

Request for Permission to Proceed with the Formal Regulatory Process
to Adopt Regulations sections 23663-0 through 23663-5, Addressing Credit Assignments which
Are Defective

The need for and potential structure of regulations under Revenue and Taxation Code section 23663 were first discussed by staff of the Franchise Tax Board at an Interested Parties Meeting held on October 1, 2012. Staff discussed a proposed structure for the regulations at a second interested parties meeting on December 5, 2013. Draft regulations were presented and discussed at a third interested parties meeting on June 12, 2014. Finally, based on comments received at the June 12, 2014 interested parties meeting, a sixty-day notice containing minor revisions to the draft regulations was posted to FTB's website and mailed to interested persons on August 29, 2014.

A. Background

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) and 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 tax 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, there is a need for clear rules to address what happens to credits listed as being assigned in such defective elections.

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.

B. The first interested parties meeting

At the first interested parties meeting, held on October 1, 2012, staff and attendees discussed the proper scope of what should be considered defective elections and the various instances in which defective elections may arise. Staff and attendees 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.

C. The second interested parties meeting

At the second interested parties meeting, held on December 5, 2013, staff presented a general framework for the regulation. Discussion focused on a series of proposed general rules setting forth the allocation of credits defectively assigned. The interested parties meeting also discussed proposed framework rules for alternative allocations and corrections available for certain defective elections.

D. The third interested parties meeting

Staff held a third interested parties meeting on June 12, 2014. At that meeting staff presented draft language as well as an explanation of the draft language, and received input from the public. On August 29, 2014, staff released a sixty-day notice with revised draft regulatory language which contained minor revisions based on input received at the third interested parties meeting. Staff has not received any comments or further suggested changes to this draft regulatory language.

Staff now requests permission to commence the formal regulatory process under the Administrative Procedure Act.

For purposes of Regulations 23663-1 through 23663-5, inclusive, the following definitions shall apply:

Section 23663-1 is adopted to read:

§ 23663-1. Definitions.

- (a) *Adjustment Date.* The term "adjustment date" shall mean the calendar date on which any adjustment under Regulations 23663-2 through 23663-5 is made by either the mailing by the Franchise Tax Board of a notice of corrected credit adjustments under Regulations 23663-2 through 23663-5, including a notice of proposed assessment under Revenue and Taxation Code section 19033, or the date on which the FTB receives a request which is later approved for either a correction of an error under Regulation 23663-4 or to apply Regulation 23663-2 or 23663-3. To the extent a final determination of a notice mailed by the FTB modifies, in whole or in part, the allocations reflected in that notice, then such modifications are treated as if made on the adjustment date on which that notice was mailed.
- (b) *Affiliated Corporation.* The term "affiliated corporation" shall mean any corporation that is a member of the same commonly controlled group within the meaning of Revenue and Taxation Code section 25105 as the assignor.
- (c) *Aggregated Eligible Assignees.* The term "aggregated eligible assignees" shall mean all eligible assignees assigned the same type of identical credits in the same taxable year.
- (d) *Assignee.* The term "assignee" shall mean any corporation (including a successor in interest) to whom an assignor has made an election to assign a credit under Revenue and Taxation Code section 23663, and shall also include any affiliated corporation (including a successor in interest) whose identifying information is listed on the defective assignment.
- (e) *Assignment.* The term "assignment" shall mean any election by an assignor to assign a credit to an assignee under the provisions of Revenue and Taxation Code section 23663. For purposes of Regulations 23663-1 through 23663-5, each election by an assignor to assign any credit to an assignee shall be treated as a separate assignment.
- (f) *Assignor.* The term "assignor" shall mean any taxpayer (including any successor in interest) who made an election to assign any credit to an assignee.
- (g) *Closed Year.* The term "closed year" shall mean any taxable year for which the Franchise Tax Board determines that it is precluded from mailing a notice of proposed deficiency assessment.
- (h) *Defective Assignment.*
 - (1) The term "defective assignment" shall mean any assignment under Revenue and Taxation Code section 23663 which does not comply with the requirements of

Revenue and Taxation Code section 23663, including, but not limited to, any assignment which:

- (A) fails to clearly identify the taxable year from which the credit to be assigned was earned by the assignor;
 - (B) fails to clearly identify the amount of any credit to be assigned;
 - (C) fails to clearly identify the type of credit intended to be assigned;
 - (D) assigns an amount of credit, or when aggregated with other assignments of the same credit in the same taxable year, which exceeds the amount of the assignor's eligible credits for that taxable year;
 - (E) assigns a credit that is not an eligible credit; or
 - (F) assigns a credit to an assignee who is not clearly identified or who is not an eligible assignee.
- (2) An assignor's intent or purpose in making an assignment is not relevant in determining whether an assignment is a defective assignment.
- (3) Examples.

Example 1: X reported that it has \$200 of 2010 R & D credits. On its original tax return for the 2010 taxable year, X elects to assign \$100 of the 2010 R & D credits to Y. Subsequently, X discovers that it only had \$120 of 2010 R & D credits. The assignment to Y is a not a defective assignment because X had the \$100 of 2010 R & D credits assigned to Y. The fact that X retained less 2010 R & D credits than it expected does not make the assignment to Y a defective assignment. Therefore, X retained \$20 of 2010 R & D credits and Y received \$100 of 2010 R & D credits.

Example 2: Assume the same facts as in Example 1, except that X elects to assign all \$200 of the 2010 R & D credits to Y. Subsequently, X discovers that it had \$300 of 2010 R & D credits. The assignment to Y is a not a defective assignment because X had all \$200 of the 2010 R & D credits assigned to Y. Even if X can demonstrate that X intended to assign all of its 2010 R & D credits to Y, the assignment of 2010 R & D credits to Y will be limited to \$200 of 2010 R & D credits because this is the amount assigned in the valid assignment.

Example 3: Assume the same facts as in Example 1, except that X discovers that X has no credits and the election to assign credits to Y was meant to have been made by its affiliate, E, the entity that had \$200 of 2010 R & D credits. No credits are transferred because the assignment of credits from X to Y was a defective assignment, and E did not elect to assign any credits. Therefore, E retained all \$200 of 2010 R & D credits, and Y received no 2010 R & D credits.

Example 4: Assume the same facts as in Example 1, except that X can demonstrate with contemporaneous evidence, such as emails, correspondence, memos and tax preparation workpapers, that X intended to assign no credits to Y and, instead, meant to assign the \$100 of 2010 R & D credits to M. Pursuant to paragraph (2), X's intent to assign to M is not relevant in determining whether the assignment is a defective assignment. Accordingly, the assignment of credits to Y is not a defective assignment. Therefore, X retained \$50 of 2010 R & D credits, Y received \$100 of 2010 R & D credits, and M received no credits.

Example 5: Assume the same facts as in Example 1, except that on X's original tax return for the 2010 taxable year, X did not elect to assign any credits, but Y's Form 3544A states that Y received \$100 of 2010 R & D credits from X in 2010. An assignment of credits in 2010 did not occur because X did not make an election to assign credits on its original tax return. Therefore, X retained \$200 of 2010 R & D credits and Y received no credits.

- (i) *Effective Date of the Adjustment.* The term "effective date of the adjustment" shall mean the date an allocation or reduction pursuant to Regulations 23663-2 through 23663-5 is treated as having occurred, which date shall be the same time that an assignor or eligible assignee would otherwise have retained or received the credits if the original assignment had reflected such an allocation.
- (j) *Election.* The term "election" shall mean an irrevocable election by an assignor to assign to an assignee a credit under the rules of Revenue and Taxation Code section 23663, in the form and manner specified by the FTB in forms and instructions, including FTB Form 3544 (and any successor form thereto).
- (k) *Eligible Assignee.* The term "eligible assignee" shall mean any affiliated corporation that is properly treated as a member of the same combined reporting group under Revenue and Taxation Code sections 25101 or 25110 as the assignor, determined as of (i) in the case of credits earned in taxable years beginning before July 1, 2008, June 30, 2008 and the last day of the taxable year of the assignor in which the eligible credit is assigned, or (ii) in the case of credits earned in taxable years beginning on or after July 1, 2008, the last day of the first taxable year in which the credit was allowed to the assignor and the last day of the taxable year of the assignor in which the eligible credit is assigned.
- (l) *Eligible Credit.* The term "eligible credit" shall mean any credit earned by a taxpayer (i) in a taxable year beginning on or after July 1, 2008, or (ii) in a taxable year beginning before July 1, 2008, provided that such pre-July 1, 2008 credit is eligible to be carried forward to the taxpayer's first taxable year beginning on or after July 1, 2008 under the provisions of Part 11 of the Revenue and Taxation Code.
- (m) *FTB.* The term "FTB" shall mean Franchise Tax Board.

- (n) *First Contact*. The term "first contact" shall mean the date the initial audit contact as defined in Regulation 19032 is sent to any assignor or assignee with respect to any taxable year in which an assignment of credits is made or in which credits which were the subject of an assignment are claimed.

- (o) *Identical Credit*. The term "identical credit" shall mean any credit that:
 - (1) is allowed under the same section of the Revenue and Taxation Code as any other credit,
 - (2) is originally allowed in the same taxable year, and
 - (3) in the case of certain credits, such as credits for activities in enterprise zones, program areas or similar geographic-based credits, is a credit based on activity in the same enterprise zone or program area.

- (p) *Parties to a Defective Assignment*. The term "parties to a defective assignment" shall mean the assignor and each potential assignee for all defective assignments the assignor made of the same type of identical credit in the same taxable year as the defective assignment.

NOTE: Authority cited: Section 19503, Revenue and Taxation Code.
Reference: Section 23663, Revenue and Taxation Code.

Section 23663-2 is adopted to read:

§ 23663-2. Assignor Has Less Credits Than Assigned.

- (a) *In General.* Pursuant to Regulation 23663-5(a), no assignor, assignee, or any other taxpayer shall claim, assign or otherwise benefit from a credit which was assigned in a defective assignment, unless that credit is allocated to the assignor or assignee under Regulations 23663-2 through 23663-5. This regulation provides default rules for the allocation of credits in defective assignments when an assignor assigns more credits than it has, and also includes alternative allocation rules that are available before first contact. This regulation shall generally apply after any correction made under Regulation 23663-4.
- (b) *Rules for Aggregating Defective Assignments.* If, in a single taxable year, an assignor makes multiple assignments of the same type of identical credit, these multiple assignments shall be aggregated for purposes of determining whether the assignments were defective assignments. If the assignor has less identical credits available than the aggregate amount assigned, then all assignments made in a single taxable year of that type of identical credit shall be defective assignments.

Example 1: X reported that it has \$200 of 2010 R & D credits. On its original tax return for the 2010 taxable year, X elects to assign \$100 of the 2010 R & D credits to Y and \$100 of the 2010 R & D credits to Z. Subsequently, X discovers that it only had \$120 of 2010 R & D credits. The assignments to Y and Z will be aggregated for purposes of determining whether both are defective assignments because both assignments involved the same type of identical credit and were made in the same taxable year. Both assignments will be treated as being defective assignments because X did not have the \$200 of 2010 R & D credits which were assigned to Y and Z in the taxable year of the assignment.

Example 2: Assume the same facts as in Example 1, except that the assignment to Z was made on X's 2011 original tax return. While the assignments to X and Y deal with the same type of identical credit, the assignments were made in different taxable years and so are not aggregated for purposes of applying subsection (b). (See also Regulation 23663-5(d)(1).)

Example 3: Assume the same facts as in Example 1, except that instead of assigning \$100 of 2010 R & D credits to Z in 2010, X assigned \$100 of 2009 R & D credits to Z on its 2010 tax return. The assignments to Y and Z are not aggregated under this section because the 2009 R & D credits and 2010 R & D credits are not identical credits.

Example 4: Assume the same facts as in Example 3, except that instead of assigning \$100 of 2009 R & D credits to Z, X assigned \$100 of 2010 low income housing credits to Z. The assignments to Y and Z are not aggregated under this section because the 2010 R & D credits and 2010 low income housing credits are not identical credits.

(c) *Default Allocation.* For an assignment which is a defective assignment because an assignor's amount of identical credits available for assignment is less than the amount of those identical credits assigned, such identical credits shall be allocated according to the following rules as of an adjustment date:

- (1) The assignor's identical credits, or remaining credits after adjusted by paragraph (2) if applicable, shall be allocated to the aggregated eligible assignees pro rata pursuant to the ratio of the identical credits assigned in the original defective assignments.
- (2) If the assignor or any aggregated eligible assignees claimed credits in a closed year, then subparagraphs (A) and (B) shall apply.
 - (A) First, the assignor's identical credits shall be allocated to the assignor and any aggregated eligible assignees to the extent they claimed such credits in a closed year; except that if the amount of identical credits claimed in closed years by the assignor and aggregated eligible assignees exceeds the assignor's amount of such identical credits available for assignment, then the credits shall be allocated to the assignor and aggregated eligible assignees pro rata based on the aggregate amount of credits each claimed in closed years.
 - (B) Second, any credits remaining after application of subparagraph (A) shall be allocated to the aggregated eligible assignees with the lowest pro rata allocation of credits until all aggregated eligible assignees have been allocated a pro rata portion of credits pursuant to the ratio of the identical credits assigned in the original defective assignments.

(3) *Examples.*

Example 5: X reported that it has \$350 of 2010 R & D credits. On its original tax return for the 2010 taxable year, X elects to assign \$200 of the 2010 R & D credits to Y and \$100 of the 2010 R & D credits to Z. Therefore, X retained \$50 of the 2010 R & D credits. Subsequently, X discovers that it only had \$150 of R & D credits in 2010. Pursuant to subsection (c)(1), as of the adjustment date, X's actual \$150 of 2010 R & D credits will be allocated to the aggregated eligible assignees (Y and Z) as follows: for Y – $\$200$ ($\$200$ is the total 2010 R & D credits assigned to Y) / $\$300$ ($\$300$ is the total 2010 R & D credits assigned to eligible assignees) x $\$150$ ($\$150$ is X's actual amount of 2010 R & D credits) = $\$100$ and for Z – $\$100$ / $\$300$ x $\$150$ = $\$50$. Therefore, under this regulation, X is treated as having retained no 2010 R & D credits, Y is treated as having received \$100 of 2010 R & D credits, and Z is treated as having received \$50 of 2010 R & D credits.

Example 6: Assume the same facts as in Example 5, except that X has claimed \$30 of 2010 R & D credits in a closed year as of the adjustment date. Pursuant to subsection (c)(2)(A), the first \$30 of 2010 R & D credits are allocated to X. Pursuant to subsection (c)(1), the remaining \$120 of 2010 R & D credits ($\$150$ less $\$30$) will be

allocated to the aggregated eligible assignees as follows: for Y – $\$200$ ($\$200$ is the total 2010 R & D credits assigned to Y) / $\$300$ ($\$300$ is the total 2010 R & D credits assigned to eligible assignees) x $\$120$ ($\$120$ is X's remaining amount of 2010 R & D credits) = $\$80$ and for Z – $\$100$ / $\$300$ x $\$120$ = $\$40$. Therefore, under this regulation, X is treated as having retained $\$30$ of 2010 R & D credits (the $\$30$ claimed in a closed year), Y is treated as having received $\$80$ of 2010 R & D credits, and Z is treated as having received $\$40$ of 2010 R & D credits.

