DISCUSSION TOPICS

FRANCHISE TAX BOARD INTERESTED PARTIES' MEETING
REGULATION SECTION 25128
APPORTIONMENT OF BUSINESS INCOME
JANUARY 9, 2008

1. Overview and History of Regulation section 25128.

In 1993, Revenue and Taxation Code (RTC) section 25128 was amended to require that the sales factor be double-weighted for most taxpayers. Exceptions to double-weighting are provided for in subdivision (b) of RTC section 25128 when an apportioning trade or business derives more than a threshold percent of its gross business receipts from one or more of the four activities that are enumerated in subdivision (c).

One enumerated exception is "banking or financial business activity" (subdivision (c)(4) of RTC § 25128). Banking or financial activity is defined generally in subdivision (d)(5) as "activities attributable to dealings in money or moneyed capital in substantial competition with national banks." The remaining three activities are defined comprehensively, either in separate regulations (extractive business activity in regulation section 25128-1 and agricultural business activity in regulation section 25128-2), or in subsection (c) (savings and loan activity). Only "banking or financial business activity" lacks a comprehensive definition, either in the statute itself or in regulation section 25128.

The original rulemaking file for regulation section 25128 indicates that the exceptions to double-weighting the sales factor were intended to be drawn narrowly. Consequently, there is uncertainty for both taxpayers and the department as to which activities come within this definition. The uncertainty could result in application of the exception more broadly than the regulatory history indicates was intended.

2. LET’S TALK ABOUT IT!

The department anticipates having an open discussion to address this concern and other concerns that may be present in the industry, together with possible approaches to resolve potential problems.

Staff believes the following core principles provide an objective basis to guide the discussion and to evaluate proposed solutions:

1) Equity: Are all taxpayers being treated similarly?
2) Administrability: Is the rule clear and simple? Can taxpayers and the department apply the new rule?
3) Elimination of potential disputes: Does the new rule raise concerns that could lead to new disputes?

4) Recordkeeping: Does the new rule use existing records as much as possible to minimize taxpayer recordkeeping burdens?

With these principles as the backdrop, the department would like your thoughts on whether regulation section 25128 should be modified to include a more comprehensive definition of "banking or financial business activity," and if so, thoughts on parameters for the definition. This would include your input on how, if at all, the existing regulation under RTC section 23183 might be relevant to that definition. A copy of regulation section 23183 is attached for your reference.

The department would additionally like to discuss any other concerns about regulation section 25128 raised during the meeting.

3. LET’S THINK ABOUT IT!

The regulation could be amended to include a more comprehensive definition of "banking or financial business activity" and to address identified concerns.