

Request for Permission to Proceed with Discussion Draft of Proposed Regulation 25106.5-11, Relating to the Filing of a Group Return by California Taxpayer Members of a Combined Reporting Group

Each taxpayer that is subject to the California Corporation Tax Law has an obligation to file a return. If a taxpayer conducts business within and without California, it must attach to its return a copy of a combined report, which shows how its business income is apportioned amongst the various states. In many instances, many California corporate taxpayers are members of the same combined reporting group. This means that the same combined report relates to each of them. Therefore, each must file its own return, attaching a copy of the same combined report to each return. This creates administrative difficulties and burdens, both for taxpayers and the Franchise Tax Board.

As a matter of administrative convenience, it has been the Franchise Tax Board's practice to allow taxpayers that are members of the same combined reporting group to file a single "group return," thereby satisfying each taxpayer's return-filing obligation. Attached to this return is a copy of the combined report, which shows how the business income of the group is apportioned amongst the various states. To qualify for this treatment, one of the affiliated taxpayers had to agree to be designated as the "key corporation" for the combined reporting group. The key corporation agreed to act as agent and surety for the remaining taxpayers included in the combined report. This allowed affiliated taxpayers to avoid the burden of filing duplicative combined reports, while allowing the Franchise Tax Board to coordinate with only one taxpayer as opposed to many. The designation of the key corporation and the identification of the remaining taxpayer members included in the single group return was effectuated by attaching a completed Schedule R, Schedule R-7, to the Form 100 that was filed by the designated key corporation.

The taxpayer community has followed this existing practice, so staff does not anticipate that this discussion draft of the proposed regulation will be controversial. This new proposed regulation will simply formally codify the department's long-standing administrative practice described above.

Staff requests approval to follow the partial symposium process described in the Chief Counsel's January 15, 1999, memorandum to the Board regarding processing regulations and to announce a tentative symposium. If no public interest is expressed and/or no written comments are received, staff requests approval to cancel the symposium and to instead commence the formal regulatory process. In the event the symposium is cancelled, staff proposes to publish a notice of cancellation on the department's website fifteen days before the date set for the symposium.

Section 25106.5-11 is adopted to read:

§ 25106.5-11. Election to File a Group Return.

(a) General. Every taxpayer subject to the California Corporation Tax Law is required to file its own tax return, including taxpayers that are members of a combined reporting group. Taxpayers subject to the California Corporation Tax Law that are members of a combined reporting group are required to attach a combined report to their tax returns. Notwithstanding these requirements, taxpayers subject to the California Corporation Tax Law that are members of a combined reporting group that includes another taxpayer that is also subject to the California Corporation Tax Law may annually elect to be included in a "group return" as provided for in this regulation. (See Regulation section 25106.5, subsections (b)(1), (3) and (13)).

(b) Requirements.

(1) In order to be eligible to make the election provided under this section, a "key corporation" (see Regulation section 25106.5, subsection (a)(14)) must be either---

(A) the parent corporation of the combined reporting group, or

(B) if the parent corporation of the combined reporting group is not a taxpayer member, the taxpayer member with the largest California property factor numerator, and

(C) the key corporation's powers, rights and privileges must not be forfeited or suspended and it must not have a petition with the United States Bankruptcy Court pending on the last day of the taxable year.

(2) A "taxpayer member" (see Regulation section 25106.5, subsection (b)(11)) is a corporation that---

(A) is required to file a return in this state under Revenue and Taxation Code section 18601,

(B) is a member of a combined reporting group, which includes the key corporation,

(C) has the same taxable year as the key corporation or has a taxable year wholly within the key corporation's taxable year, and

(D) has the same statutory return filing due date as the key corporation for the taxable year.

(c) Manner for Making the Election. An election to file a group return is made by the key corporation filing a California Form 100, Schedule R-7 of Schedule R, which identifies the name, California corporate number, federal employer identification number and total self-

assessed tax liability of the affiliated taxpayer members of a combined reporting group that are intended to be included in the group return.

(d) Consequences of Making an Election.

(1) The election is binding on all the taxpayer members and the key corporation for all matters for the taxable year of the election.

(2) The key corporation shall file the group return. The group return satisfies the requirement for filing a California Form 100 for each taxpayer member listed on the key corporation's Schedule R-7.

(A) By signing the California Form 100, an officer of the key corporation is attesting that he has the legal authority to bind the key corporation to all of its duties.

(B) Failure of a taxpayer member to file its own return shall be deemed to be an acknowledgement that the officer of the key corporation possesses the authority to fulfill the taxpayer member's return filing obligation.

(C) A taxpayer member asserting that it is not properly included in a group return must independently satisfy its obligation to file a return.

(3) The key corporation is a surety for each taxpayer member for payments owed under the California Corporation Tax Law.

(4) The key corporation is an agent for each taxpayer member.

(5) Extensions or waivers of the statute of limitations shall be executed by the key corporation and shall be effective for all taxpayer members.

(6) All notices regarding the liability of a taxpayer member may be sent to the key corporation and additional amounts due with respect to any taxpayer member may be assessed and billed to the key corporation and it shall be liable for payment of such amounts. Any refund or credit due to a taxpayer member may be made to the key corporation.

(7) If some or all of the corporations included in the election to file a group return are subsequently determined not to be members of the combined reporting group of the key corporation, then the key corporation and the electing taxpayer members shall be deemed to agree that any subsequent adjustment for any and all members included in the original group return may still be assessed to, billed to or paid by the key corporation.

(e) Duration of election to file group return. The election to file a group return for all matters for the taxable year of the election will remain in effect until 30 days following the receipt by the Franchise Tax Board of a written notice of termination of the election by any of the taxpayer members. If an employee, agent or representative of the Franchise Tax Board is conducting an

examination of a single group return at the time when any of the taxpayer members sends a written notice of termination to the Franchise Tax Board, the terminating taxpayer member must provide the employee, agent or representative of the Franchise Tax Board that is conducting the examination with a copy of the written notification of termination of the election.

(f) Failure or Inability of Key Corporation to Perform Its Duties. If the key corporation does not fulfill its obligation to pay any tax liability or to act on behalf of the taxpayer members, or if its powers, rights and privileges are forfeited or suspended at any time with respect to that taxable year, each taxpayer member may be independently assessed or billed for its own tax liability. In that event, each taxpayer member will be credited with taxes previously paid in accordance with the taxpayer member's self-assessed tax liability as indicated in the return data as filed. In the event that the self-assessed liabilities of the taxpayer members cannot be derived from the return data as filed, the individual liabilities of the each of the respective members may be determined by the Franchise Tax Board from data obtained during audit or supplied by the taxpayer members, using the best available information. If insufficient information is available to determine individual liabilities, the Franchise Tax Board, may, in its discretion, credit taxes paid in a manner that is reasonable under the circumstances.

(g) Curing an Invalid Election.

(1) In the event that a taxpayer fails to satisfy one or more of the conditions of this regulation, the Franchise Tax Board may, at the request of the taxpayer and at its own discretion, treat the election as being valid.

(2) In lieu of disallowing an election, the Franchise Tax Board may, at its own discretion, allow the taxpayer members to designate another taxpayer member in substitution for the key corporation originally designated in the election.

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

Reference: Section 25106.5, Revenue and Taxation Code.