

**Request for Permission to Proceed with the Formal Regulatory Process  
to Adopt Proposed Regulation Section 24465-3, Relating to the Annual Reporting  
Requirement for the Transfer of Appreciated Property to an Insurer**

The purpose of proposed California Code of Regulations section 24465-3 is to implement subdivision (c) of Revenue and Taxation Code (RTC) section 24465, the annual reporting requirement for those corporations that transfer appreciated property to an insurer and claim the gain deferral provided under subdivision (b) of RTC section 24465 (transferred property used in the active conduct of a trade or business of the insurer).

Subsection (a) of the regulation provides a non-exhaustive list of data to be provided on the annual statement.

Subsection (b) prescribes when and how the annual statement is to be filed.

Subsection (c) sets forth a records retention requirement.

RTC section 24465 is an anti-abuse provision enacted in 2003 by the Legislature to proscribe the use of specified insurers as receptacles of appreciated assets transferred by affiliated corporations, effectively eroding the corporation tax base as those insurers are subject only to the gross premiums tax. Nevertheless, RTC section 24465 allows for a deferral of gain recognition if the transferred asset is used in the active conduct of the insurer's trade or business.

In order to provide the Franchise Tax Board with sufficient notice of the status of such transferred assets and subsequent trigger of the deferred gain, RTC section 24465, subdivision (c), provides that until that asset is subsequently disposed of and gain is fully recognized, an annual statement must be filed with FTB. This regulation would prescribe the parameters for the contents of that annual statement.

This regulation is authorized by RTC section 24465, subdivision (c) specifically, and RTC section 19503 generally, which provides in subdivision (a) that "[t]he Franchise Tax Board shall prescribe all rules and regulations necessary for the enforcement of Part 10 (commencing with Section 17001), Part 10.7 (commencing with Section 21001), Part 11 (commencing with Section 23001), and this part and may prescribe the extent to which any ruling (including any judicial decision or any administrative determination other than by regulation) shall be applied without retroactive effect."

An Interested Parties Meeting was held on February 15, 2011, to elicit public input on a proposed regulation to implement RTC section 24465, subdivisions (c) and (f). The Discussion Topics from the February 15, 2011, Interested Parties Meeting provided a general background of the purpose behind the proposed regulation, and general principles upon which staff intended to base the proposed regulation language. After this first

Interested Parties Meeting, language for the proposed regulation was drafted based upon the public comments received at that first Interested Parties Meeting.<sup>1</sup>

A second Interested Parties Meeting was held on March 29, 2012, during which a draft of the proposed language was discussed with the public. The language of the proposed regulation section was generally acceptable to the interested parties in attendance. A question was raised as to whether the proposed regulation could include a provision addressing an unintentional non-filing of the annual statement for the taxable year of the transfer, where the department has not been prejudiced and/or had yet to begin auditing the transferor/taxpayer, and whether such a non-filing could be excused. Staff took this comment into consideration when drafting the attached proposed regulation language, and determined that such an exception would conflict with the terms and tenor of the statute. In enacting RTC section 24465, the Legislature specifically inserted a "reasonable cause" exception only for post-transfer taxable years. Moreover, as RTC section 24465 is an anti-abuse provision, providing yet another exception to an existing exclusionary provision would tend to irreparably erode the statute's effectiveness. In addition, based on public input, staff added clarifying language and a record retention requirement.

Staff believes that the regulation as proposed provides appropriate guidance regarding the annual statement prescribed in RTC section 24465, subdivision (c), and requests permission to commence the formal regulatory process under the Administrative Procedure Act.

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<sup>1</sup> No public input was provided with respect to section 24465, subdivision (f) and, thus, staff decided not to proceed thereon.

Section 24465-3 is adopted to read:

§ 24465-3. Annual Statement.

(a) The annual statement required under Revenue and Taxation Code section 24465, subdivision (c), shall include, but is not limited to, the following information:

- (1) Transferor name, California corporation number (if available) and federal employer identification number (FEIN).
- (2) Insurer Name, California corporation number (if available) and FEIN.
- (3) Taxable year and date of transfer of property to Insurer.
- (4) Description and location of property transferred to Insurer.
- (5) Fair market value and adjusted basis of transferred property on date of transfer.
- (6) Whether the property transferred is used in the active conduct of the Insurer's trade or business.
- (7) Whether the Insurer disposed of, in whole or in part, any transferred property during the taxable year.
- (8) Whether the Insurer disposed of any transferred property to a member of the transferor's combined reporting group or to another Insurer in the transferor's commonly controlled group during the taxable year.
- (9) Whether ownership of the holder of the transferred property has changed during the taxable year.
- (10) Taxable year and date of disposition by Insurer.
- (11) Description, percentage and location of property disposed of.
- (12) Amount realized from disposition and adjusted basis of property disposed of.
- (13) If shares of stock were transferred to Insurer, percentage of Insurer or transferred stock (measured by relative fair market value) that was subsequently transferred or disposed of.
- (14) Whether Insurer or transferred entity issued additional or canceled existing shares of stock during the taxable year. If so, indicate number of shares outstanding before and after such issuance or cancellation.

(15) Whether Insurer or transferred entity issued another class of stock or type of equity interest.

(16) Whether the equity interest in the transferred entity became worthless.

(17) Signatures of Transferor and Insurer.

(18) Any other information necessary to identify the property transferred and to compute the amount of gain deferred and the amount of gain to be recognized.

(b) The statement prescribed herein shall be filed for each taxable year that gain is deferred under Section 24465, subdivision (b), with the transferor's original return, on a form and in the manner prescribed by the Franchise Tax Board.

(c) The transferor and any person filing the annual statement shall retain all books and records relating to the contents thereof until such statement is no longer required to be filed and the limitations periods for issuing notices prescribed under Part 10.2 of the Revenue and Taxation Code have expired.

NOTE: Authority cited: Section 19503, Revenue and Taxation Code.  
Reference cited: Section 24465, Revenue and Taxation Code.