Example 7: Assume the same facts as in Example 6, except that Y has also claimed $\$40$ of 2010 R & D credits in a closed year as of the adjustment date. Pursuant to subsection (c)(2)(A), $\$30$ of 2010 R & D credits are first allocated to X and $\$40$ of 2010 R & D credits to Y. Next, pursuant to subsection (c)(2)(B), of the remaining $\$80$ of 2010 R & D credits ($\$150$ less $\$70$), $\$20$ of 2010 R & D credits will be allocated to Z so that Y and Z end up with a pro rata allocation of credits using the original defective assignment amounts. $\$40$ ($\$40$ is the 2010 R & D credits already allocated to Y) / $\$200$ ($\$200$ is the total 2010 R & D credits assigned to Y) = 20% x $\$100$ ($\$100$ is the total 2010 R & D credits assigned to Z) = $\$20$. Finally, pursuant to subsection (c)(1), the remaining $\$60$ of 2010 R & D credits ($\$150$ less $\$70$ less $\$20$) will be allocated as follows: for Y – $\$200$ ($\$200$ is the total 2010 R & D credits assigned to Y) / $\$300$ ($\$300$ is the total 2010 R & D credits assigned to aggregated eligible assignees) x $\$60$ ($\$60$ is X's remaining amount of 2010 R & D credits) = $\$40$ and for Z – $\$100$ / $\$300$ x $\$60$ = $\$20$. Therefore, under this regulation, X is treated as having retained $\$30$ of 2010 R & D credits, Y is treated as having received $\$80$ of 2010 R & D credits and Z is treated as having received $\$40$ of R & D credits.

Example 8: Assume the same facts as in Example 5, except that instead of assigning credits to Y and Z in the amounts listed, X assigns $\$150$ of the 2010 R & D credits to Y, $\$100$ of the 2010 R & D credits to Z, and $\$50$ of the 2010 R & D credits to T. As of the adjustment date, Y has claimed $\$90$ of 2010 R & D credits in a closed year and Z has also claimed $\$10$ of 2010 R & D credits in a closed year. Pursuant to subsection (c)(2)(A), as of the adjustment date, X's actual $\$150$ of 2010 R & D credits will be allocated to the aggregated eligible assignees (Y, Z and T) as follows: $\$90$ of 2010 R & D credits are first allocated to Y and $\$10$ of 2010 R & D credits to Z. Therefore, after this first step, Y, Z and T have received the following percentage of the credits assigned to them in the original defective assignments: Y – 60% ($\$90$ / $\$150$), Z – 10% ($\10 / $\$100$) and T – 0% ($\0 / $\$50$).

Next, pursuant to subsection (c)(2)(B), $\$5$ of 2010 R & D credits (10% x 50 credits assigned to T) will be allocated to T so that T has the same 10% allocation as Z. Z and T now both have a 10% allocation of the 2010 R & D credits assigned to them in the original defective assignments. The remaining $\$45$ of 2010 R & D credits ($\$150$ less $\$100$ less $\$5$) will be allocated to Z and T until they both have received a 60% allocation of 2010 R & D credits. The credits to be allocated to Z and T are calculated as follows:

- (i) for Z – 60% x $\$100$ = $\$60$ less the $\$10$ already allocated to Z = $\$50$, and
- (ii) for T – 60% x $\$50$ = $\$30$ less the $\$5$ already allocated to Z = $\$25$.

Therefore, a total of \$75 of 2010 R & D credits are to be allocated to Z and T.

However, because X only has \$45 of 2010 R & D credits remaining to be allocated to the aggregate eligible assignees after the earlier adjustments (instead of \$75), the \$45 of 2010 R & D credits are allocated pro rata between Z and T as follows:

- (iii) for Z – $\$45 \times \100 (the amount of credits assigned to Z in the original assignment) / $\$150$ (total credits assigned to Z and T on the original assignment) = \$30 of 2010 R & D credits to go to Z, and
- (iv) for T – $\$45 \times \$50 / \$150 = \15 of 2010 R & D credits to go to T.

Therefore, under this regulation, X is treated as having retained \$0 of 2010 R & D credits, Y is treated as having received \$90 of 2010 R & D credits, Z is treated as having received \$40 of 2010 R & D credits and T is treated as having received \$20 of 2010 R & D credits.

- (d) *Alternative Allocation.* Any request for an alternative allocation of a defective assignment under this regulation shall meet all of the following conditions:
 - (1) *Maximum Credits to Assignor.* The alternative allocation shall not allocate to the assignor a higher amount of identical credits than the amount the assignor would have retained had all defective assignments of identical credits aggregated under subsection (b) been valid, as increased by the amount of identical credits otherwise allocated to the assignor pursuant to Regulation 23663-3.
 - (2) *Maximum Credits to Assignees.* The alternative allocation shall not allocate to any eligible assignee a higher amount of identical credits than the amount assigned to such eligible assignee in the original defective assignment.
 - (3) *Eligible Parties.* The alternative allocation shall only allocate credits to the assignor and those aggregated eligible assignees of the defective assignment who have joined the assignor's request for an alternative allocation.
 - (4) *Included Credits.* An alternative allocation shall be limited to the type of identical credit which was assigned in the defective assignment for which an alternative allocation is being requested.
 - (5) *Excluded Credits.* An alternative allocation shall not include the following:
 - (A) The aggregate amount of identical credits assigned in the same taxable year to assignees who do not join in the assignor's request for an alternative allocation, except to the extent Regulations 23663-3 and 23663-4 have already allocated such amounts to the assignor.

- (B) The amount of identical credits which would create the actuality or possibility of that amount of identical credits being claimed more than once if they were to be included in the alternative allocation.
- (6) *Closed Years.* An alternative allocation shall first allocate identical credits pursuant to subsection (c)(2).
- (7) *First Contact.* An assignor may only request application of this subsection before first contact.
- (8) *Limitation on Requests.* The assignor or any members of the same combined reporting group (pursuant to Revenue and Taxation Code sections 25101 or 25110) shall not have requested another alternative allocation in any other taxable year within a four taxable year period. For purposes of the preceding sentence, the four taxable year period means the taxable year of the defective assignment for which the alternative allocation is being requested, and the three taxable years immediately preceding that taxable year and the three taxable years immediately following that taxable year.
- (9) *Examples.*

Example 9: X reported that it has \$350 of 2010 R & D credits. On its original tax return for the 2010 taxable year, X elects to assign \$200 of the 2010 R & D credits to Y and \$100 of the 2010 R & D credits to Z. Therefore, X retained \$50 of the 2010 R & D credits. Subsequently, X discovers that it only generated \$150 of R & D credits in 2010. X makes a request, joined by Y and Z, for an alternative allocation under this subsection to allocate X's \$150 of 2010 R & D credits from X's aggregated defective assignments as follows: \$50 of 2010 R & D credits to X and \$100 of 2010 R & D credits to Y. Assuming all other conditions of this subsection are satisfied, the FTB would approve X's request; therefore, under this regulation, X is treated as having retained \$50 of 2010 R & D credits, Y is treated as having received \$100 of 2010 R & D credits, and Z is treated as having received \$0 of R & D credits.

Example 10: Assume the same facts as in Example 9, except that X, joined by Y and Z, requests an alternative allocation under this subsection to allocate all of X's \$150 of 2010 R & D credits from its aggregated defective assignments to X. Under these facts, the FTB would reject X's request because under paragraph (1) it would result in X being treated as retaining more 2010 R & D credits than X would have retained had the defective assignments been valid.

Example 11: Assume the same facts as in Example 9, except that X, joined by Y and Z, requests to allocate X's \$150 of 2010 R & D credits from its aggregated defective assignments to K. Under these facts, the FTB would reject X's request because under paragraph (3), K is not an aggregated eligible assignee.

Example 12: X reported that it has \$200 of 2009 R & D credits and \$200 of 2010 R & D credits. On its original tax return for the 2010 taxable year, X elects to assign \$100

of the 2009 R & D credits to Y and \$100 of the 2010 R & D credits to Z. Therefore, X retained \$100 of the 2009 R & D credits and \$100 of the 2010 R & D credits. Subsequently, X discovers that it only generated \$50 of 2009 R & D credits and \$40 of 2010 R & D credits. X makes a request, joined by Y and Z, to allocate \$50 of 2009 R & D credits and \$40 of 2010 R & D credits to Y. Under these facts, the FTB would reject X's request because under paragraph (3) of this subsection, X and Y are not aggregated eligible assignees; therefore, the identical credits in X's defective assignment to Y cannot be combined with the identical credits in X's defective assignment to Z.

Example 13: Assume the same facts as in Example 9, except that X, only joined by Z, requests to allocate \$100 of X's actual \$150 of 2010 R & D credits from its aggregated defective assignments to Z. Under these facts, the FTB would reject X's request because under paragraph (5) of this subsection, X has only \$50 of 2010 R & D credits available for an alternative allocation (X's actual \$150 of 2010 R & D credits reduced by the \$100 of 2010 R & D credits assigned to Y who did not join the request for an alternative allocation). See also Regulation 23663-5(e)(3).

Example 14: X reported that it has \$350 of R & D credits generated in 2010. On its original tax return for the 2010 taxable year, X elects to assign \$200 of the 2010 R & D credits to Y and \$100 of the 2010 R & D credits to Z. Therefore, X retained \$50 of the 2010 R & D credits. Subsequently, X discovers that it only generated \$150 of R & D credits in 2010. The FTB mails correspondence to Y regarding taxable year 2010. Subsequently, X mails a request for an alternative allocation to the FTB. Under these facts, the FTB would reject X's request because it was sent after first contact.

Example 15: Assume the same facts as in Example 9, except that in 2017, six taxable years after the alternative allocation adjustment, X requests an alternative allocation for a defective assignment made on X's original 2008 tax return. Under these facts, the FTB would reject X's request for the 2008 alternative allocation because pursuant to paragraph (8) of this subsection, the second alternative allocation request is for an alternative allocation for a taxable year (2008) that is within the four taxable year period of the alternative allocation request made for the 2010 taxable year.

- (e) *Request to Apply this Regulation.* For rules governing the form and manner of any request by an assignor to apply this regulation, see Regulation 23663-5(f).

NOTE: Authority cited: Section 19503, Revenue and Taxation Code.
Reference: Section 23663, Revenue and Taxation Code.

Section 23663-3 is adopted to read:

§ 23663-3. Other Defective Assignments.

- (a) *In General.* Pursuant to Regulation 23663-5(a), no assignor, assignee, or any other taxpayer shall claim, assign or otherwise benefit from a credit which was assigned in a defective assignment, unless that credit is allocated to the assignor or assignee under Regulations 23663-2 through 23663-5. This regulation provides rules for the allocation of credits in all defective assignments not covered by Regulation 23663-2, relating to situations where an assignor assigns more credits than it has, and also includes additional restrictions for certain types of defective assignments. This regulation shall generally apply after any correction made under Regulation 23663-4.
- (b) *Default Allocation.* For an assignment which is a defective assignment for any reason other than that listed in Regulation 23663-2(c), relating to situations where an assignor assigns more credits than it has, or subsection (c) of this regulation, the following allocation rules shall apply as of an adjustment date:
- (1) The identical credits listed as assigned in the defective assignment, or remaining credits after reduction by paragraphs (2) and (3), if applicable, shall be allocated to the assignor.
 - (2) The identical credits listed as assigned in the defective assignment shall be reduced by the amount of such identical credits claimed in a closed year by the assignee.
 - (3) If a defective assignment has multiple potential assignees:
 - (A) Subsection (b)(2) shall apply to each potential assignee, and
 - (B) If the application of subparagraph (A) would reduce an assignor's identical credits by an amount in excess of the identical credits listed as being assigned on the defective assignment, the assignor's other identical credits shall be reduced as of the taxable year of the defective assignment.
 - (4) *Examples.*

Example 1: X reported that it has \$350 of 2010 R & D credits. On its original tax return for the 2010 taxable year, X elects to assign \$200 of the 2010 R & D credits to Y and \$100 of the 2010 R & D credits to Z. Therefore, X retained \$50 of 2010 R & D credits. Further assume that Y was not an eligible assignee. Also, Y has claimed \$30 of 2010 R & D credits in a closed year as of the adjustment date. Pursuant to subsection (b)(2), as of the adjustment date, the \$200 of 2010 R & D credits assigned to Y will be reduced by the \$30 which Y claimed in a closed year and the remainder of \$170 will be allocated to X. Therefore, assuming any additional restrictions under this regulation have been satisfied, X is treated as having retained \$220 of 2010 R & D

credits (\$50 plus \$170), Y is treated as having received no 2010 R & D credits, and Z received \$100 of 2010 R & D credits.

Example 2: X reported that it has \$350 of 2010 R & D credits. On its original tax return for the 2010 taxable year, X elects to assign \$200 of the 2010 R & D credits. However, X's assignment lists the name of Y but FEIN of Z. Subsequently, the FTB mails a notice of proposed assessment to X at which time Y has claimed \$150 of 2010 R & D credits in closed years and Z has claimed \$60 of 2010 R & D credits in closed years. The 2010 assignment is a defective assignment because it is not clear if Y or Z is the assignee. Under subsection (b)(3), X's \$350 of 2010 R & D credits are reduced by the \$210 (\$150 + \$60) of 2010 R & D credits claimed by Y and Z in closed years. Therefore, X is treated as having retained \$140 of 2010 R & D credits (\$350 less \$210), and Y and Z are treated as having received no 2010 R & D credits.

(c) *Unspecified Type of Identical Credit or Amount.* In the case of any assignment which is a defective assignment under paragraphs (1), (2) or (3) of this subsection, the rules of paragraphs (4) through (7) shall apply in lieu of subsection (b).

(1) The type of identical credits being assigned is unspecified.

(2) The amount of identical credits being assigned is unspecified.

(3) Both paragraphs (1) and (2) apply.

(4) If the assignee claimed credits in a closed year, then as of an adjustment date, the assignor's credits listed as assigned in the defective assignment and the assignor's other credits as of the effective date of the adjustment shall be reduced as follows:

(A) First, the assignor's unclaimed and unassigned credits shall be reduced.

(i) The assignor's credits shall be reduced beginning with the oldest unclaimed and unassigned credits.

(ii) If after reducing all of the assignor's oldest credits, the amount of credits reduced does not equal the amount of credits claimed by the assignee in a closed year, then the assignor's next oldest unclaimed and unassigned credits shall be reduced. This reduction shall continue until the assignor's credits have been reduced in an amount equal to the amount of credits claimed by the assignee in a closed year.

(iii) If an assignor has multiple types of unclaimed and unassigned identical credits which were generated in the same taxable year, then each type of identical credit shall be reduced pro rata based on the assignor's amount of such identical credits.

