

**Explanation of the Discussion Draft**, California Code of Regulations, title 18, section 25137, subsection (b). Special Rules. Property Factor.

Attached is a discussion draft of a proposed addition to the regulation addressing special rules for the property factor of the apportionment formula.

The addition to the existing regulation will apply to taxpayers who use property owned by third parties to extract natural resources such as timber, oil, gas or hard minerals, but who either pay no rent or a nominal rent for use of that property. The proposed addition calculates the net annual rental rate to be included in the property factor by including only those payments required to be made by the taxpayer to the holder of interest in the property, multiplied by eight.

Regulations adopted to implement UDITPA provide for an adjustment of the standard apportionment formula under certain circumstances. The discussion draft amendments provide for treating royalty and other payments made for timber, oil, gas and hard mineral interests located on the property of someone other than the taxpayer as rent for property factor purposes. The draft amendments reflect the Franchise Tax Board's current administrative practice, as set forth in Legal Ruling 97-2, that such payments constitute fair rental values and provide appropriate property factor representation for the assets at issue.