not expressly addressed in CCR section 25137-11. The department would like to obtain input from interested parties as to whether these fact situations should be expressly included in CCR section 25137-11 and what method of apportionment should apply to each scenario.

Finally, the entire trucking regulation should be reviewed for areas that need further detail and guidance in light of the current business environment for trucking companies.

2. STAFF'S EXPECTATIONS FOR THE MEETING

The FTB believes that in the wake of the Swift Transportation appeal, the existing trucking regulation needs to be clarified. In addition, other common situations not currently contained within the regulation should be addressed. Staff believes that the following core principles provide an objective basis upon which to evaluate proposed

solutions and should guide any amendments to the regulation. Among these principles are:

1. Equity: Are all similarly situated taxpayers being treated in a similar manner?
2. Administration: Is a rule as clear and simple as possible? Can taxpayers and the FTB apply a rule?
3. Elimination of potential disputes: Does a rule raise new concerns that could lead to new disputes?
4. Recordkeeping: Does a rule use existing records as much as possible to minimize the burdens of recordkeeping on taxpayers?

The following regulatory changes should be considered:

1. Clearly identify how the regulation applies to a unitary business that includes trucking activities.
2. Add a definition for "trucking activities" in CCR section 25137-11(b) and clearly identify the application of that term in CCR section 25137-11(a)(2).
3. Add a freight forwarding subsection to CCR section 25137-11 that addresses what method of apportionment applies when a taxpayer engages in such activities.
4. Add a subsection to CCR section 25137-11 that addresses the method of apportionment that applies when third party independent contractors are utilized, including subsections governing each of the different fact situations described above.
5. Address any other concerns of interested parties.

3. POSSIBLE SOLUTIONS

The trucking regulation could be amended to incorporate the above additions. This approach would allow the FTB to incorporate recent decisions of the State Board of Equalization and clarify current practices. An alternative approach would be to create new regulations for freight forwarding and third party independent contractor situations that recognize other modes of transportation such as air, sea, and rail.

Either of these alternatives would clarify apportionment methods for the trucking industry, thereby easing compliance burdens and decreasing the potential for conflicts.

The FTB anticipates hosting an open discussion to address these and other concerns that may be presented by the industry. Interested parties should discuss possible approaches to administering the apportionment factors for the trucking industry, keeping in mind that the underlying objective is to eliminate disputes and create straightforward rules that may be easily applied by taxpayers and administered by the FTB.