PROPOSED REGULATION SECTION 23663
SECOND INTERESTED PARTIES MEETING DISCUSSION PAPER
DECEMBER 5, 2013

Revenue and Taxation Code (RTC) section 23663 permits the assignment of credits among affiliated members of the same combined reporting group. RTC section 23663 was added by section 10 of AB 1452 (Stats. 2008, ch. 763), is specifically operative for assignments made in taxable years beginning on or after July 1, 2008, and first permits assigned credits to be claimed against the tax of the assignee in taxable years beginning on or after January 1, 2010.

An assignment is made as an election on Form FTB 3544, and is filed with the original return for the tax year in which the assignment is made. The election to assign is irrevocable under RTC section 23663, subdivision (c). In some situations taxpayers have made defective elections, such as when the total credits available to be assigned are less than the assignor contemplated when the original tax return was filed, or it is later discovered that an assignee was not a member of the same combined reporting group on the required dates. Because the assignment election is irrevocable, taxpayers are left with uncertainty regarding the allocation of credits which are the subject of a defective election, as well as having no clear recourse to correct the defective election.

Under RTC section 23663, subdivision (e)(4), the Franchise Tax Board is specifically authorized to issue necessary regulations to specify the treatment of any assignment that does not comply with the requirements of RTC section 23663.

FIRST INTERESTED PARTIES MEETING

At the first interested parties meeting we discussed the definition of defective elections and the various instances in which defective elections may arise. We then discussed the possible methods in which defective elections could be treated as well as the standards under which the department should review any potential requests to correct defective elections.

DISCUSSION TOPICS

Based on input from the first interested parties meeting, the department has included in this document for discussion purposes: 1) default allocation rules for defective elections, and 2) a general framework for alternative allocations and corrections available for certain defective elections. In addition, the department prepared a Power Point slideshow illustrating the application of the default rules.

1. Default Allocation Rules

The Power Point slides provide examples of the following default rules and **are meant to be viewed at the same time as the default rules.**

Default Rule A The term "assignment" shall mean the assignment of a specific dollar amount of a specific credit type from a specific taxable year to an assignee. **(See Example A of Power Point slides.)**

Default Rule B Assignments made in prior taxable years are given effect before subsequent assignments. **(See Example B of Power Point slides.)**

Default Rule C The term "noncompliant assignment" shall mean any assignment under RTC section 23663 which does not comply with the requirements of the statute. All assignments concerning the same type of credit from the same taxable year which are made in a given taxable year shall be aggregated for purposes of this determination. **(See Example C and Example C / D of Power Point slides.)**

Default Rule D If an assignment is a noncompliant assignment solely because an assignor's actual credits are less than the amount assigned to an eligible assignee, the assignor's actual credits shall be entirely allocated to the eligible assignee in order to give as full an effect to the original intent of the assignor as possible. If the assignor made the noncompliant assignment to multiple eligible assignees (if the same specific credit type from the same specific taxable year was assigned to multiple eligible assignees in the same tax year), then the assignor's actual credits shall be entirely allocated amongst the eligible assignees, based on the ratio the assignor assigned credits to such eligible assignees in the noncompliant assignments. **(See Example C / D of Power Point slides.)**

Default Rule E If an assignment is a noncompliant assignment for any reason other than that listed in Default Rule D, then the assignment shall be treated as if it had not been made. **(See three Examples E of Power Point slides.)**

Default Rule F The following rules shall apply when the assignor or eligible assignees of a noncompliant assignment in which Default Rule D applies have already claimed the assigned credits on their California tax returns and the credits cannot be reallocated under Default Rule D at the earlier of 1) the time a notice of proposed assessment is issued, or 2) at the time the assignor and all affected eligible assignees send written notification to the Franchise Tax Board (FTB) informing FTB of their application of the rules under this regulation. This situation will generally arise when some of the assigned credits were claimed by the assignee in a year for which the statute of limitations is closed, but could also include instances in which the corporation is suspended, bankrupt, etc. In such cases, the following rules are proposed: **(See two Examples F of Power Point slides.)**

1) First, the credits shall be allocated to the assignor and eligible assignees who claimed the credits to the extent credits were claimed and cannot be reallocated (due to closed statute of limitations, etc.).
2) Next, any remaining credits shall be allocated to any other eligible assignees until all eligible assignees have been allocated a pro rata

portion of the actual credits based on the ratio discussed in Default Rule D.

3) Thereafter, any remaining credits shall be allocated to the eligible assignees pro rata based on the ratio discussed in Default Rule D.

