DISCUSSION TOPICS

Franchise Tax Board Interested Parties Meeting -
Trucking Regulation 25137-11
May 26, 2009

1. BACKGROUND

An interested parties meeting was held on July 17, 2008 at FTB's Central Office in Sacramento. The parties discussed areas of concern with the trucking regulation, California Code of Regulations, title 18, section 25137-11, and possible amendments to that regulation. A summary of that interested parties meeting was posted on the website and sent to known attending parties, portions of which are incorporated below. During the process of drafting the amendments, it became evident that the approach discussed at that meeting was not workable due to complications in defining "trucking company" in the context of a unitary group. As a result, the FTB is proposing amendments that result in a streamlined and simplified regulation that eliminates references to "trucking company," relying instead on references to "trucking activities" which are defined in the amendments. Since the treatment was the same for property, payroll and receipts from trucking companies and non-trucking companies engaged in trucking activities, the conclusion was that the regulation could apply to both under the one definition of "trucking activities." The full text of the proposed amendments is provided at:

http://www.ftb.ca.gov/law/intParty/index.shtml.

A summary of the proposed changes follows below.

2. DISCUSSION

a. "Trucking Company" definition in CCR § 25137-11(b)(1):

Discussion opened in the first interested parties meeting focusing on whether the definition of "trucking company" in subsection (b) (1) needed to be clarified. Parties discussed advantages and disadvantages of three sample amendments provided in the discussion outline. Ms. McElhatton explained the facts of the recent California State Board of Equalization case, *Appeal of Swift Transportation.* Following extensive discussion, those present indicated their preference for additional language to be inserted at the end of the existing subsection (b)(1) of the trucking regulation. After further consideration attempting various amendments, it was found that further defining of the term "trucking company" complicated the regulation unduly.

Proposed amendment - delete "trucking company" definition at CCR § 25137-11(b)(1).

- Discussion

b. "Trucking Activity" definition in CCR §25137-11(b):

Discussion at the first interested parties meeting proceeded as to whether a definition of "trucking activities" should be added to subdivision (b) of the regulation, and if so, what form it should take. There was general discussion on the level of specificity required to have the regulation function as intended. Public response to the possibility of proposing a definition of "trucking activities" was generally neutral.

Proposed amendment - add definition (CCR § 25137-11(b)):

> (1) As used in this regulation, the term "~~trucking company"~~ "trucking activities" means the transportation of tangible personal property by motor carrier. ~~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.~~

- Discussion

c. Independent Contractors and the sales factor:

The attendees at the interested parties meeting were not opposed to continuing use of the interstate mileage ratio to assign receipts paid for shipments carried by independent contractors; therefore independent contractors are not being included in the proposed changes to this regulation. Currently, if the independent contractor drives the taxpayer's truck or trailer, then those miles are included in the interstate ratio and the truck or trailer is included in the property factor. However, payments to the independent contractor are not included in the payroll factor for that shipment as the independent contractor is not an employee. If the independent contractor is an owner-operator driving its own motor carrier, then the taxpayer does not include the motor carrier in the taxpayer's property factor since it does not own it, the cost of hiring the independent contractor is not included in the payroll factor since the owner-operator is not an employee, but the receipts paid to taxpayer for shipments carried by the owner-operator are included in the sales factor.

- Discussion

d. "Owner operator miles" definition in Regulation § 25137-11(b):

It has recently come to the attention of the FTB that the public may benefit from clarification of whether miles driven by owner operators should be included in the interstate ratio of the taxpayer hiring the owner operator. This situation was discussed at the prior interested parties meeting, during which some attendees stated that they include those miles as a matter of routine,

and others stated that they do not include those miles because they do not always have access to that information.

It is necessary to define "owner operator." An owner operator is a third party that drives his own tractor and trailer and does not drive a tractor or a trailer that is owned or leased by the taxpayer or related parties. It is acceptable for the taxpayer subject to this regulation to exclude owner operator miles that meet this definition from its own interstate ratio, but it is not required. The following proposed amendments address this situation.

