

TITLE 18. FRANCHISE TAX BOARD  
AMENDMENTS TO PROPOSED REGULATION SECTION 25106.5-1,  
RELATING TO ASSIGNMENT OF INTERCOMPANY TRANSACTIONS BETWEEN MEMBERS  
OF A COMBINED REPORTING GROUP

A hearing was held on July 25, 2013 by Laurie McElhatton and Craig Swieso, ("hearing officers") of the Franchise Tax Board Legal Division. The hearing addressed proposed amendments to Regulation section 25106.5-1, which was noticed in the California Regulatory Notice Register on April 26, 2013.

A 15-day notice of proposed changes was published on October 2, 2013, but that notice inadvertently omitted the ending date of the 15-day public comment period. As a result, staff is issuing this second 15-day notice to the public specifying the ending date of the 15-day public comment period. There are no other changes in this notice from the earlier 15-day notice published on October 2, 2013.

Department staff reviewed the proposed regulation language and considered the comments submitted by the hearing date. The hearing officers recommend that three changes to the proposed regulation be made to clarify that (1) the regulation does not need to address whether the same amount of money is being distributed when a series of distributions of money is made up through multiple tiers of corporations, resulting in a deferred intercompany stock account (hereinafter DISA) arising only as a result of the first distribution in the series, (2) the regulation should instead indicate that the series of distributions must be related to one another, regardless of when they are made and amount, and (3) the effective date of the revisions to subsections (f), (j)(4) and (j)(7) of Regulation section 25106.5-1. These proposed changes are summarized below:

1. The purpose of the proposed revision to Regulation section 25106.5-1(j)(4) is to make sure that multiple DISAs did not arise from distributions through multiple tiers of corporations. Without the proposed revision, multiple DISAs would arise. However, the initial proposed revision indicated that the same amount of money needed to be distributed through the multiple tiers. Upon further consideration, the proposed revision does not need to reference the amount of money that is distributed. However, staff does believe that the original distribution and any subsequent distributions in a series must be related, because the goal of this revision is not to treat all distributions that create a DISA as creating earnings and profits. Rather, only those initial distributions that are related to subsequent distributions as a means of moving money or property through a chain of corporations to the ultimate distributee should do so. Therefore, Regulation section 25106.5-1(j)(4) is proposed to be revised to state:

(4) Earnings and profits. The timing rules of this regulation apply to the calculation of California earnings and profits. Therefore, the California

earnings and profits of S will not reflect S's intercompany items until those items are taken into account under this regulation. However, when a member distributes an amount of money or property to another member in a related series of distributions, and the other member thereafter distributes no more than the same an amount of money or the same property to another member, any DISA arising from the initial distribution will be treated as earnings and profits for purposes of determining the DISA, if any, arising from the second distribution.

2. While it can be presumed that most taxpayers will want the revisions to the DISA provisions to be applied retroactively, cases may arise where a taxpayer does not want it to be applied retroactively. With that in mind, Regulation section 25106.5-1(k) is proposed to be revised to state:

(k) Effective date

(1) This regulation applies to intercompany transactions occurring on or after January 1, 2001.

(2) A taxpayer may elect to have the revisions to subsections (f), (j)(4) and (j)(7) apply prospectively as of the effective date of these changes.

These nonsubstantial or sufficiently related changes are being made available to the public for the 15-day period required by Government Code section 11346.8, subdivision (c), and Section 44 of Title 1 of the California Code of Regulations. Written comments regarding these changes will be accepted until 5:00 p.m. on November 8, 2013.

A copy of the proposed amendments is being sent to all individuals who requested notification of such changes, as well as those who attended the hearing and those who commented orally or in writing, and will be available to other persons upon request. All inquiries and written comments concerning this notice should be directed to Colleen Berwick at (916) 845-3306, FAX (916) 845-3648, E-Mail: [colleen.berwick@ftb.ca.gov](mailto:colleen.berwick@ftb.ca.gov), or by mail to the Legal Division, Attn: Colleen Berwick, P.O. Box 1720, Rancho Cordova, CA 95741-1720. This notice and the proposed amendments and adoptions will also be made available at the Franchise Tax Board's website at [www.ftb.ca.gov](http://www.ftb.ca.gov).