Default Rule G The following rule shall apply when an assignor assigns credits to an ineligible assignee and the ineligible assignee has claimed credits, such that the application of Default Rule E would prejudice the interests of the government. This Default Rule is applied at the earlier of 1) the time a notice of proposed assessment is issued, or 2) at the time the assignor and all affected assignees send written notification to FTB informing FTB of their application of the rules under this regulation. While the assignment discussed in Default Rule E is treated as having not been made, the amount of the assignor's credits will be reduced by the amount of credits claimed by an ineligible assignee which prejudice the interests of the government. This Default Rule would generally apply when the credits were claimed in a year for which the statute of limitations is closed but could also include instances in which the corporation is suspended, bankrupt, etc. **(See Example G of Power Point slides.)**

2. Alternative Allocation

A. If an assignor assigns more credits than it actually has available, then an alternative allocation will be available if both of the following requirements are met:
    1) The assignor acted reasonably and in good faith in making the assignment; and
        i. There will be a presumption of not reasonable and not in good faith if any members of the same combined reporting group request an alternative allocation or correction of a clerical error for two tax years within a five year period, unless the multiple requests are related to a single transaction.
    2) The interests of the government are not prejudiced.

B. The alternative allocation shall be available to the assignor and any eligible assignees who request the alternative allocation together with the assignor.
    1) Any eligible assignees who do not agree to the alternative allocation shall receive an allocation in accordance with the default rules.

C. The assignor must request the use of an alternative allocation from the department. Any eligible assignees who also desire an alternative allocation may be included in the request together with the assignor. If all requirements for an alternative allocation are met, the department will then propose an alternative allocation which reasonably reflects the intent of the assignor as demonstrated by contemporaneous evidence from the time the original assignment was made,

with the assignment form generally being the strongest indication of the assignor's original intent.

3. Correction of a clerical error

A. If an assignment is defective because of an error made on the face of the assignment form, then a correction of the clerical error will be available if:
    1) The assignment on the form is fully completed;
    2) The assignor acted reasonably and in good faith in making the assignment;
        i. There will be a presumption of not reasonable and not in good faith if any members of the same combined reporting group request an alternative allocation or correction of a clerical error for two tax years within a five year period, unless the multiple requests are related to a single transaction.
    3) The interests of the government are not prejudiced; and
    4) There is clear and convincing evidence demonstrating the assignor's intended entry on the form.
    5) Examples
        i. Correction of a clerical error would apply in the case that the entity's name and FEIN do not match.
        ii. Correction of a clerical error would not apply when the assignor accidentally assigned the wrong amount of credits on the assignment form.
B. An assignor shall request the correction of a clerical error from the department.

COST IMPACTS OF PROPOSED RULEMAKING

In addition to discussion regarding potential language for this regulation, the Administrative Procedure Act (APA) requires the department to assess the economic impact of this proposed regulation on business, representative private persons, and small businesses. Recent legislation (SB 617, Stats. 2011, ch. 496) revised certain aspects of the standardized regulatory cost impact analysis, particularly with respect to "major regulations" (as defined), but also with respect to other rulemaking activities. As a result, the department intends to solicit information from interested parties during the pre-APA process that will assist in preparation of the regulatory cost impact analysis.

Specifically, the APA requires the department to assess the economic and fiscal impact of this regulation on the following –

(1) Estimated private sector cost impacts on businesses and/or employees, small businesses, jobs or occupations, competitiveness of California businesses, reporting

requirements, or individuals. This includes the total number and types of businesses impacted, including the number or percentage of those businesses that are small businesses, the number of businesses that will be created or eliminated, the geographic extent of the impacts (local or statewide), the number of jobs created or eliminated, and the ability of California businesses to compete with businesses in other states.

(2) Estimated total statewide dollar costs that businesses and individuals may incur to comply with this regulation, including start-up and ongoing costs. This includes an identification of the costs for each industry affected, the annual costs a typical business may incur to comply with these requirements (including programming, recordkeeping, reporting and other paperwork, whether or not the paperwork is required to be submitted), whether the regulation directly impacts housing costs, and whether there are comparable federal regulations.

(3) Estimated benefits from the regulation (both whom will benefit and by how much).

(4) Any suggested alternatives to the proposed regulation, and the costs and benefits of those suggested alternatives under 1, 2 and 3 above.

(5) Whether the estimated costs of this regulation to California businesses will exceed $10 million.

The department encourages submission of any comments and/or cost data on the items set forth above by any interested parties.