(B) Second, if after reducing all of an assignor's unclaimed and unassigned credits pursuant to subparagraph (A), an assignor's credits have not been

reduced in an amount equal to the credits claimed by an assignee in a closed year, then the following shall apply:

- (i) The assignor's claimed credits shall be reduced beginning with the assignor's most recent taxable year for which the extended filing date has passed and which is not a closed year.
 - (ii) If after reducing all of the assignor's credits claimed in its most recent taxable year for which the extended filing date has passed, the amount of credits reduced does not equal the amount of credits claimed by the assignee in a closed year, then the assignor's claimed credits in its next most recent taxable year for which the extended filing date has passed and which is not a closed year shall be reduced. This reduction shall continue until the assignor's credits have been reduced in an amount equal to the amount of credits claimed by the assignee in a closed year.
 - (iii) If an assignor has multiple types of claimed identical credits in a taxable year, then each type of identical credit shall be reduced pro rata based on the assignor's amount of such identical credits.
- (C) Finally, if after reducing all of an assignor's credits claimed in taxable years which are not closed years pursuant to subparagraph (B), an assignor's credits have not been reduced in an amount equal to the credits claimed by an assignee in a closed year, then the following shall apply:
- (i) The assignor's assigned credits shall be reduced beginning with the assignor's most recent taxable year for which the extended due date for filing has passed and which is not a closed year.
 - (ii) If after reducing all of the assignor's credits assigned in its most recent taxable year for which the extended due date for filing has passed and which is not a closed year, the amount of credits reduced does not equal the amount of credits claimed by the assignee in a closed year, then the assignor's assigned credits in its next most recent taxable year for which the extended filing date has passed and which is not a closed year shall be reduced. This reduction shall continue until the first of the following occurs 1) the assigned credits have been reduced through the taxable year subsequent to the taxable year of the defective assignment or 2) the assignor's credits have been reduced in an amount equal to the amount of credits claimed by the assignee in a closed year.
 - (iii) If an assignor has multiple assignments in a taxable year, then each such assignment shall be reduced pro rata based on the amount of credits assigned over the total assignments in that taxable year.
- (D) Any assigned credits reduced pursuant to subparagraph (C) shall be treated as if such credits had never been assigned, so that the assignee listed on the assignment shall not be entitled to claim or otherwise benefit from such credits.

- (5) If the defective assignment clearly identifies the amount of credits being assigned, then the assignor's credits reduced under paragraph (4) shall be limited to such amount of credits for each potential assignee.
- (6) If the defective assignment does not clearly identify the type of identical credit being assigned only because it does not clearly identify the year such credits were generated, then subparagraphs (A) through (C) of paragraph (4) shall first be applied in regard to that partially identified type of identical credit.
- (7) If the defective assignment clearly identifies the type of identical credit being assigned, then subparagraphs (A) through (C) of paragraph (4) shall first be applied in regard to that identified type of identical credit.
- (8) *Examples.*

Example 3: X reported that it has \$300 of 2010 R & D credits, \$100 of 2010 low income housing ("LIH") credits, and \$200 of 2011 R & D credits. On its original tax return for the 2011 taxable year, X elects to assign \$200 of R & D credits to Y, except that the assignment lists the taxable year the credit was generated as "various". The assignment to Y is a defective assignment because the assigned credits did not identify the year the credits were generated. Y has claimed \$100 of 2011 R & D credits in a closed year as of the adjustment date. Y has not shown that it earned or received the 2011 R & D credits from any other source. Pursuant to paragraphs (4) and (6), as of the adjustment date, X's 2010 R & D credits are reduced by \$100. Notably, the year in which Y listed the R & D credits as generated does not impact the application of this subsection. Therefore, under this regulation, X is treated as having retained \$200 of 2010 R & D credits, \$100 of 2010 LIH credits, and \$200 of 2011 R & D credits, and Y is treated as having received no credits.

Example 4: Assume the same facts as in Example 3, except that in addition to not listing the year of R & D credits being assigned, X's assignment of credits to Y also does not list the amount of credits being assigned. Assume further that instead of having claimed \$100 of 2011 R & D credits, Y has claimed \$300 of 2010 R & D credits in a closed year as of the adjustment date, and X has also claimed \$300 of 2010 R & D credits and \$50 of 2010 LIH credits in a taxable year which is not a closed year as of the adjustment date. Pursuant to paragraphs (4) and (6), the following reductions to X's credits occur as of the adjustment date: first, X's \$200 of unclaimed, unassigned 2011 R & D credits are reduced to \$0 (\$300 claimed by Y in a closed year less \$200 of X's 2011 R & D credits = \$100 of credits remaining to be reduced). Next, X's \$50 of unclaimed, unassigned 2010 LIH credits are reduced to \$0 (\$100 of credits remaining to be reduced less \$50 of X's 2010 LIH credits = \$50 of credits remaining to be reduced). Finally, \$50 of X's claimed 2010 R & D credits are reduced, which may result in an additional assessment to X. Therefore, under this regulation, X is treated as having retained \$250 of claimed 2010 R & D credits, \$50 of claimed 2010 LIH, and no 2011 R & D credits, and Y is treated as having received no credits.

Example 5: Assume the same facts as in Example 4, except that as of the adjustment date, X has subsequently generated \$100 of 2013 R & D credits. The result would be the same as the result in Example 4 because under paragraph (4) the reduction is limited to the assignor's credits as of the effective date of the adjustment.

Example 6: X reported that it has \$175 of 2010 R & D credits, \$100 of 2010 low income housing ("LIH") credits, and \$300 of 2011 R & D credits. On its original tax return for the 2011 taxable year, X elects to assign credits to Y, with the credits being assigned listed as "various" and the amount as \$300. On its original tax return for the 2012 taxable year, X elects to assign \$200 of 2011 R & D credits to Z. On its original tax return for the 2013 taxable year, X elects to assign \$50 of 2010 R & D credits to W and \$100 of 2011 R & D credits to Z. The adjustment date occurs in 2016. As of the adjustment date, Y has claimed \$300 of 2011 R & D credits in a closed year, and X has claimed \$75 of 2010 R & D credits in 2014 which is not a closed year. Y has not shown that it earned or received the 2011 R & D credits from any other source.

Under the assumed facts above, the 2011 assignment to Y is a defective assignment because the credits being assigned were not identified. Under this subsection, X's credits are reduced by the \$300 of credits Y claimed in a closed year. Pursuant to paragraph (4)(A), as of the adjustment date, X's oldest unclaimed and unassigned credits are reduced first. Accordingly, X's \$50 of unclaimed, unassigned 2010 R & D credits and \$100 of 2010 LIH credits are first reduced. After these reductions, the \$300 of credits claimed by Y has been reduced to \$150 (\$300 less \$150 = \$150 of credits remaining to be reduced). Next, pursuant to paragraph (4)(B), X's \$75 of claimed 2010 R & D credits are reduced, which may result in X being assessed additional tax for 2014 (\$300 less \$150 less \$75 = \$75 of credits remaining to be reduced). Finally, because X assigned both 2010 R & D credits and 2011 R & D credits in 2013, and the total credits assigned (\$150) exceeds the remaining \$75 of credits to be reduced, the 2013 assignments to Z and W shall be reduced pro rata pursuant to paragraph (4)(C) by the following amounts:

- (i) Z's assigned \$100 of 2011 R & D credits are reduced by \$50, calculated as \$75 credits to be reduced x \$100 (2011 R & D credits assigned to Z in 2013) / \$150 (total credits assigned by X in 2013).
- (ii) W's assigned \$50 of 2010 R & D credits are reduced by \$25, calculated as \$75 credits to be reduced x \$50 (2010 R & D credits assigned to W) / \$150 (total credits assigned by X in 2013).

Therefore, under this regulation, X is treated as having retained no 2010 R & D credits, no 2010 LIH credits, and no 2011 R & D credits, Y is treated as having received no credits, the 2012 assignment of \$200 of 2010 R & D credits to Z was valid, the otherwise valid 2013 assignment of \$100 of 2011 R & D credits to Z is reduced to \$50 of 2011 R & D credits, and the otherwise valid 2013 assignment of \$50 of 2010 R & D credits to W is reduced to \$25 of 2010 R & D credits.

Example 7: X reported that it has \$300 of 2010 R & D credits and \$200 of 2011 low income housing ("LIH") credits. On its original tax return for the 2011 taxable year, X

elects to assign credits; however, X's assignment lists the name of Y but FEIN of Z, and also the assignment does not list the type or amount of credits being assigned. As of the adjustment date in 2016, Y has claimed \$150 of 2010 R & D credits in closed years and Z has claimed \$300 of 2010 R & D credits in closed years. Y and Z have not shown that they earned or received the claimed credits from any other source. The 2011 assignment is a defective assignment because the assignee is uncertain and the credits being assigned were not identified. Under this subsection, as of the adjustment date, X's credits are reduced based on the total amount of \$450 of credits claimed by Y and Z in closed years. First, X's \$300 of 2010 R & D credits are reduced by \$300 (\$450 less \$300 = \$150 of credits remaining to be reduced). Next, X's \$200 of 2011 LIH credits are reduced by \$150. Therefore, under this regulation, X is treated as having retained no 2010 R & D credits and \$50 of 2011 LIH credits, and Y and Z are treated as having received no credits.

- (d) *Ineligible Assignees.* For the portion of any defective assignment which is a defective assignment only because the assignee is not an eligible assignee, the portion of any such credits shall not be allocated to the assignor, so that the assignor shall neither claim nor assign such credits, unless the FTB approves a request under paragraph (1), or the assignor and assignee meet the conditions set forth in paragraph (2).
 - (1) The assignor and assignee shall make a request, in the form and manner specified under Regulation 23663-5(f), that the FTB determine that the assignee was not an eligible assignee for purposes of this regulation.
 - (A) The FTB shall have six months from the receipt of the request to approve the request, unless a longer time period is agreed upon by the FTB, the assignor and the assignee. The FTB may request any information from the assignor and assignee as it deems necessary to make this determination, including any information that might otherwise be requested under Revenue and Taxation Code section 19032 and the regulations thereunder.
 - (B) At or before the end of the time period specified in subparagraph (A), the FTB shall notify the assignor and the assignee in writing of its determination; otherwise, the request shall be deemed rejected.
 - (C) If the FTB approves the request that an assignee be found to not be an eligible assignee, then the credits assigned to the assignee in the defective assignment shall be allocated in accordance with subsection (b) and shall be binding on all parties and may not later be changed, even if it is later determined that the assignee was in fact an eligible assignee.
 - (D) As a condition for approval of a request under this paragraph, the assignor and assignee shall agree that they will not later assert the assignor and assignee are unitary, including filing a claim for refund, for the taxable year or years for which the request asserted the assignee was not an eligible assignee.

- (E) The determination made by the FTB under this subsection shall be limited to Revenue and Taxation Code section 23663 and the regulations thereunder, and no inference shall be drawn for any other purpose under Part 11 of the Revenue and Taxation Code.
- (2) If the FTB asserts that an assignee is not an eligible assignee, then the limitations of this subsection shall not be removed until a final determination that the assignee is not an eligible assignee has been made for both the assignor and assignee. If, after an FTB assertion in this paragraph, a final determination is made for both the assignor and assignee that the assignee was not an eligible assignee, then the credits in the defective assignment shall neither be claimed by nor benefit the assignee under any circumstances.
- (3) For purposes of paragraph (2), a final determination means the date on which a deficiency becomes final pursuant to Revenue and Taxation Code section 19049 or an action on a refund claim becomes final under Revenue and Taxation Code section 19321.
- (4) *Examples.*

Example 8: X reported that it has \$100 of 2010 R & D credits. On its original tax return for the 2010 taxable year, X elects to assign \$100 of the 2010 R & D credits to Y. Subsequently, the FTB mails a notice of proposed assessment to X and Y stating that X and Y were not unitary in 2010 and assessing X \$150 of additional tax liability for other reasons. The assignment of credits from X to Y is a defective assignment because Y is not an eligible assignee. X and Y protest the notice of proposed assessment. Under this subsection, as of the adjustment date, Y would be treated as having received no 2010 R & D credits and X would be treated as having retained \$100 of 2010 R & D credits, but under this subsection, X would not be allowed to claim those \$100 of 2010 R & D credits against its \$150 of additional tax liability until a final determination of whether Y was an eligible assignee has been made for both X and Y.

Example 9: Assume the same facts as in Example 8, except that the notice of proposed assessment is mailed to X only. X does not protest the notice of proposed assessment, so that the notice goes final. Under this subsection, X is still not allowed to claim or assign the \$100 of 2010 R & D credits because a final determination has not been made for Y as to whether Y is an eligible assignee.

Example 10: X reported that it has \$100 of 2010 R & D credits. On its original tax return for the 2010 taxable year, X elects to assign \$100 of the 2010 R & D credits to Y. The assignor and assignee make a request under paragraph (1) that Y be found to not be an eligible assignee on the basis that X and Y were not unitary in 2010. The FTB approved X and Y's request. Subsequently, Y files amended tax returns asserting that it was unitary with X in 2010. The FTB would reject Y's amended tax returns because Y agreed under paragraph (1)(D) that it would not assert that it was unitary with X for 2010.

Example 11: Assume the same facts as in Example 10, except that two years after the FTB approves the request in Example 10, the FTB audits X and Y and determines that X and Y were unitary in 2010. The allocation of credits to X under the approved request would be unaffected by the FTB's subsequent determination and the \$100 of 2010 R & D credits would remain with X and be available to be claimed or assigned as of the adjustment date (the date the FTB approved the request in Example 10).

- (e) *Request to Apply this Regulation.* For rules governing the form and manner of any request by an assignor to apply this regulation, see Regulation 23663-5(f).

NOTE: Authority cited: Section 19503, Revenue and Taxation Code.
Reference: Section 23663, Revenue and Taxation Code.

Section 23663-4 is adopted to read:

§ 23663-4. Correction of Error.

- (a) *In General.* Pursuant to Regulation 23663-5(a), no assignor, assignee, or any other taxpayer shall claim, assign or otherwise benefit from a credit which was assigned in a defective assignment, unless that credit is allocated to the assignor or assignee under Regulations 23663-2 through 23663-5. Under this regulation, parties to a defective assignment may, prior to the filing of their subsequent taxable year's tax return, request permission to correct errors in an assignment made pursuant to Revenue and Taxation Code section 23663. For example, parties to a defective assignment that filed original assignment forms with unclear, inconsistent or incomplete information, or forms containing erroneous assignors, assignees, credit types or credit amounts, may request permission to correct such errors subject to the limitations and requirements of this regulation.

Example 1: In its election to assign credits, X includes the name of Y but the FEIN of Z. This is a defective assignment because the identity of the assignee is uncertain. Under these facts and assuming the other requirements of this regulation were met, X would be able to request correction of the defective assignment.

Example 2: X reported that it has \$200 of 2010 R & D credits. On its original tax return for the 2010 taxable year, X elects to assign \$10 of the 2010 R & D credits to Y. However, X now asserts that it intended to assign \$100 of the 2010 R & D credits to Y. No correction would be allowed under this regulation because X's assignment to Y was not a defective assignment.

