

**FINAL STATEMENT OF REASONS FOR THE  
ADOPTION OF AMENDMENTS TO  
CALIFORNIA CODE OF REGULATIONS,  
TITLE 18, SECTION 17952**

The proposed regulations do not impose any mandate on local agencies or school districts.

**UPDATE OF INITIAL STATEMENT OF REASONS**

The public Notice required by Section 11346.4 of the Government Code was mailed and published in the California Notice register on May 26, 2006. The hearing was held, as noticed, on July 17, 2006, to consider the adoption of proposed amendments to regulation section 17952 that address when the source of income from the sale or other disposition of intangible property is determined. There were six attendees at the hearing and oral testimony was received from three individuals representing various interests. Forty written comments were received during the comment period, which ended on July 17, 2006. A summary of and responses to the comments received was prepared and is included in the rulemaking file as Tab 11.

As a result of comments received, non-substantial, sufficiently related changes were made to the initial proposed regulation. The changes were noticed in a 15-day change notice, mailed on January 26, 2007. No comments were received regarding the 15-day changes.

The final version of the regulation was presented to the Franchise Tax Board for its approval at its December 4, 2006, public meeting. The Board was provided with all of the comments received during the regulatory process as well as responses to the comments. The Board approved the regulation by a vote of 3-0. A transcript of that meeting is included in the rulemaking file as Tab 11.

Although stated in various ways, the comments fell into 7 categories:

- The examples presented as part of the proposed amendment were read as requiring solely the application of the mobilia doctrine and precluding the application of the business situs exception;
- The proposed regulation is seen as incompatible with the repeal of Revenue and Taxation Code section 17554 and other changes made pursuant to AB 1115 (Stats. 2001, ch. 920);
- Questions were posed regarding the application of federal or California-only elections out of the installment method;
- There were questions concerning how, particularly, installment sales would be sourced and which intangible property gave rise to the sourcing of income;
- Since this is a clarifying regulation, challenges were made to the FTB's authority to apply this policy prior to the adoption of this amendment;
- A request for the inclusion of further examples; and
- A petition for staff to survey how other states handle this issue and the availability of the Other State Tax Credit to former nonresidents now living in California for taxes imposed

by states where they formerly resided on these types of gains, assuming those states adopt the same approach as provided in the proposed amendment.

First, as provided in the 15-day notice, staff recommended a change to the proposed language to resolve the first category of comments.

Next, staff does not agree the proposed amendment to regulation section 17952 is incompatible with the repeal of Revenue and Taxation Code section 17554 or contrary to the changes made under AB 1115. Staff believes the proposed amendments to regulation section 17952 are merely clarifying how the sourcing rules already work.

Revenue and Taxation Code section 17554 was repealed in 2002, operative for taxable years beginning on or after January 1, 2002. That section provided for the accrual of income under certain circumstances upon a change of residency. It was repealed, in part, because subsequent to the *Appeal of Money* in 1983, section 17554 was rarely applicable.<sup>1</sup> The *Appeal of Money* provided Revenue and Taxation Code section 17554 would apply only when two conditions were satisfied: (1) when California's sole basis for taxation is the taxpayer's residency, and (2) when that taxation would differ depending on whether the taxpayer used the accrual or the cash method of accounting. Since the Board of Equalization limited section 17554 to only cases of California residency, it was not applicable to nonresidents even back to 1983. Therefore, its application or repeal has no bearing on a sourcing rule applied to nonresidents.

As stated in various pronouncements, AB 1115 specifies clear, definitive rules that will be applied consistently to all taxpayers for calculating loss carryovers, deferred deductions, and deferred income. Specifically it provides resident taxpayers will be taxed based on residency jurisdiction and carryovers and deferred items will be calculated regardless of source. Nonresident taxpayers will be taxed solely based on sourcing jurisdiction and carryovers and deferred items will be calculated to reflect such approach. This regulation project was begun as part of the AB 1115 implementation. At that time, it was determined by FTB staff that existing sourcing rules did not adequately address the timing of sourcing in the case of the sale or other disposition of intangible property. The FTB has authority under Revenue and Taxation Code section 17954 to promulgate rules and regulations in this area. It is fundamental that sourcing principles apply at the moment of realization since they apply to attach jurisdiction to the sale or other disposition and the resulting income, not personal jurisdiction over the individual.

Staff responses to the remaining comments can be found in the rule-making file as Tab 11.

Briefly,

- Federal elections remain valid and California taxpayers may make California-only elections out of the installment method.
- The intangible property sold or otherwise disposed of gives rise to the sourcing of the income. The installment note itself is a deferral mechanism. Absent that deferral, the income would be recognized at realization.

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<sup>1</sup> *Appeal of Money* (December 13, 1983) 83-SBE-267.

- The proposed amendment is a clarification of how the law operates presently.
- The example proposed concerns a California resident. Revenue and Taxation Code sections 17951 through 17955 concern the taxation of nonresidents. Specifically they address sourcing rules that are only relevant to nonresidents. Resident taxpayers are taxable on all income, regardless of source. Staff recommends no change.
- Staff conducted a survey as requested and included the results in its official responses to comments. The Other State Tax Credit remains available to former nonresidents now living in California for taxes imposed by the states where they formerly resided on these types of gains, assuming those states adopt the same approach as provided in the proposed amendment.

No other major concerns were raised, and technical changes made through a 15-day notice received no comments.

### **ALTERNATIVES DETERMINED**

The Franchise Tax Board has not received any proposed alternatives that would be more effective in carrying out the purpose of the proposed regulation or would be as effective and less burdensome than the proposed regulation.