Proposed amendments to Regulation §25137-11(b):

> (5) The "interstate ratio" is the ratio which the aggregate of the mobile property miles traveled in this state by units of mobile property which are located within more than a single state during the year bears to the aggregate of the total mobile property miles traveled by such property everywhere during the year. ***The "interstate ratio" may exclude "owner operator miles."***
>
> ***(6) "Owner operator miles" are miles driven by third parties who are not employees of the entity or group of entities subject to this regulation and who drive mobile property that is neither owned nor leased by the entity or group of entities subject to this regulation.***

- Discussion

e. New Proposed Approach: In order to memorialize the proposed approach of referring only to "trucking activities" and not to "trucking companies," it is necessary to make the following conforming changes:

Proposed amendment to CCR § 25137-11(a)(1) to set forth new approach:

> When ~~a trucking company~~an entity or group of entities engaged in a unitary business has income from sources both within and without this state ~~, the amount of business income from sources within this state shall be determined pursuant to this regulation.~~ and derives some or all of its business income from trucking activities, its business income from sources within this state which is derived from these trucking activities shall be determined pursuant to this regulation. In such cases, the first step is to determine what portion of the ~~trucking company's~~ income of the unitary business constitutes "business" income and what portion constitutes "nonbusiness" income under Revenue and Taxation Code, Section 25120 and Title 18, California Code of Regulations, Section 25120. Nonbusiness income is directly allocable to this state pursuant to the provisions of Revenue and Taxation Code Sections 25123 through 25127, inclusive. Business income derived from trucking activities is apportioned to this state

pursuant to the property, payroll and sales apportionment factors set forth in this regulation. Business income from other than trucking activities is apportioned pursuant to Revenue and Taxation Code sections 25128 through 25137. The sum of the items of nonbusiness income directly allocated to this state plus the amount of business income attributable to this state constitutes the amount of the taxpayer's entire net income which is subject to tax in this state.

Proposed amendment - delete CCR § 25137-11(a)(2) as unnecessary:

~~(2) When a taxpayer, or an affiliate of a taxpayer, other than a trucking company conducts trucking activities and the apportionment factors directly related to such activities are separately identified, such factor shall be assigned to the apportionment formula pursuant to subsection (c) herein.~~

Proposed amendment -- delete CCR § 25137-11(a)(3) as unnecessary or redundant:

~~(3) When a trucking company employs property, other than mobile property as defined herein, for the transport of goods between states, such property, and the personnel which operate or maintain it during the course of such movement, shall be assigned to the numerator of the property and payroll factors respectively pursuant to Regulations 25137-7 and 25137-9, in the circumstances of an air transport or railroad business, respectively, or Regulations 25129 and 25133 otherwise~~

Amend CCR § 25137-11(e) to correspond with subdivision (a):

(e) De minimis nexus standard. Notwithstanding any other provision ~~contained herein,~~of this regulation, this regulation shall not apply to require the apportionment of income to this state if the ~~trucking company~~entity or group of entities subject to this regulation does not engage in any of the following activities during the course of the ~~income~~taxable year: ~~neither~~:

(1) own~~s n~~or rent~~s~~ any real or personal property in this state, except mobile property which is operated within and without this state during the ~~income~~taxable year; ~~nor~~

(2) make~~s~~ any pick-ups or deliveries within this state; ~~nor~~

(3) travel~~s~~ more than twenty-five thousand *(25,000)* mobile property miles within this state; provided that the total mobile property miles traveled within this state during the ~~income~~taxable year does not exceed 3 percent of the total mobile property miles traveled in all

states by the entity or group of entities subject to this regulation~~trucking company during that period~~; ~~nor~~or

**(4)** make~~s~~ more than 12 trips into this state.

## 3. STAFF'S EXPECTATIONS FOR THE MEETING

FTB staff believes that the existing trucking regulation needs to be clarified and simplified. 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 has trucking activities.
(2) Delete the "trucking company" definition from CCR section 25137(b).
(3) 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)(1).
(4) Address any other concerns of interested parties.

## 4. POSSIBLE SOLUTIONS

The trucking regulation could be amended to incorporate the above additions and deletions in the manner set forth in the Discussion section. These amendments would clarify the apportionment method for the trucking industry and parties engaged in trucking activities, thereby easing compliance burdens and decreasing the potential for conflicts.

The FTB anticipates hosting an open discussion to address these proposed amendments and concerns that may be presented by the industry. Interested parties should discuss the proposed changes to the regulation governing apportionment 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.