- (b) *Requirements to Request a Correction of an Error.* An assignor may request the correction of an error in the form and manner specified in Regulation 23663-5(f), provided all of the following conditions are met:
- (1) The assignment for which a correction is requested is a defective assignment;
 - (2) All parties to a defective assignment consent in writing to such a correction;
 - (3) The assignor demonstrates by clear and convincing objective evidence contemporaneous to the time of the original assignment that an error was made;
 - (4) The assignor demonstrates by clear and convincing objective evidence contemporaneous to the time of the original assignment that the correction is consistent with the assignor's original intent;
 - (5) The corrected assignment meets the requirements of a valid assignment as set forth in Revenue and Taxation Code section 23663, except for the requirement under Revenue and Taxation Code section 23663(c) that the assignment must be made on an original return; and

(6) The request is made no later than 60 days before the earlier of the filing date or the extended due date of the assignor's or any parties to the defective assignment's subsequent taxable year's tax return following the taxable year of the original assignment.

(7) *Examples.*

Example 3: X reported that it has \$200 of 2010 R & D credits. On its original tax return for the 2010 taxable year, X elects to assign \$1,000 of the R & D credits to Y. X's assignment form shows X as having \$200 of 2010 R & D credits, assigning \$1,000 of these credits to Y and retaining \$100 of these credits. X intended to assign \$100 of the credits to Y. Here, the assignment is defective due to the error in the amount of credits X assigned to Y on the original assignment form. If X satisfied all the other requirements under this regulation, X would be able to request use of this regulation to correct the defective assignment to Y of \$1,000 of 2010 R & D credits to \$100 of the credits.

Example 4: Assume the same facts as in Example 3, except that on its original tax return for the 2010 taxable year, X assigned \$100 of the 2010 R & D Credits to Y and \$100 of the 2010 R & D credits to Z. Three months after filing its 2010 tax return, X requests a correction of an error and has contemporaneous evidence sufficient to meet the conditions in paragraphs (3) and (4) to demonstrate that X intended to assign \$100 of 2010 R & D credits to W, and not Z. Under these facts, X would not be able to use this regulation because the original assignment to Z was not a defective assignment.

Example 5: In its election to assign credits, X includes the name of Y but the FEIN of Z. X requests a correction of an error to show that W was the intended assignee, and provides an affidavit from X's chief financial officer stating that X intended to assign credits to W. Under these facts, X would not be able to use this regulation because it did not provide contemporaneous evidence as required by paragraphs (3) and (4).

Example 6: Assume the same facts as in Example 5, except that instead of the affidavit, X provides forms and schedules which are consistent with the requested correction and were filed with the original tax return in the year of the defective assignment, contemporaneous tax preparation workpapers, emails, correspondence, and memos as evidence to demonstrate that W was the intended assignee. Under these facts and assuming the other requirements of this regulation were met, X would be able to request a correction of an error under this regulation to correct the assignment substituting W for Z.

Example 7: Assume the same facts as in Example 5, except that instead of the affidavit, X provides W's Form 3544A which was filed with the original tax return in the year of the defective assignment and which shows W as receiving the assigned credits from X. X also provides contemporaneous tax preparation workpapers. Under these facts and assuming the other requirements of this regulation were met, X would be

able to request a correction of an error under this regulation because it provided contemporaneous evidence sufficient to meet the conditions in paragraphs (3) and (4).

Example 8: Assume the same facts as in Example 7, except that W, Y and Z's Forms 3544A all show that they each received the same identical credits from X. Under these facts, X would not be able to use this regulation to correct the defective assignment because the Forms 3544A that were provided are conflicting and thus X did not provide clear and convincing objective evidence of the assignor's original intent as required in paragraph (4).

Example 9: Assume the same facts as in Example 7, except that instead of providing W's Form 3544A, X only provides contemporaneous tax preparation workpapers that do not include copies of contemporaneous emails, correspondence, and memos demonstrating that W was the intended assignee. X provides no other contemporaneous evidence. Under these facts, X would not be able to use this regulation because, for purposes of this regulation, tax preparation workpapers alone do not provide clear and convincing objective evidence of the assignor's original intent as required in paragraph (4).

- (c) *Excluded Credits.* A correction of an error shall not be made for any credits to which such correction would result in the actuality or possibility of the credits being claimed more than once.
- (d) *Additional Limitations.* For defective assignments made in taxable years beginning on or after January 1, 2017, the following limitations shall apply:
 - (1) The amount of credits that may be allocated pursuant to a request for a correction of an error under this regulation shall not exceed the amount originally assigned in the defective assignment for which a correction is requested under this regulation.
 - (2) If the assignor or any members of the same combined reporting group (pursuant to Revenue and Taxation Code sections 25101 or 25110) have requested another correction of an error in any other taxable year within a four taxable year period, then no additional correction of an error shall be allowed for the defective assignments listed in paragraph (3). For purposes of the preceding sentence, the four taxable year period means the taxable year of the defective assignment for which the correction of an error is being requested, and the three taxable years immediately preceding that taxable year and the three taxable years immediately following that taxable year.
 - (3) Paragraph (2) shall apply to the following defective assignments:
 - (A) Wrong assignor;
 - (B) Wrong, ineligible or unspecified assignee;
 - (C) Wrong or unspecified type of identical credit; or
 - (D) Wrong or unspecified amount of credits was assigned.

(4) *Examples.*

Example 10: X reported that it has \$100 of 2010 R & D credits. On its original tax return for the 2010 taxable year, X assigned \$25 of 2010 R & D credits to Y and \$25 of 2010 R & D credits to Z. The assignees' FEINs on X's Form 3544 do not match Y and Z's FEINs, so the assignments to Y and Z are defective. X provides Y and Z's Forms 3544A and tax preparation workpapers to show that it intended to assign \$50 of 2010 R & D credits each to Y and Z. Under these facts, and assuming the other requirements of this regulation were met, X may request a correction of an error to use this regulation to correct the FEINs on the original defective assignments, but would not be able to allocate \$50 of 2010 R & D credits each to Y and Z because the amount allocated would exceed the maximum amount that may be allocated under paragraph (1).

Example 11: Assume the same facts as in Example 10, except that X assigned 2010 R & D credits to Y and Z and put "various" as the amount on X's Form 3544. X provides Y and Z's Forms 3544A and tax preparation workpapers to show that it intended to assign \$50 of 2010 R & D credits each to Y and Z. Under these facts, X will not be able to allocate any amount of 2010 R & D credits to Y and Z because it did not specify an amount of credits on the original defective assignment, because, under paragraph (1), an assignment using the amount "various" shall be treated as though X assigned no credits.

Example 12: Assume the same facts as in Example 6, except that X makes its second request under this regulation within four taxable years for a correction of an error to show that W was the intended assignee. Under these facts, and assuming the other requirements of this regulation were met, X may not use this regulation to correct the assignee because paragraph (3)(B) applies.

- (e) *Prior Defective Assignments.* For a period of one year from the effective date of this regulation for any defective assignments made prior to that date, an assignor may request a correction of an error under this regulation, without regard to the limitation set forth in subsection (b)(6).

NOTE: Authority cited: Section 19503, Revenue and Taxation Code.

Reference: Section 23663, Revenue and Taxation Code.

Special Rules. For purposes of Regulations 23663-2 through 23663-5, inclusive, the following special rules shall apply:

Section 23663-5 is adopted to read:

§ 23663-5. Special Rules.

(a) Credits Which Are the Subject of Defective Assignments.

- (1) No assignor, assignee, or any other taxpayer shall claim, assign or otherwise benefit from a credit which was assigned in a defective assignment, unless that credit is allocated to the assignor or assignee on an adjustment date pursuant to Regulations 23663-2 through 23663-5.
- (2) Any assignment of an amount of identical credits by the assignor in a taxable year after the taxable year in which the defective assignment of that amount of identical credits was made, and before the adjustment date when an adjustment is made under Regulations 23663-2 through 23663-5, shall be invalid and may not be corrected or adjusted under Regulations 23663-2 through 23663-5.
- (3) In any case where an assignee claims a credit in a closed year that was the subject of an invalid assignment under paragraph (2), then the assignor's credits shall be reduced in the same manner as set forth in Regulation 23663-3(c).
- (4) *Example.*

Example 1: X reported that it has \$200 of 2010 R & D credits. On its original tax return for the 2010 taxable year, X elects to assign \$200 of the 2010 R & D credits. However, X's assignment lists the name of Y but the FEIN of Z. X discovers that the 2010 assignment was a defective assignment, and in the 2013 taxable year X elects to assign the \$200 of the 2010 R & D credits to T. In the 2014 taxable year, X, Y and Z request and are allowed application of the rules under Regulation 23663-3 so that the \$200 of 2010 R & D credits assigned in the 2010 defective assignment are allocated to X as of the date of the defective assignment. However, pursuant to paragraph (2) the 2013 assignment of \$200 of 2010 R & D credits to T is an invalid assignment because the assignment was made before the adjustment date in the 2014 taxable year. Therefore, under this regulation, X is treated as having retained \$200 of 2010 R & D credits, and Y, Z and T are treated as having received no 2010 R & D credits.

- (b) **Finality of Election to Assign Credits.** Except as otherwise specifically provided in Regulations 23663-1 through 23663-5, the election to assign credits under Revenue and Taxation Code section 23663 is irrevocable and final as of the date the assignor files its original tax return for the taxable year in which the assignment is made, and any subsequent adjustments to the assignor's tax liability for the taxable year in which the assignment was made cannot modify the original assigned amount of eligible credit. Within any taxable year, any credit assigned under Revenue and Taxation Code section 23663, or allocated or reduced under Regulations 23663-2 through 23663-5,

shall not be available for application against any tax liability of the assignor in the same taxable year.

Example 2: X reported that it has \$500 of 2010 R & D credits. On its original tax return for the 2010 taxable year, X elects to assign \$250 of the 2010 R & D credits to Y and \$250 of the 2010 R & D credits to Z. In 2015, a notice of proposed assessment for the 2010 taxable year makes an adjustment unrelated to the amount of R&D credits allowable, and increases X's tax liability by \$300. X cannot claim the 2010 R&D credits to offset the increased 2010 tax liability because the assignments to Y and Z are valid assignments, and under this subsection, X's available 2010 R & D credits (\$500) are first reduced by the amount of credits assigned to Y and Z ($\$250 + \$250 = \$500$) before being available to X to offset the increased tax liability of \$300. Therefore, X has no remaining 2010 R & D credits to offset the increased tax liability.

Example 3: Assume the same facts as Example 2, except that X had \$700 of 2010 R&D credits in 2010 and carried the \$200 excess forward to 2011. X can claim \$200 of the 2010 R&D credits to offset the increased 2010 tax liability because X retained \$200 of 2010 R & D credits after the valid assignments to Y and Z. Under this subsection, X's available 2010 R & D credits (\$700) are first reduced by the amount of credits assigned to Y and Z ($\$250 + \$250 = \$500$) before being available to X to offset the increased tax liability of \$300. Therefore, X has \$200 of remaining 2010 R & D credits to offset the increased tax liability of \$300.

Example 4: Assume the same facts as in Example 3, except that on the 2010 assignment form X listed the name of Y but FEIN of W. X also claimed \$50 of 2010 R & D credits against its own tax liability in 2010. As of the adjustment date, Y and W have each claimed \$225 of 2010 R & D credits in a closed year. X's available 2010 R & D credits (\$700) are first reduced by the amount of credits assigned to Z (\$250). Next, pursuant to this subsection and Regulation 23663-3, X's remaining \$450 of 2010 R & D credits are further reduced by the amount of credits claimed by Y and W in a closed year ($\$225 + \$225 = \$450$). Therefore, X does not have the \$50 of 2010 R & D credits that X claimed against its tax in 2010 nor does X have any 2010 R & D credits to offset the additional tax assessed by the notice of proposed assessment.

- (c) *Ordering Rules.* In any case where there is an overlap between Regulations 23663-2 through 23663-4 on the adjustment date, the rules of those regulations shall be applied in the following order:
- (1) If an assignor requests an adjustment (or multiple adjustments) prior to the earlier of the date set forth in Regulation 23663-4(b)(6), as modified by Regulation 23663-4(e), or first contact, and the requested adjustment (or multiple adjustments) could be made under the authority of either Regulation 23663-4 or Regulations 23663-2 or 23663-3, and the assignor has not clearly requested application of Regulations 23663-2 or 23663-3 pursuant to subsection (f)(1)(A), then the adjustment (or multiple adjustments) shall be treated as having been made under Regulation 23663-4.

- (2) If multiple adjustments are being made simultaneously, and the adjustments to be made include both adjustments under Regulation 23663-2 and adjustments under Regulation 23663-3, then the adjustments under Regulation 23663-3 shall be treated as occurring first.
- (3) (A) In any case where adjustments are being made under either, or both, Regulation 23663-2 and Regulation 23663-3, and a portion of the adjustments involve credits claimed in a closed year by either an assignor or an assignee, the amount of any closed year adjustments shall first be taken from any credits originally earned by the assignor or assignee, as the case may be, prior to reducing any credits received via assignment under Revenue and Taxation Code section 23663 or any other provision of Part 11 of the Revenue and Taxation Code permitting assignment of credits.

(B) If credits have been received by an assignee both via assignment under a provision of Part 11 of the Revenue and Taxation Code permitting assignment of credits (other than under Revenue and Taxation Code section 23663) and also under Revenue and Taxation Code section 23663, then for purposes of applying subparagraph (A), credits received under a provision of Part 11 of the Revenue and Taxation Code permitting assignment of credits (other than under Revenue and Taxation Code section 23663) shall be treated as being reduced before credits received via assignment under Revenue and Taxation Code section 23663.

(1) *Examples.*

Example 5: X reported that it has \$350 of 2010 R & D credits. On its original tax return for the 2010 taxable year, X elects to assign \$200 of the 2010 R & D credits to Y and \$100 of the 2010 R & D credits to Z. Therefore, X retained \$50 of 2010 R & D credits. Subsequently, X discovers that it only generated \$150 of 2010 R & D credits. X also discovers that Y is not an eligible assignee. X requests and is allowed adjustments pursuant to Regulations 23663-2 and 23663-3, including a determination under Regulation 23663-3(d) that Y is not an eligible assignee. Pursuant to paragraph (2), the adjustment under Regulation 23663-3 is applied first, thereby allocating credits from the X - Y assignment to X, so that X has \$150 of 2010 R & D credits available for assignment before the application of Regulation 23663-2 for the X - Z assignment. As a result, Regulation 23663-2 does not apply, because X's assignment to Z is not a defective assignment as X has the \$100 of 2010 R & D credits assigned to Z. Therefore, X is treated as having retained \$50 of 2010 R & D credits, Y is treated as having received no 2010 R & D credits, and Z received \$100 of R & D credits.

Example 6: Assume the same facts as in Example 5, except that X discovers Y is not an eligible assignee after the adjustment date in Example 5. Therefore, X requests and is allowed an adjustment pursuant to Regulation 23663-2. Accordingly, pursuant to Regulation 23663-2, X's actual \$150 of 2010 R & D credits are allocated \$100 to Y and \$50 to Z, with X treated as having retained no 2010 R & D credits.

