

Summary of Interested Parties Meeting California Schedule M-3

- I. Administration: On August 11, 2008 at 9:30 a.m., members of the public attended an interested parties meeting at the Franchise Tax Board office in Sacramento. Parties attended in person and by telephone.

The meeting facilitator, Jeanne Harriman, explained that the purpose of the meeting was to explain why the California Schedule M-3 is being proposed and get feedback on how to ease the burden of filing the California Schedule M-3 as well as identify any other impacts that FTB may take into consideration when finalizing the form.

- II. Why is a California Schedule M-3 needed?

Since the introduction of the Federal Form M-3, the Financial Accounting Standards Board Interpretation No. ("FIN") 48, and the Sarbanes-Oxley Act of 2002, disclosures related to income tax have been enhanced at the federal level. However, due to the differences in California and federal law and the combined versus consolidated group of taxpayers, these disclosure requirements do not readily provide disclosures relevant to California tax matters which can contribute to noncompliance from a taxpayer's perspective and hinder the Franchise Tax Board's ability to detect noncompliance issues so as to address them with educational efforts.

The M-3 is an expansion of the Schedule M-1. It helps the taxpayer understand the tax return position taken as far as what they may need to disclose under FIN 48 or what may be at risk under Sarbanes-Oxley. It also helps tax agencies identify the taxpayers that are taking a very aggressive tax planning effort that might not be identifiable otherwise.

- III. Why isn't the federal Schedule M-3 enough for California purposes?

FTB has been looking at the federal M-3 the last few years, but there are major differences between the federal consolidated group and the California combined group along with federal/state differences. Because of these differences it is difficult to understand what is reported for California purposes because the federal schedule does not break down the information from the federal group level to the California group level.

In addition, both California and the IRS have noticed continued aggregation of line items on the Sch M-1. Aggregation makes it harder to determine what is being reported for California purposes.

- IV. Water's-edge taxpayers and foreign companies

Regarding water's-edge taxpayers and foreign companies the question was asked whether a California Schedule M-3 would be required to be filed by each affiliate, included or not

included, showing the adjustments for each affiliate. Concern was raised that this requirement would double the size of some taxpayer's returns and would be very burdensome. FTB staff answered that FTB's intention is that only the information for those corporations that are part of the combined report would be required. This is also consistent with how the federal form M-3 is filed.

For a Water's-edge taxpayer with Controlled Foreign Corporations ("CFCs") that are excluded under California Regulation Section 25110, the schedule would not be required for the excluded corporations. At this point the intention is that if any partially included CFCs are included in the group they would be required to file the schedule M-3. However, numerous questions were raised regarding the requirement of CFCs to file the M-3 and how the M-3 related to information provided on Form 5471. FTB staff agreed to further study this issue and this issue will be further discussed at the next Interested Party Meeting.

V. Filing Requirements for CA Schedule M-3

Similar to the IRS, FTB is looking at different asset levels to determine filing requirements. For federal purposes corporations with assets of over \$10 million are required to file the M-3 and for partnerships there are other tests used to determine the filing requirement. FTB is looking at these limitations to narrow down the taxpayers that will be impacted by filing of the schedule. FTB staff requested feedback in establishing this limitation and identifying issues related to determining how that limitation is applied.

VI. Computer and Accounting Systems

Industry tax representatives and software developers stated that revising financial accounting systems and tax forms to capture and report the additional information will be a time consuming and costly process. Additionally, an analysis of whether the information desired is available or can be obtained from foreign affiliates or parents has not been done.

A suggestion was made to defer the Schedule M-3 by at least a year to allow companies to evaluate their systems and figure out how to collect the information and put it in a form that can be reported.

VII. Difference between the Domestic Disclosure Spreadsheet ("DDS") and the Schedule M-3

The purpose of the Form 100-DDS was to provide Franchise Tax Board with a list of all related entities to facilitate audit inquiries into unitary relationships and transactions with related entities. It also provided a full accounting of income apportioned or allocated among the States in order to identify possible inconsistencies in State tax filings. Items reported on the form include income, apportionment factors, business and nonbusiness income reported to each state the taxpayer filed returns with. The DDS was required by statute and was subsequently repealed when the Water's-edge election fee was eliminated.

The purpose of the Schedule M-3 is to reconcile financial statement net income (loss) for the combined financial statement group to income (loss) per the income statement for the California combined group or entity.