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

PUBLIC PROBLEM THAT THE REGULATION IS INTENDED TO ADDRESS

Revenue and Taxation Code section 17554 was repealed in 2002, operative for taxable years beginning on or after January 1, 2002.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.

The proposed amendment to California Code of Regulations, title 18, section 17952, is intended to provide clarification and guidance to the taxpayer community and audit staff concerning when the source of income from the sale or other disposition of intangible property is determined. Under the *mobilia* doctrine, absent a business situs, intangible property is sourced to the state of residence of the owner. If a California resident sells intangible property, the gain is taxable under a residency theory. If a California nonresident sells intangible property, the gain would be sourced to the nonresident's state of residence and California would not tax the gain, unless the intangible property had acquired a California business situs.

However, if a California resident sells intangible property under the installment method (or employs another type of deferral mechanism) and subsequently moves away, there may be some ambiguity as to the source of the gain. Arguably, the *mobilia* doctrine already provides that the source of the gain is in California because that is where the taxpayer resided when the property was sold. The source could not have moved with the taxpayer because he or she no longer owned the property.

This has not been an issue in the past because California would have applied Revenue and Taxation Code section 17554 to assert that the gain had already accrued prior to the move.

SPECIFIC PURPOSE OF THE REGULATION

This proposed amendment to the regulation adds subsection (d) to directly state that sourcing of gains or losses from a sale or other disposition of intangible property is determined at the time of that sale or other disposition. Deferral of the gain realized does not affect the sourcing rules for the income realized when that gain is ultimately recognized.

NECESSITY

Revenue and Taxation Code section 17954 provides that gross income from sources within and without this state shall be allocated and apportioned under rules and regulations prescribed by the Franchise Tax Board. Especially since the repeal of Revenue and Taxation Code section 17554, it is presently not clear how the sourcing rules apply with respect to the sale or transfer of intangible property.

The proposed regulation is needed in order to clarify to the taxpayer community and Franchise Tax Board audit staff that the income sourcing rules apply regardless of the accounting method of the taxpayer. It is realization, not recognition, of income that controls sourcing.

TECHNICAL, THEORETICAL, AND/OR EMPIRICAL STUDY, REPORTS, OR DOCUMENTS RELIED UPON

The Franchise Tax Board did not rely upon any technical, theoretical, or empirical studies, reports or documents in proposing adoption of this regulation.

ALTERNATIVES TO THE PROPOSED REGULATORY ACTION THAT WOULD LESSEN ANY ADVERSE IMPACT ON AFFECTED PRIVATE PERSONS OR SMALL BUSINESS

In accordance with Government Code section 11346.5, subdivision (a)(12), the Franchise Tax Board has determined that no alternative considered by it would be more effective in carrying out the purpose for which the action is proposed or would be as effective and less burdensome to affected private persons or small businesses than the proposed regulatory action.

Minimal impact to private persons or businesses is foreseen as a result of this regulation. The proposed regulation would only affect individual taxpayers who realize a gain from the sale of intangible property but defer recognition of that gain until after a change in residency. The only businesses that would be impacted would be "flow-through" entities, including partnerships, limited liability companies and S corporations, to the extent that their individual partners, members or shareholders, respectively, would be impacted. The proposed amendment to the existing regulation may make it easier for a taxpayer to anticipate the tax consequences when the deferral of tax liability is involved.

ADVERSE ECONOMIC IMPACT ON BUSINESS

The proposed regulatory action will not have a significant adverse economic impact on business. The proposed regulation does not provide any new reporting requirements.