Later, the FTB issues a notice of proposed assessment. As of this subsequent adjustment date, adjustments are made pursuant to Regulation 23663-3, so that, assuming the limitations of Regulation 23663-3(d) no longer apply, the \$100 of 2010 R & D credits previously allocated to Y would then be allocated to X. Therefore, following these two adjustments, X would be treated as retaining \$100 of 2010 R & D credits, Y is treated as having received no 2010 R & D credits, and Z is treated as having received \$50 of R & D credits.

Example 7: X reported that it has \$350 of 2010 R & D credits. On its original tax return for the 2010 taxable year, X elects to assign \$150 of the 2010 R & D credits to Y and \$150 of the 2010 R & D credits to Z. Y has also generated \$100 of 2010 R & D credits. Subsequently, X discovers that it only generated \$100 of 2010 R & D credits. As of the adjustment date, Y has claimed \$100 of 2010 R & D credits in a closed year. Pursuant to paragraph (3)(A), in applying Regulation 23663-2, Y is treated as having claimed no 2010 R & D credits assigned from X in a closed year because the 2010 R & D credits that Y earned are treated as having been claimed before credits received in the assignment from X. Therefore, under Regulation 23663-2, X is treated as retaining no 2010 R & D credits, and Y and Z are both allocated \$50 of 2010 R & D credits.

- (d) *Effect and Timing of Adjustments.* Any credits allocated or reduced under Regulations 23663-2 through 23663-5 are treated as if they were assigned or retained by the assignor on a timely-filed original tax return as of the effective date of the adjustment, or reduced as of the effective date of the adjustment.

Example 8: X reported that it has \$350 of 2010 R & D credits. On its original tax return for the 2010 taxable year, X elects to assign \$200 of the 2010 R & D credits to Y and \$100 of the 2010 R & D credits to Z. Therefore, X retained \$50 of the 2010 R & D credits. Subsequently, X discovers that it only generated \$150 of R & D credits in 2010. X makes a request, joined by Y and Z, for an alternative allocation under Regulation 23663-2 to allocate X's \$150 of 2010 R & D credits from X's aggregated defective assignments as follows: \$50 of 2010 R & D credits to X and \$100 of 2010 R & D credits to Y. The FTB allows X's request. Subsequently, the FTB issues a notice of proposed assessment which reduces X's actual 2010 R & D credits from \$150 to \$75. Pursuant to subsection (d), for purposes of applying 23663-2(c), the alternative allocation is treated as if it were the original assignment on the timely-filed original tax return. As a result of the prior alternative allocation, Z would now receive no 2010 R & D credits under Regulation 23663-2, so that X's \$75 of 2010 R & D credits are allocated to Y. Accordingly, X is treated as having retained \$0 of 2010 R & D credits, Y is treated as having received \$75 of 2010 R & D credits, and Z is treated as having received \$0 of R & D credits.

- (e) *Other Rules.* For purposes of Regulations 23663-2 through 23663-5, the following other rules shall apply:
- (1) For purposes of determining the order in which assignments are treated as having been made:

- (A) In the case of assignments of identical credits made in the same taxable year, the assignments shall be treated as being made simultaneously.
 - (B) In the case of assignments made in different taxable years than the taxable year for which an adjustment is being made, a first-in, first-out rule shall apply, and assignments from earlier years shall be treated as occurring before assignments from subsequent years.
 - (C) In the case of multiple assignments of identical credits made in the same taxable year under both a provision of Part 11 of the Revenue and Taxation Code permitting assignment of credits (other than under Revenue and Taxation Code section 23663) and under Revenue and Taxation Code section 23663, the assignments made under such other provisions shall be treated as occurring before any assignments made under Revenue and Taxation Code section 23663.
- (2) To the extent the provisions of Regulations 23663-2 through 23663-5 are applied on multiple adjustment dates, allocations and reductions based on credits claimed in closed years shall not be modified based on such closed years being open at the time the provisions of Regulations 23663-2 through 23663-5 are subsequently applied.
 - (3) In the case of any defective assignment for which a request is made under Regulation 23663-5(f) to allocate credits pursuant to Regulations 23663-2 through 23663-5, where one or more parties to a defective assignment does not join the request, the adjustments made under Regulations 23663-2 through 23663-5 shall not include the aggregate amount of identical credits from all defective assignments assigned to any parties to the defective assignment who do not join in the request, except to the extent the provisions of Regulations 23663-2 through 23663-5 have already allocated such identical credits to the assignor or assignees who do join the request.
 - (4) In any case where an assignor has requested an adjustment to a defective assignment under either Regulation 23663-2 or 23663-3 and the FTB has allowed such request, then no further request shall be made with respect to the same defective assignment.
 - (5) Pursuant to a written request by the FTB, any parties to a defective assignment shall provide within 45 days of the request all requested copies of tax returns and amended tax returns that demonstrate whether such party has claimed credits which were the subject of a defective assignment in any taxable year, including any closed year. If a party to a defective assignment does not provide such copies within 45 days, then it shall be conclusively presumed that such party has claimed all credits listed as assigned to that assignee in the original defective assignment in closed years.

- (6) In the case of multiple assignors making separate defective assignments to one or more assignees, for purposes of applying the rules of Regulations 23663-2 through 23663-5, the credits claimed in closed years by such assignee shall be allocated to the assignors pro rata based on the amount of credits assigned on the original defective assignments.
- (7) Any adjustments of a credit under the rules of Regulations 23663-2 through 23663-5 shall not be treated as a recapture of such credit under any specific credit provision of Part 11 of the Revenue and Taxation Code.
- (8) *Examples.*

Example 9: X reported that it has \$200 of 2010 R & D credits. On its original tax return for the 2010 taxable year, X elects to assign \$100 of the 2010 R & D credits to Y. On its original tax return for the 2011 taxable year, X elects to assign \$100 of the 2010 R & D credits to Z. Subsequently, X discovers that it only generated \$120 of 2010 R & D credits. While the assignments to X and Y deal with the same type of identical credit, they are not aggregated pursuant to Regulation 23663-2(b). Under paragraph (1)(B), because the 2010 assignment to Y was made in an earlier year than the 2011 assignment to Z, the assignment to Y is treated as having occurred before the assignment to Z. Therefore, the assignment of \$100 of 2010 R & D credits to Y is a valid assignment because X has the \$100 of 2010 R & D credits being assigned. But, the 2011 assignment to Z is a defective assignment because X only has \$20 of 2010 R & D credits (\$120 available in 2010 less the \$100 assigned to Y = \$20) available for assignment in 2011.

Example 10: X reported that it has \$200 of 2010 R & D credits. On its original tax return for the 2010 taxable year, X elects to assign \$100 of the 2010 R & D credits to Y and \$100 of the 2010 R & D credits to Z. In 2016, X discovers that it only had \$140 of 2010 R & D credits, and requests and is allowed to apply the default rules of Regulation 23663-2. Y has claimed \$100 of the 2010 R & D credits in 2010, which is a closed year for Y as of the adjustment date. Under Regulation 23663-2, X's actual \$140 of 2010 R & D credits are allocated \$100 to Y and \$40 to Z. Subsequently, in 2017 under Revenue and Taxation Code section 19058, the FTB issues a notice of proposed assessment for the 2010 taxable year which reduces X's 2010 R & D credits to \$80. As of this subsequent adjustment date, the 2010 taxable year is no longer a closed year for Y. However, pursuant to paragraph (2), the 2016 adjustment is not later changed if a closed year subsequently opens. In addition, under subsection (d), the adjustment in 2016 is treated as if made on an original tax return. Therefore, as of the second adjustment date, all \$80 of 2010 R & D credits are allocated to Y and no 2010 R & D credits are allocated to Z because under paragraph (2) the allocation of \$100 of 2010 R & D credits to Y based on credits claimed in a closed year is not modified as of a subsequent adjustment.

Example 11: X reported that it has \$200 of 2010 R & D credits. On its original tax return for the 2010 taxable year, X elects to assign \$100 of the 2010 R & D credits to Y and \$100 of the 2010 R & D credits to Z. Subsequently, X discovers that it only had

\$120 of 2010 R & D credits. X, joined by Y, requests application of the default rules under Regulation 23663-2. Pursuant to paragraph (3), \$20 of 2010 R & D credits are available for allocation under Regulation 23663-2. Therefore, X is treated as retaining no 2010 R & D credits, Y is treated as receiving \$10 of 2010 R & D credits, and Z is treated as receiving \$10 of 2010 R & D credits. The other \$100 of 2010 R & D credits are not allocated to Z, but instead, as of an adjustment date, such \$100 of 2010 R & D credits would be allocated among X, Y and Z pursuant to Regulation 23663-2.

Example 12: On its original tax return for the 2010 taxable year, X elects to assign 2010 R & D credits to Y and Z. Subsequently, X discovers that it had less credits than it assigned. X requests and is allowed application of the default rules under Regulation 23663-2. After the adjustment date, X, joined by Y and Z, requests an alternative allocation under Regulation 23663-2. Under these facts, the FTB would reject the alternative allocation request because, pursuant to paragraph (4), X may only request the application of Regulations 23663-2 or 23663-3 once per defective assignment.

- (f) *Form and Manner for Requests for Correction of an Error or Alternative Allocation.*
- (1) Any requests made under Regulations 23663-2 through Regulation 23663-4 shall contain all of the following information:
- (A) The applicable regulation and applicable subsection of that regulation under which the request is made (Regulation 23663-2(c), Regulation 23663-2(d), Regulation 23663-3(b), Regulation 23663-3(c), Regulation 23663-3(d), or Regulation 23663-4).
 - (B) The name, FEIN, signature, date, and telephone number of the assignor.
 - (C) The name, FEIN, signature, date, and telephone number of the assignee, and, if there are multiple potential assignees, then the name, FEIN, signature, date, and telephone number of each potential assignee.
 - (D) The name, FEIN, signature, date, and telephone number of each party to the defective assignment joining the request.
 - (E) A summary of the defective assignment including:
 - (i) The type and amount of identical credits assigned in the defective assignment.
 - (ii) The amount of identical credits listed as retained by the assignor on the defective assignment.
 - (F) The reason that the assignment was a defective assignment.
 - (G) The amount and taxable year in which the assignor or any assignees have claimed credits which were assigned in the defective assignment.

- (H) For the same type of identical credit which is the subject of the defective assignment, the amount of the assignor's actual identical credits available for assignment as of the taxable year of the assignment.
- (I) A summary of all subsequent assignments of the same type of identical credit, including:
 - (i) The amount of identical credits assigned in the assignment.
 - (ii) The amount of identical credits listed as retained by the assignor in the assignment.
 - (iii) The name and FEIN of the assignee in the assignment.
- (J) A copy of the original Form 3544 (or successor form) which contained the defective assignment for which a request is being made.
- (K) Copies of all Forms 3544A (or successor form) relating to the defective assignment.
- (L) A copy of the assignor's tax return for the year of the defective assignment.
- (M) A copy of the assignor's tax returns in which the type of identical credit type assigned in the defective assignment was claimed.
- (N) A copy of the assignor's most recently filed tax return.
- (O) A copy of the tax returns for the year of the defective assignment for each assignee and each party to the defective assignment joining the request.
- (P) A copy of tax returns in which the type of identical credit assigned in the defective assignment was claimed for each assignee and each party to the defective assignment joining the request.
- (Q) A copy of the most recently filed tax return for each assignee and each party to the defective assignment joining the request.
- (R) All correspondence that the assignor, assignee, and parties to the defective assignment joining the request have received from the FTB regarding the taxable year of the defective assignment or any taxable year in which the assignor, assignee or parties to the defective assignment joining the request have claimed credits which were the subject of the defective assignment.
- (S) Amended tax returns reflecting the requested allocation for the assignor and all parties to the defective assignment joining the request for the taxable year in which the defective assignment was made and all subsequent taxable years that would be affected by the request.

- (T) Necessary waivers of the statute of limitations on assessment from all parties to the defective assignment joining the request for the taxable year of the defective assignment and all other taxable years in which any credits which were the subject of the defective assignment were claimed which are not closed years.
- (2) In addition to the information required under paragraph (1), any requests for default allocations under Regulations 23663-2(c), 23663-3(b), or 23663-3(c) shall also include:
- (A) The requested amount of credits to be allocated to the assignor under the regulation.
 - (B) The requested amount of credits to be allocated to the assignee under the regulation, or for allocations involving aggregated eligible assignees, the amount to be allocated to each eligible assignee.
 - (C) The calculations to be made under Regulations 23663-2(c), 23663-3(b), or 23663-3(c) which demonstrate the requested allocation.
- (3) In addition to the information required under paragraph (1), any requests for an alternative allocation under Regulation 23663-2(d) shall also include:
- (A) The requested amount of credits to be allocated to the assignor under the regulation.
 - (B) The requested amount of credits to be allocated to the assignee under the regulation, or for allocations involving aggregated eligible assignees, the amount to be allocated to each assignee.
 - (C) A summary of any actual or deemed requests under the subsection in other taxable years.
 - (D) The calculations to be made under Regulation 23663-2(d) which demonstrate the requested allocation.
- (4) In addition to the information required under paragraph (1), any requests for the correction of an error under Regulation 23663-4 shall also include:
- (A) The requested corrected amount of credits to be allocated to the assignor under the regulation.
 - (B) The requested corrected amount of credits to be allocated to the assignee under the regulation.
 - (C) A summary of any actual or deemed requests under the regulation in other taxable years.

- (D) The calculations to be made under Regulation 23663-4 which demonstrate the requested correction.
 - (E) Documentation required under Regulation 23663-4(b)(3).
 - (F) Documentation required under Regulation 23663-4(b)(4).
- (5) In the case of any request under this subsection that is incomplete, and therefore invalid, but in the sole discretion of the Franchise Tax Board contains substantially all of the information specified in this subsection, the FTB may allow the assignor 30 additional days to provide the missing information to complete the invalid request. If the assignor provides all missing information to the FTB within 30 days of the date the FTB mailed notice to the assignor of additional time to provide missing information, and the request is subsequently granted, the adjustment date shall be the date that the assignor's original request was received by the FTB.
- (g) *Miscellaneous.*
- (1) *Disclosure.* In adjusting credits under Regulations 23663-2 through 23663-5, an audit, protest, and claim for refund are all considered administrative proceedings regarding tax administration within the meaning of Revenue and Taxation Code section 19545.
 - (2) *Math Error.* To the extent an assignor or an assignee claims credits in a manner inconsistent with the provisions of Regulations 23663-2 through 23663-5, the provisions of Revenue and Taxation Code section 19051 shall apply and the amount of credit claimed shall be treated as a math error adjustment.
 - (3) *Examples in Regulations.* Unless otherwise provided, assume that all entities in the examples in Regulations 23663-2 through 23663-5 are affiliated corporations for all taxable years relevant to the examples and, unless otherwise specifically stated, meet all of the other conditions and requirements of Revenue and Taxation Code section 23663 and Regulations 23663-2 through 23663-5.

NOTE: Authority cited: Section 19503, Revenue and Taxation Code.
Reference: Section 23663, Revenue and Taxation Code.

Background and Summary

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) and 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. The statute specifies that credits may only be assigned to an "eligible assignee", which is generally defined in RTC section 23663, subdivision (b), paragraph (3) as an affiliated corporation which is a member of the same combined group as the assignor in both the taxable year the credits were earned and the taxable year the credits are assigned to the assignee.

An assignment is made as an election on a taxpayer's original tax return on Form FTB 3544 and is irrevocable under RTC section 23663, subdivision (c). In some situations taxpayers have made defective elections, such as when the taxpayer's total credits available to be assigned are later determined to be less than the taxpayer thought it had when the original tax return was filed, such as when credits have been adjusted at audit, or when an assignee was not a member of the same combined reporting group on the dates required under the statute. Because the assignment election is irrevocable, taxpayers are left with no clear recourse regarding the consequences of such defective elections, and the Franchise Tax Board ("FTB") has not yet established any standards to apply in adjusting such defective elections.

Under RTC section 23663, subdivision (e), paragraph (4), the FTB is specifically authorized to issue necessary regulations to specify the treatment of any assignment that does not comply with the requirements of section 23663, including where the taxpayer and assignee are not members of the same combined reporting group on the dates required.

These proposed regulations start from the premise that under the statutory language in RTC section 23663, a defective election is invalid. Because of the uncertainty created by the statute's silence on what happens following a defective election, the FTB, under the broad legislative rulemaking delegation of RTC section 23663, subdivision (e), paragraph (4), proposes to issue these regulations as the exclusive means by which defective elections may be corrected. In order to ensure consistency in correcting defective elections, the regulations mandate a "request" process whereby the FTB will review a taxpayer's request to apply any of the permissive correction provisions in the regulations and either approve or deny such request. It is contemplated that requests that are granted will be formally memorialized via a closing agreement between the affected parties and the FTB.

The correction and allocation provisions of the regulations are structured to provide broader and more favorable corrections the earlier the taxpayer self-identifies defective assignments

and files a request with the FTB. This approach was chosen to encourage taxpayers to self-identify and seek correction of defective elections as early as possible, and before the FTB has initiated any audit activity with respect to the taxpayer's return. Both taxpayers and the FTB benefit under this structure by creating certainty as to which corporations have which credits as soon as possible, and before taxpayer and audit resources are expended dealing with defective elections.

The most favorable and liberal correction and allocation rules are contained in Regulation 23663-4 which allows taxpayers to correct defective elections when a taxpayer discovers and files a request to correct the defective election at least 60 days before filing its subsequent taxable year's California tax return. The next most favorable set of rules in Regulation 23663-2 allow taxpayers flexibility in allocating credits when the assignor files a request with the FTB after the period in Regulation 23663-4 has passed but before first contact for an audit has occurred. Finally, Regulations 23663-2 and 23663-3 provide default allocation rules that allocate credits pursuant to a mechanical formula either upon a taxpayer's request and FTB's approval, or by the FTB during an audit.

Regulation 23663-5 contains a series of special rules and ordering rules, and Regulation 23663-1 contains definitions of the terms used throughout these regulations.

Proposed Regulation 23663-1 – Definitions

1. Subsection (a) defines the date on which any adjustment to a defective assignment the FTB allows under Regulations 23663-2 through 23663-5 shall be treated as being made. In the case of adjustments made by the FTB, the adjustment date shall be the calendar date on which a notice is mailed. In the case of requests made by a taxpayer, the adjustment date shall be the date a taxpayer's request is received by the FTB, even though the adjustment is approved later. In addition, the adjustment date provides the specific date on which the FTB will determine the amount of credits claimed in a closed year for purposes of reallocating credits pursuant to Regulations 23663-2 through 23663-5.
2. Subsection (b) defines "affiliated corporation" using the same definition used in RTC section 23663(b)(1).
3. Subsection (c) defines the term "aggregated eligible assignees" to include all eligible assignees that receive identical credits from the same assignor in the same taxable year, since those eligible assignees are subject to aggregation for purposes of determining the validity of those assignments and any reallocation of credits under Regulations 23663-2 through 23663-5.
4. Subsection (d) defines "assignee" as the recipient of an assignment under RTC section 23663, including any successor in interest. This definition further states that the assignee may be any affiliated corporation whose name or identifying information is on the original assignment form. For purposes of applying these regulations, this definition is meant to encapsulate all potential assignees of a defective assignment, including situations where an assignor lists the identifying information of different assignees in a single assignment.
5. Subsection (e) defines the term "assignment" to specifically refer to an assignment made pursuant to RTC section 23663, and further provides that each assignment will be treated on its own and each defective assignment will be treated separately. Special rules will aggregate multiple such defective assignments where necessary to apply the allocation rules in the regulations.
6. Subsection (f) defines the term "assignor" to mean the taxpayer, including any successor in interest, which makes an election to assign credits to an assignee.
7. Subsection (g) defines the term "closed year" to mean any taxable year for which the FTB determines that, as of the adjustment date, it is precluded from mailing a notice of proposed deficiency assessment with respect to any credits that were assigned or claimed in a defective assignment. This determination is necessary because allocations under these

regulations first look to credits claimed in taxable years that are closed, because not taking such closed year claimed credits into account would result in credits being claimed more than once. The regulations further provide that once a closed year determination has been made for purposes of applying these regulations, any subsequent application of these regulations to that particular year will consistently treat that year as a closed year.

8. Subsection (h)(1) defines a "defective assignment" as any assignment that does not comply with the requirements of RTC section 23663, and identifies some of the types of defective assignments, which include assignments which fail to clearly identify the year from which the assigned credit was generated, fail to clearly identify the amount of assigned credit, fail to identify the type of assigned credit, assign more credits than the assignor has available to assign, assign a credit that is not an eligible credit, or assign a credit to an assignee who is not clearly identified or is not an eligible assignee. Subsection (h)(2) clarifies that an assignor's purpose or intent in assigning credits, such as the intention to assign one half of the available credits to its wholly owned subsidiary, is not relevant in determining whether an assignment is a defective assignment. Finally, subsection (h)(3) provides five examples to illustrate some of the above rules.

9. Subsection (i) defines "the effective date of an adjustment" as the date on which an adjustment under Regulations 23663-2 through 23663-5 is treated as being legally effective, which generally will be the same date that credits would have been retained or assigned if the defective assignment on the assignor's original tax return had been a valid assignment.

10. Subsection (j) defines "election" to mean the irrevocable election to assign by an assignor to an assignee a credit on the assignor's original tax return under the rules of RTC section 23663.

11. Subsection (k) defines the term "eligible assignee" using the same definition used in RTC section 23663(b)(3).

12. Subsection (l) defines "eligible credit" using the same definition used in RTC section 23663(b)(2).

13. Subsection (m) defines "FTB" to mean the Franchise Tax Board.

14. Subsection (n) defines "first contact" to mean the date the initial audit contact, as defined in Regulation 19032, is first sent to any assignor or assignee with respect to any taxable year in which either an assignment of credits is made or the taxable year in which assigned credits are claimed.

15. Subsection (o) defines "identical credit" to mean any credit that is (i) allowed under the same RTC section as the other credit, (ii) is originally allowed in the same year, and, (iii) in the case of certain credits with limitations that only allow use against income generated in the same zone or program area, is a credit based on activity in the same zone or program area. Identical credits may be aggregated under Regulations 23663-2 through 23663-5 for purposes of determining if an assignment is a defective assignment and also for purposes of applying the allocation provisions in those regulations.

16. Subsection (p) defines "parties to a defective assignment" to include the assignor and each potential assignee to a defective assignment. The definition also includes all assignees to whom the assignor defectively assigns the same type of credit in the same taxable year. This definition is necessary because the standard allocation rules are impacted by credits claimed in closed years by other assignees who are assigned the same type of credit. Beyond the standard allocation rules, this definition is also important in identifying which entities have to consent to allocations and corrections under these regulations. For example, Regulation 23663-4 allows, under limited circumstances, corrections of errors, which may result in the assignee listed on a defective assignment no longer receiving a credit, so requiring consent of all affected parties is necessary before the FTB will make an allocation pursuant to a such a request.

Proposed Regulation 23663-2 – Assignor Has Less Credits Than Assigned

1. Subsection (a) begins by referencing the rules set forth in Regulation 23663-5 that credits which are the subject of a defective assignment cannot be claimed, assigned or used for any purpose unless and until the FTB has allocated those credits to a taxpayer pursuant to Regulations 23663-2 through 23663-5. This subsection generally describes this regulation as containing rules for allocating credits from an assignment which is defective due to an assignor discovering that it has less credits than the amount it assigned in the original assignment. There is also an elective mechanism under this regulation, the alternative allocation rules, which is only available before first contact and when requested by the assignor and other parties to a defective assignment. There is a cross-reference to Regulation 23663-4 that acknowledges that when there is overlap between this regulation and Regulation 23663-4, Regulation 23663-4 shall apply.

2. Subsection (b) provides rules for aggregating multiple defective assignments for purposes of applying the default allocation rules and the alternative allocation rules of this regulation. The purpose of these rules is to treat all assignments of the same credit type in the same taxable year in a uniform manner, including the regulation's approach of allocating defectively assigned credits to assignees "pro rata". These aggregation rules first identify all defective assignments of the same credit type (i.e., "identical credits") that were assigned by an assignor in the same taxable year, and then aggregate these identical credits for purposes of determining whether all the assignments in that taxable year are valid or defective. As a result of this aggregation rule, where an assignor has less identical credits available for assignment than were assigned in a single taxable year, all of the assignments of that type of credit made in that taxable year will be treated as defective assignments. Four examples are provided to illustrate these concepts, the first two demonstrate how the basic aggregation rules will apply, and the latter two illustrate the scope of the identical credit definition.

3. Subsection (c) provides the default allocation rules that apply under this regulation. This regulation applies when an assignor assigns more credits than it actually has. This situation often comes up when an assignor's credits are reduced during an audit. In these cases where an assignment is defective only because an assignor assigned more credits than it actually had, the regulation generally allocates the credits the assignor actually does have to the assignee of the defective assignment. If an assignor assigned the same type of identical credit to multiple assignees, then the regulation allocates the assignor's actual credits to the assignees on a pro rata basis based on the amount of credits assigned to each assignee in the original defective assignment. The purpose of these default rules allocating credits to the assignee is to try to give effect to the assignor's intent to assign credits to that assignee. Notably, the structure of the regulation effectuates the assignor's intent to assign credits. This, however, should not be confused with the rules of these

regulations that an assignor's intent is not relevant in determining when an assignment is a defective assignment.

Also, under this regulation no credits are allocated back to the assignor since this regulation applies when the assignor had less credits than it assigned and all the assignor's credits are allocated to the assignee. However, in limited circumstances the alternative allocation rules, discussed below, give taxpayers flexibility to allocate credits to the assignor.

When the assignor or assignee has claimed credits from a defective assignment in a closed year, subsection (c)(2)(A) requires that identical credits first be allocated to that assignor or assignee. The requirement to first allocate credits to the assignor and/or assignee who used those credits in a year that is a closed year is necessary since closed years cannot be changed and the taxpayer has already received a tax benefit as a result of their utilization of the credits in that closed year. To allocate those credits in any other manner would result in them being claimed twice.

Subsection (c)(2)(B) applies if the same type of identical credits were assigned to multiple eligible assignees in the same taxable year. In which case, after first allocating credits under subsection (c)(2)(A), based on those credits being claimed in closed years, subsection (c)(2)(B) would then allocate any remaining credits to the other eligible assignees in order to result in a pro rata allocation to all eligible assignees. If no credits had been claimed in closed years, subsection (c)(1) would have allocated credits to the eligible assignees on a pro rata basis based on their relative original assigned amounts. Therefore, subsection (c)(2)(b)'s allocation methodology is designed to achieve, if possible, the same pro rata result despite any necessary but non-pro rata allocations in subsection (c)(2)(A). If allocations under subsection (c)(2)(B) result in all eligible assignees receiving a pro rata allocation of identical credits, then subsection (c)(1) would allocate any remaining identical credits to such eligible assignees on a pro rata basis. Four examples are provided that illustrate the application of these rules.

The pro rata allocation is based on the credits the assignor listed as assigning to the assignee in the defective assignment form. Using the assignment form as the basis for a pro rata allocation is the best contemporaneous reflection of the assignor's intent since it results in credits being allocated in the same proportions that the assignor originally assigned them.

If the rules of this subsection and Regulation 23663-3 are applied at the same time, then the credits which Regulation 23663-3 allocates back to the assignor would then be available to be allocated under this subsection. By specifying that Regulation 23663-3 applies first before Regulation 23663-2, the application of these two regulations are consistent with this subsection's general purpose of first giving effect to the assignor's intent to assign credits.

4. Subsection (d) provides rules for alternative allocations that may be requested by an assignor before first contact. Under such a request, and when joined by other parties to a defective assignment, an assignor is able to choose the allocation of credits among the eligible assignees of a defective assignment and may even allocate credits to itself, subject to some limitations.

In order to be consistent with the underlying statute's requirements that assignments are irrevocable once made and must be made on the original tax return, any request for an alternative allocation under subsection (d) can only allocate identical credits to those parties involved in the original defective assignment. Further, the amounts listed as being assigned to an assignee or retained by the assignor on the original assignment form represent a maximum ceiling limiting what can be allocated to either an assignee or the assignor in an alternative allocation. These limitations are consistent with the underlying statute since the assignor should not be entitled to retain credit amounts in excess of what would have been retained if the defective assignment had been valid. The same principle applies with respect to each assignee, since they should not end up with more credits than they were originally assigned. As a result, the alternative allocation gives the assignor some flexibility to allocate the identical credits it actually has within the general framework of how the assignor originally allocated the identical credits.

Subsection (d)(3) provides that an alternative allocation may only allocate credits to the assignees who join the request; therefore, the assignor and all assignees involved in an alternative allocation must be knowingly involved in the process of allocating credits in a manner different than the default allocation rules of subsection (c). However, if any assignees do not join the alternative allocation request, then subsection (d)(5) (as well as Regulation 23663-5(e)(3)) excludes the amount originally assigned to such non-consenting assignee from being part of an alternative allocation request. Another special rule under subsection (d)(6) requires that identical credits claimed in closed years must be taken into account first before any allocations are made among the assignor and eligible assignees under these alternative allocation rules.

The limitation that an alternative allocation must be requested before first contact is intended to incentivize taxpayers to come forward to correct a defective assignment before being audited, and also is intended to preclude taxpayers from reallocating credits during an audit, which staff believes would be allowing hindsight tax planning that is inconsistent with the irrevocable nature of the original assignment statute. Moreover, the alternative allocation is not available for frequent use on a year after year basis, since that would be inconsistent with the irrevocable nature of the original election to assign. Instead, once an alternative allocation is used, another alternative allocation will not be allowed for the rolling four year period, consisting of the taxable year for which an alternative allocation is

requested as well as the three taxable years preceding and following that taxable year. Seven examples are provided to illustrate different alternative allocations, as well as the special rules described above.

5. Subsection (e) provides a cross-reference to Regulation 23663-5(f), which contains the form and manner requirements for requesting a default allocation under subsection (c) of this regulation and an alternative allocation under subsection (d) of this regulation.

Proposed Regulation 23663-3 – Other Defective Assignments

1. Subsection (a), similar to Regulation 23663-2, begins by reiterating the rules set forth in Regulation 23663-5 that credits which are the subject of a defective assignment cannot be claimed, assigned or used for any purpose unless and until the FTB has allocated those credits to a taxpayer pursuant to Regulations 23663-2 through 23663-5. The subsection goes on to provide that this regulation applies to all defective assignments not covered under either Regulation 23663-2, relating to assignments that are defective because the assignor assigned more credits than it had available for assignment, and Regulation 23663-4, which applies only to requests for corrections that are made before the filing of the subsequent taxable year's tax return.

2. Subsection (b) provides the default allocation rules for all defective assignments that are defective for reasons other than those specified under Regulation 23663-2(c), which addresses situations where an assignor assigns more credits than it has, or under subsection (c) of this regulation, which addresses assignments where the type, amount, or both, of assigned credits are unspecified. Specifically, the general rule of subsection (b) is to allocate credits from such defective assignments back to the assignor. The purpose of the rule allocating credits back to the assignor is because, unlike Regulation 23663-2(c) where the requirements of the underlying statute were met except for the assignor having fewer credits available to assign than it originally assigned, in these situations the other requirements of the statute were not met. In addition, in these situations the assignment intent of the assignor is often not clearly reflected on the defective assignment form. Returning the credits defectively assigned in these situations back to the assignor creates certainty that the credits are available to be reassigned, so that the assignor can immediately move forward once the default rules are applied.

In the case where a defective assignment has multiple potential assignees, then the reduction rules of subsection (b) are applied to each potential assignee. This is intended as a general rule of fairness when an assignor creates a situation where multiple assignees could reasonably believe that they were the intended assignee, so the assignor's credits should be reduced based on any credits claimed in any closed year by any of the potential assignees. Notably, this rule has the potential to reduce the assignor's credits in an amount in excess of the credits assigned on the defective assignment because multiple potential assignees could have claimed all of the credits listed on the assignment. Without this rule, it is possible that credits could be claimed more than once due to the assignor's error on the original defective assignment.

The default allocation rules under subsection (b) first require that closed years be taken into account in a manner similar to Regulation 23663-2(c), so that any credits that are the subject of a defective assignment under subsection (b)(2) of this regulation will be reduced by the amount of credits claimed in a closed year by an assignee. However, consistent with

the fact that the assignment under RTC section 23663 was not valid, credits are not allocated to an assignee. Therefore, to the extent the assignee's closed year opens for the claimed credits and the FTB discovers the year is open, the FTB would attempt to assess the assignee for those claimed credits.

In the case of multiple potential assignees of a defective assignment, subsection (b)(3) requires the closed year rule to be taken into account for each potential assignee. If the application of this closed year rule to these multiple potential assignees reduces the assignor's identical credits reflected on the original defective assignment form below zero, then the assignor's other identical credits as of the year of the defective assignment will be reduced. There are two examples provided, one illustrating the mechanics of the application of these rules, and the other illustrating a situation where there might be more than one potential assignee attempting to claim a credit from the same defective assignment.

3. Subsection (c) provides a different default allocation rule when assignments are defective assignments because the type, amount, or both, of assigned credits are unspecified or unclear in the original assignment. Because the credit type or amount may not be specified clearly in the original assignment, the approach in subsection (b) of analyzing the identical credit being assigned does not work for these types of situations. Instead, this subsection reduces the assignor's credits using a standard methodology depending on whether the amount, or the type, of credit was not clearly specified in the original assignment.

Thus, in the case of assignments where the credit type is not clearly specified, the assignor's credits will be reduced based on the amount of credits claimed by an assignee in a closed year. If the assignor partially lists the type of credit being assigned (for example, where a research and development credit is specified, but the year in which such credit was originally allowed is unspecified), then the assignor's partially-listed type of credit is first reduced. The rules also provide that the amount of an assignor's credits that may be reduced are capped at an amount equal to the amount of credits listed on the original assignment form. In the case of assignments where the amount of credits to be assigned are not listed or clearly specified, the assignor's credits will be reduced based on the amount of credits an assignee claims in a closed year. Similar to the reduction rules throughout these regulations, the purpose of this rule is based upon the fact that it was the assignor's defective assignment that created the opportunity for credits to be claimed by a potential assignee in a year that is now closed to adjustment. As a result, the reduction provisions apply only when an assignee claims credits in a closed year, since this results in the possibility that credits will be claimed more than once due to the assignor's error.

The type of credits reduced under subsection (c) are based on what the assignor lists on the defective credit assignment form, regardless of whether the assignee lists more detailed

information on its own tax return (usually on Form 3544A). This approach is consistent with the regulations' general approach that the consequences to the assignor are generally based on the assignor's actions.

The methodology of reducing the assignor's credits in the subsection is structured so that the assignor's unclaimed and unassigned credits are reduced, followed by the assignor's claimed credits, and, lastly, by the assignor's assigned credits. This methodology is structured so that the assignor's claimed and assigned credits are not disturbed unless all other credits have been reduced, with the assigned credits being the last to be unwound.

Five examples are provided illustrating the various types of defective assignments that are covered by subsection (c), as well as how the default allocation rules applicable to these types of defective assignments will apply.

4. Subsection (d) provides the rules that apply to any assignment that is defective because the assignee is not an eligible assignee. This generally occurs when the assignee is not unitary with the assignor at either the date the credit was originally earned (or June 30, 2008, if the credit was earned before July 1, 2008) or the date of the original assignment. This is the most difficult defective assignment to address in these regulations because the determination of whether an assignee is eligible often requires an in-depth factual and legal unitary analysis. In addition, the assignor and assignee might argue different positions, thereby making it difficult for the FTB staff to analyze the fundamental question of whether an assignment is defective without a comprehensive audit. Staff is especially concerned about situations where an assignor argues that an assignee was not unitary, which would cause assigned credits to be allocated back to the assignor under the general rules of this regulation, while the assignee simultaneously claims that it was in fact unitary at both relevant dates, thereby causing those same credits to be part of a valid and irrevocable assignment and stay with the assignee. To avoid this potential whipsaw situation, this subsection requires that both the assignor and assignee apply for relief according to this regulation, and consent to the potential adjustment, before the provisions of this subsection are applied.

Subsection (d) also contains several provisions that prohibit an assignor from claiming or assigning credits until a final determination has been made regarding whether the assignee was not an eligible assignee, thereby freezing use of the credits as to the assignor until the status of the assignee is resolved. Further, once an assignee asserts that it is not an eligible assignee, then, as a condition of the FTB making a finding that the assignee was not an eligible assignee, the assignor and assignee will be precluded from subsequently changing their position on this issue, even though the FTB might conclude later, upon audit, that the assignor and assignee were in fact unitary. Even in the case of an audit adjustment, the assignor will not be able to claim or assign a credit in an ineligible assignee situation until

determinations of whether the assignee is an eligible assignee are final for both the assignor and assignee. Once again, this is to prevent the assignor and assignee from arguing contrary positions, and both claiming the credit, and also to reduce the ability of taxpayers from claiming an assignee was not an eligible assignee as a form of retroactive tax planning.

Subsection (d)(1) gives assignors and assignees an opportunity to finalize this issue quickly by jointly coming forward to the FTB before first audit contact. This option allows taxpayers to finalize an allocation of credits in an assignment dealing with an ineligible assignee in a much quicker fashion than would otherwise be possible, and notably without the requirement for a final determination to be made for both the assignor and assignee. If the assignor and assignee jointly come forward, then the FTB staff will complete a streamlined review of the claim that the assignee was not an eligible assignee. This review will be a high level review and of much less detail than a regular audit. If the FTB deems that the evidence submitted demonstrates that the assignee was not an eligible assignee, then the credits in the defective assignment will be allocated back to the assignor. However, because the FTB's review in this situation will be streamlined, the determination that is made will be limited in its scope to the allocation of credits under RTC section 23663 and will not impact nor raise any inference under any other parts of the Revenue and Taxation Code, including the issue of whether unity exists under Part 11.

Specifically, the assignor and assignee could later be audited by the FTB and it might be determined that the assignor and assignee were in fact unitary at the relevant dates, with the assignee being found to be an eligible assignee. In this situation, the credits previously allocated back to the assignor under subsection (b)(1) would remain with the assignor, providing certainty that the allocation of credits back to the assignor based on the streamlined review may be relied upon. This follows a general goal of these regulations of making adjustments as early as possible once defects are discovered, and making adjustments upon which taxpayers can rely. In order to take advantage of subsection (b)(1), the assignor and assignee must agree to not later assert that the assignor and assignee were unitary in the years they asserted they were not unitary in the request under subsection (d)(1). This requirement was implemented based on fairness because the assignor and assignee have more information than the FTB; and the FTB is not doing a normal unitary audit. Finally such a rule reduces the opportunity to utilize the remedies contained in this regulation as a retroactive tax planning device.

Four examples are provided to illustrate these situations and the rules described above.

5. Subsection (e) provides a cross-reference to Regulation 23663-5(f), which contains the form and manner requirements for requesting allocations under this regulation.

23663-4 – Correction of Error

1. Subsection (a), similar to Regulations 23663-2 and 23663-3, begins by reiterating the rules set forth in Regulation 23663-5 that credits which are the subject of a defective assignment cannot be claimed, assigned or used for any purpose unless and until the FTB has allocated those credits to a taxpayer pursuant to Regulations 23663-2 through 23663-5. The subsection goes on to generally describe that this regulation will permit the parties to an assignment that is defective to correct the errors in those assignments, so long as the correction is requested prior to the filing of the subsequent taxable year tax return and subject to the other limitations in this regulation. The errors on defective assignments which may be corrected under this regulation include, for example, originally-filed assignment forms that contain unclear, inconsistent or incomplete information, erroneous assignors, erroneous assignees, or clerical errors listing the wrong credit types or amounts.

Note that this regulation contains the most favorable rules to correct defective assignments. By allowing parties to a defective assignment to correct a wide range of errors, the FTB is providing the opportunity for taxpayers to come forward and request the FTB correct errors and thereby gain certainty regarding the allocation of credits before the filing of their subsequent taxable year's tax return. Because the taxpayer is self-identifying the errors before the filing of its next return, this regulation permits the widest range of corrections to a defective assignment. Two examples are provided to illustrate when a defective assignment might or might not be eligible for correction under this regulation.

2. Subsection (b) contains the conditions that must be satisfied in order to request a correction of an error under this regulation. Specifically, the request must be filed in the form and manner specified in Regulation 23663-5(f), and may only be used to correct defective assignments. Taxpayers will not be able to use this regulation to change, amend or revoke an otherwise valid assignment. Moreover, all parties to a defective assignment must join in the request and consent in writing to the correction, since the FTB will not reallocate credits from one taxpayer to another without all affected parties' written consent.

The assignor must demonstrate by clear and convincing objective evidence that is contemporaneous with the original assignment that an error was made, and must further demonstrate with clear and convincing objective evidence that is contemporaneous with the original assignment that the requested correction is consistent with the assignor's original intent. Tax preparation workpapers, which are generally comprised of the calculations and financial statements that a preparer will use to complete an income or franchise tax return, are not enough to meet the clear and convincing standard for purposes of this regulation. Moreover, the regulation requires other contemporaneous evidence to corroborate tax workpapers, such as emails, memos, and Forms 3544A.

The requested corrected assignment also has to meet all other requirements of RTC section 23663. In order to allow the FTB enough time to review a request in time to approve or deny the request before the assignor and any assignees' tax filing deadline, the request must be made at least 60 days before the assignor and assignees file their subsequent year's tax return. The purpose of having the request approved before the next year's tax return is to have consistent tax filings of all taxpayers involved in a corrected defective assignment. There are seven examples, the first two of which illustrate these various conditions, and the remaining five of which discuss the contemporaneous evidence and clear and convincing evidence standards that will be applied in evaluating requests for corrections of an error.

3. Subsection (c) states the rule that no correction request shall be granted where the correction would result in the actuality or possibility of the credits being claimed more than once.

4. Subsection (d) contains additional limitations that will apply to defective assignments made in taxable years beginning on or after January 1, 2017. The purpose of this rule is to allow taxpayers to become familiar with the requirements under RTC section 23663 and these regulations, and to allow taxpayers to correct errors for approximately one year after this regulation's assumed effective date before the rules become more restrictive.

First, the additional limitations provide that no corrections of an error under this regulation will be allowed that have the effect of allocating an amount of credits greater than that shown on the original assignment form, which means that in the case of defective assignments where the amount is not clear on the original assignment form, this rule would preclude any correction since the amount for the limitation would be zero. Second, in the case of defective assignments relating to the wrong assignor, the wrong, ineligible or unspecified assignee, the wrong or unspecified amount of identical credit, or the wrong or unspecified amount of credits assigned, a request under this regulation would only be permitted once every four years, with the four years to be determined on a rolling basis. Three examples illustrate the additional limitations described above.

5. Subsection (e) provides a special election for taxpayers whereby for one year following the effective date of this regulation, assignors may elect to request corrections of prior defective assignments without regard to the rule precluding application of this regulation after the subsequent taxable year's tax return is filed. This special election is intended to allow taxpayers to correct defective assignments made in years prior to the promulgation of these regulations to come forward to correct all defective assignments without limitation on the number of requests or the type of defect.

23663-5 – Special Rules

1. Subsection (a)(1) provides that a credit assigned in a defective assignment cannot be claimed, assigned or used in any way by any taxpayer, including the assignor or assignee, unless and until the FTB has specifically allocated that credit to a taxpayer pursuant to Regulations 23663-2 through 23663-5. The purpose of effectively freezing credits until the FTB has allocated them is to make it clear that taxpayers may not apply the rules in Regulations 23663-2 through 23663-5 on a self-help basis, but instead, the rules may only be applied by the FTB either on its own initiative or upon request by an assignor and following review of that request.

Subsection (a)(2) provides that an assignor cannot unilaterally reassign credits which were the subject of a defective assignment unless and until the rules of Regulations 23663-2 through 23663-4 have been applied as of an adjustment date and allocated any credits back to the assignor by the FTB, even though the rules contained in these regulations would have allocated these credits back to the assignor as of the time of the defective assignment (the "effective date of an adjustment"). Subsection (a)(2) treats any attempted assignment by the taxpayer before an allocation back to the assignor as an "invalid assignment" that cannot be corrected or otherwise fixed rather than as a defective assignment under Regulations 23663-2 through 23663-5. The reason for this rule is that an invalid assignment is viewed as an attempt to sidestep one of the core principles of these regulations, which is that a credit in a defective assignment must be allocated by the FTB, either upon request or following an audit, under these regulations to be available to an assignor or assignee.

Subsection (a)(3) provides that where an assignee has claimed a credit in a closed year that was the subject of an invalid assignment as described above, then the assignor's remaining credits shall be reduced in the same manner as specified in Regulation 23663-3(c); notably, even if the assignee were an otherwise eligible assignee, the credits claimed in a closed year would result in the assignor's credits being reduced and not allocated to the eligible assignee as would be the case for a defective assignment under Regulation 23663-2. Later, to the extent the assignee's closed year opens for the improperly claimed credit and the FTB discovers it, the FTB would attempt to assess the assignee for that claimed credit. An example is provided to illustrate an invalid assignment.

2. Subsection (b) provides rules regarding the finality of an election to assign credits, and also specifies the allocation and reduction ordering rules that apply to defective assignments. The purpose of these rules is first to clarify that if audit or other later adjustments result in an increase in the assignor's tax liability for the taxable year of the original assignment, the valid assignments will not become defective or otherwise be set aside to offset the increased tax liability of the assignor. Specifically, under these rules, the

assignor's available credits for a taxable year are first allocated to valid assignments, and adjusted by the allocations and reductions pursuant to these regulations, and, lastly, available to be claimed against the assignor's tax liability. Allocating available credits first to assignments is consistent with the statute's requirement that assignments are irrevocable once made. This approach is also consistent with having adjustments under Regulation 23663-3 occur before adjustments under Regulation 23663-2, when simultaneous adjustments occur under both regulations, as this allows an otherwise defective assignment due to the assignor not having enough credits to be a valid assignment.

3. Subsection (c) provides several ordering rules that apply to Regulations 23663-2 through 23663-5. First, for purposes of limitations on requests that can be made either for corrections of an error or alternative allocations, subsection (c)(1) specifies that if the request doesn't clearly specify the regulation and subsection under which the request is being made, and the request could have been made under Regulation 23663-4 and also under Regulation 23663-2 or 23663-3, then the request is treated as if it were made under Regulation 23663-4.

Subsection (c)(2) specifies that when both Regulation 23663-2 and 23663-3 are being applied to correct defective assignments simultaneously, the rules of Regulation 23663-3 are applied before the rules of Regulation 23663-2. Applying the rules in this order increases an assignor's available credits for assignment so that an assignment which would have otherwise been a defective assignment under Regulation 23663-2 may become a valid assignment and, in the case where an assignment is defective under Regulation 23663-2 because an assignor does not have the amount of credits being assigned, there would be a larger pool of credits to allocate to the intended eligible assignees.

Subsection (c)(3) provides that in any situation where an assignee has claimed credits in a closed year, for purposes of calculating the amount of credits claimed by such assignee in the closed year, Regulations 23663-2 and 23663-3 shall first reduce credits of the same type that the assignee has from other sources, such as where the assignee generated the credits itself or was assigned the credits under a different provision of the RTC. Thus, this rule would, to the extent that an assignee claimed a credit in a closed year and has the same type of credit from sources other than from the defective assignment, treat the claimed credit as first coming from a source other than the defective assignment. Not only does this potentially increase the amount of credits to be allocated back to the assignor or to other assignees, but it reduces the number of situations where assignees claim credits that they were improperly assigned for adjustments dealing with Regulation 23663-3 and allows a more pro rata allocation of credits for adjustments dealing with Regulation 23663-2. Finally, three examples are provided to illustrate the ordering rules above.

4. Subsection (d) provides a special rule regarding the effect and timing of any adjustments under Regulations 23663-2 through 23663-5, so that they are treated as if they had been made on the originally-filed tax return in the year of the defective assignment. Likewise, any credits that are required to be reduced under Regulations 23663-2 through 23663-5 are also treated as being reduced as of the taxable year of the defective assignment. These rules also allow, in certain instances, credits allocated back to an assignor to be allocated to another assignment in the taxable year of the defective assignment which would otherwise have been another defective assignment due to an assignor having less credits than the amount assigned. Further, this subsection provides that if the allocated credits are again the subject of a later defective assignment, the original assignment for purposes of analyzing the subsequent defective assignment under Regulations 23663-2 through 23663-5 is the previous allocation made under these regulations, not the actual original defective assignment made on the assignor's originally-filed tax return. Finally, an example is also provided.

5. Subsection (e) provides a series of additional rules that apply to Regulations 23663-2 through 23663-5. First, subsection (e)(1)(A) provides that all assignments made in a taxable year are treated as having been made simultaneously. This simultaneous rule results in assignments made in the same taxable year all being treated the same and is also consistent with Regulation 23663-2(b), which groups same year assignments of the same type of credit in determining whether all are defective assignments.

Subsection (e)(1)(B) specifies a first-in-time rule whereby assignments made in prior taxable years are treated as having occurred prior to assignments made in subsequent taxable years.

Subsection (e)(2) provides that an adjustment based on credits being claimed in a closed year are final, and even if the defective assignment is later adjusted again under these regulations, the allocations based on a year being closed will not be revisited even if the year is open at the time of the subsequent adjustment date. This is consistent with the rules in subsection (d), which treats an adjustment under these regulations as having been made on a timely-filed original tax return and having occurred at the time of the original tax return. This rule also gives taxpayers certainty that an adjustment is final and the basic adjustment ratios will not later change even if a closed year opens up. This approach also adds finality to adjustments so that they are not contingent on future events possibly occurring, and avoids a perceived burdensome administrative issue.

Subsection (e)(2)(C) provides an ordering rule for assignments made in the same taxable year under different sections of the RTC. To the extent an assignor assigns a credit under a RTC section different than RTC section 23663 and also assigns that same identical credit type under RTC section 23663 in the same taxable year, the subsection treats assignments

under the sections other than RTC section 23663 as being made before assignments under RTC section 23663.

Subsection (e)(3) provides the rule that any credits defectively assigned to an assignee that does not join a request to apply Regulations 23663-2 through 23663-4 will not be adjusted under those regulations. Instead, the credits will remain unadjusted credits from a defective assignment which cannot be claimed by either the assignor or assignee until the rules of these regulations are first applied. Notably, the language in subsection (d) which treats adjustments as having been assigned on a valid original tax return do not apply to these credits which are not allocated. Also, if a defective assignment is corrected and a portion of the credits are excluded from the correction due to a party to the defective assignment not joining a request to apply these rules, then the portion of credits that are adjusted under these rules are treated as having been assigned on a valid tax return but the unadjusted credits are not. Therefore, if the FTB then issues a notice of proposed deficiency assessment regarding this defective assignment, the adjusted credits would be allocated based on the adjustments being treated as having occurred on an original tax return, and the unadjusted amounts would be adjusted based on the actual original tax return.

Subsection (e)(4) provides that an assignor may only request that the defective assignment rules be applied to a defective assignment once. Afterwards, the assignor is prohibited from requesting that the default rules be applied, even if another defect is discovered. In this situation, neither the assignor nor the assignee would be able to claim or assign the credits until an adjustment under these regulations allocates the credits to the assignor or assignee as of an adjustment date. This rule is based on the statute's requirements that an assignment be irrevocable and be made on an original tax return, and requires an assignor correcting a defective assignment to thoroughly prepare their request to correct a defective assignment, as opposed to revisiting the defective assignment on a continual basis. In this regard, allowing assignors to make multiple adjustments to a single defective assignment would also give the parties to the defective assignment no certainty as to the finality of these adjustments.

Subsection (e)(5) provides a rule to allow the FTB to allocate credits if taxpayers do not provide requested credit usage information. Since many of the rules of these regulations require information as to the amount of credits claimed in closed years, subsection (e)(5) assumes that the FTB may not have access to information regarding whether a party to a defective assignment has claimed credits in a closed year. Therefore, this subsection requires that a party to a defective assignment provide the FTB with tax returns upon request. If the party does not provide the FTB with copies of the relevant tax returns, then adjustments are made under these regulations based on the conclusive presumption that a party who did not provide the required tax returns in fact claimed all credits allocated to it in a closed year. This rule is necessary for the administration of these regulations; otherwise,

adjustments made by the FTB would give taxpayers and the FTB no certainty that an adjustment was final and what the ultimate allocation of credits would be. Accordingly, under subsection (e)(2) and other provisions of these regulations an adjustment based on this subsection is a final adjustment as if made on an originally-filed tax return, and cannot be contested even if the party who did not respond within 45 days later provides evidence that no credits were claimed in a closed year.

Subsection (e)(6) provides that if two different assignors assign the same assignee the same type of identical credits in defective assignments, then any credits of that type which are considered claimed in a closed year shall be allocated under these regulations pro rata between the two defective assignments. However, if one assignor assigned credits in a valid assignment and another assignor assigned the same type of credits to the same assignee in a defective assignment, then any credits of that type which are considered claimed in a closed year are first attributable to the valid assignment.

Subsection (e)(7) provides that any adjustments under these regulations are not treated as if the credit being adjusted was recaptured under any recapture rules that may exist with respect to a particular credit that was assigned.

Four examples are provided to illustrate some of the above rules.

6. Subsection (f) provides the form and manner in which requests to apply Regulations 23663-2 through 23663-4 must be made, including any requirements that must be met in order for the request to potentially be allowed. Any requests which do not contain all of the required information are not considered valid requests under these regulations. When a taxpayer's request is incomplete, subsection (f)(5) allows the FTB, in its sole discretion, to give the taxpayer an additional 30 days to provide the missing information in which case the cured request will be treated as received on the date the original request was received. The purpose of subsection (f)(5) is to give the FTB discretion to allow a taxpayer to cure a request which included all necessary information, but would otherwise be invalid due to a minor piece of information not being included with the taxpayer's request.

7. Subsection (g) contains some miscellaneous rules. First, subsection (g)(1) states the rule that credit adjustments made by the FTB under these regulations could require the FTB to disclose relevant taxpayer information to other parties to a defective assignment, notably whether another taxpayer claimed a credit in a closed year, since this fact changes the allocations and reductions of credits required under these regulations. The disclosure rule clarifies that these disclosures during audit, protest or pursuant to a claim for refund are all treated as made during an administrative proceeding regarding tax administration for purposes of the disclosure provisions of RTC section 19545.

Subsection (g)(2) states the rule that any credits improperly claimed in a manner inconsistent with the provisions of Regulations 23663-2 through 23663-5 shall be treated as a math error adjustment under RTC section 19051.

Subsection (g)(3) clarifies that the variables discussed in the various examples within the regulations are the focus of the examples, and that it is not intended by the FTB that information omitted from a particular example may be relied upon in any manner as supporting a conclusion on a different issue under these regulations. Due to the many requirements of the statute and underlying regulations, the examples in these regulations would be untenably long if all background information were included in each example.

SIXTY-DAY NOTICE OF CHANGES TO PROPOSED REGULATION SECTION 23663

The third interested parties meeting for proposed regulations under Revenue and Taxation Code (RTC) section 23663 was held on June 12, 2014. At the third interested parties meeting staff elicited and received public comments on draft language for new regulations that address defective assignments under RTC section 23663. Staff informed the attendees that staff planned to amend the draft regulatory language based on the comments received at the interested parties meeting. Further, attendees generally indicated agreement with staff's proposal to have the amended regulatory language disseminated through an online posted notice, and that it would not be necessary to hold an additional interested parties meeting solely for the purpose of discussing the minor changes in the amended language. Attendees requested, and staff agreed, to allow the public at least 60 days, through November 1, 2014, to comment on the amended regulatory language.

This notice discusses the proposed amendments staff has made to the draft regulatory language based on comments at the June 12, 2014 interested parties meeting. All changes made to the regulatory language are tracked using the standard format of deleted language being struck through and added language being underscored. Staff intends to present the amended regulatory language at the Franchise Tax Board meeting on December 4, 2014 and request permission to proceed with the formal Administrative Procedures Act process following that meeting. However, staff may delay bringing proposed language to the Franchise Tax Board in order to address any comments or concerns raised by or received from interested parties in response to this notice.

The following documents are posted with this notice:

- The Meeting Notice for the third interested parties meeting held on June 12, 2014.
- The Amended Proposed Regulations 23663-1 through 23663-5 based on the amendments discussed within this notice.

The proposed amendments are summarized below.

1) Regulation 23663-3(d)(2)

The proposed regulation states that when the Franchise Tax Board (FTB) audits an assignor or assignee and determines that the assignor and assignee were not unitary on the required dates for a credit assignment, then the credits that were the subject of that defective assignment are not available to the assignor until a final determination that the assignor and assignee were not unitary is made for both the assignor and assignee. Furthermore, the regulation provides that if the FTB only issued a notice of proposed assessment (NPA) for the assignor or assignee, but not both, then the credits still would not be available to the assignor until a final determination had been made for both the assignor and assignee.

Amended language: In the case where the FTB issues an NPA for only the assignor or the assignee, but not both, then the limitation on the credits shall be based solely on whether a final determination has been made for the entity to whom the NPA was issued.

2) Regulation 23663-4(b)(3) and -(4)(b)(4) and Regulation 23663-4(d)(2)

In the proposed regulation a correction of an error is allowed when a taxpayer presents clear and convincing contemporaneous evidence demonstrating that an error was made on the taxpayer's defective assignment and what the intended assignment was. The proposed regulation includes a number of examples demonstrating how the department would view various kinds of evidence. A practitioner expressed concern that the details of an assignment may not be documented, which in turn would result in a taxpayer not being able to take advantage of the correction of an error rules. Staff believes the documentation standards in the regulation are necessary to avoid retroactive tax planning and are also necessary in order to be consistent with the statute's explicit requirements that assignment elections be made on an original tax return and be irrevocable once made. Further, staff notes that the correction of an error regulation is a special, generous exception created to allow the correction of defective assignments only in those limited circumstances where evidence contemporaneous to the defective election clearly and convincingly demonstrates the intended assignment. Finally, staff notes that the proposed regulation informs taxpayers of exactly what is necessary to document an assignment, so taxpayers can choose to document their assignments in a manner which allows them to take advantage of the correction of an error rules.

However, staff notes that the proposed regulation allows a correction of an error request to be made only once every four taxable year period. Therefore, to the extent a taxpayer requests a correction of an error but the request is not granted, the four taxable year limitation would apply. Staff proposes instead basing the limitation on those instances in which a request is both requested and granted.

Amended language: The four taxable year limitation will only be triggered when a correction of an error request is requested and granted.

3) Regulation 23663-4(b)(6)

The proposed regulation states that a request for the correction of an error must be made no later than 60 days before the filing date of the taxpayer's subsequent year's tax return. The 60-day deadline was originally inserted in order to allow staff sufficient time to review a request and respond to a taxpayer before their next tax filing deadline. At the interested parties meeting a practitioner proffered that many prior year defective assignments would likely not be noticed by practitioners until after the 60-day deadline had passed, and would likely only be discovered during the preparation of the subsequent year's tax return. After due consideration of the comment, staff believes that allowing taxpayers to request a correction of an error through their tax filing deadline for their subsequent year's tax return outweighs the benefit of having staff respond to such request before the taxpayer's tax filing deadline.

Amended language: The request for a correction of an error will be due no later than the earlier of the extended due date or filing date of the taxpayer's subsequent year's tax return.

Staff further notes that additional very minor, self-explanatory grammatical and other changes that were discussed at the third interested parties meeting were also made to the proposed regulatory language. In addition, the headers for Regulations 23663-1 and 23663-5 were moved to inside the regulations to comport with the department's general regulation drafting style.

Written comments regarding the amended language will be accepted until 5:00 p.m. on November 1, 2014. All inquiries and written comments concerning this notice should be directed to Ciro Immordino or Richard Tay per the below contact information.

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This notice and the proposed amendment will also be made available at the Franchise Tax Board's website at www.ftb.ca.gov.