

INITIAL STATEMENT OF REASONS FOR THE
ADOPTION OF CALIFORNIA CODE OF REGULATIONS,
TITLE 18, SECTION 24451

PUBLIC PROBLEM, ADMINISTRATIVE REQUIREMENT, OR OTHER CONDITION OR
CIRCUMSTANCE THAT THE REGULATION IS INTENDED TO ADDRESS

The proposed regulation is intended to make IRS Notice 2008-83 not applicable for California tax purposes, as if that federal Notice was never issued.

SPECIFIC PURPOSE OF THE REGULATION

IRS Notice 2008-83, I.R.B. 2008-42, dated October 20, 2008, provides that "[f]or purposes of section 382(h), any deduction properly allowed after an ownership change (as defined in section 382(g)) to a bank with respect to losses on loans or bad debts (including any deduction for a reasonable addition to a reserve for bad debts) shall not be treated as a built-in loss or a deduction that is attributable to periods before the change date." The IRS Notice further provides that "[c]orporations described in section 1 of this notice may rely on the treatment set forth in this notice, unless and until there is additional guidance."

The proposed regulation specifically makes IRS Notice 2008-83 not applicable for California tax purposes, as if that federal Notice was never issued.

NECESSITY

The proposed regulation is necessary to clarify that IRS Notice 2008-83, which makes the limitations under Internal Revenue Code (IRC) section 382 inapplicable to banks, has no effect for California tax purposes.

IRC section 382 protects against loss "trafficking" by barring an investor from achieving a greater benefit, through acquisition of a company with loss carryovers, than would be obtainable from an investment in tax-exempt securities. Absent the section 382 limitations, investors would use the acquired losses to offset their taxable income. Pursuant to Revenue and Taxation Code (RTC) sections 17024.5, 23051.5, and 24451, for taxable years beginning on or after January 1, 2005, California fully conforms to IRC section 382 as in effect on January 1, 2005.

In October of 2008, the Treasury Department issued Notice 2008-83, making IRC section 382 limitations on loss carryovers (including any deduction for a reasonable addition to a reserve for bad debts) in change of ownership circumstances inapplicable to banks. This resulted in a debate over whether the Notice conflicted with the legislative intent of IRC section 382 as well as whether the Treasury Department has the authority to provide exemptions or special rules restricted to particular industries or classes of taxpayers. Consistent with congressional action described below, the Franchise Tax Board views Notice 2008-83 as a precursor to federal regulatory action under IRC section 382(m). To date, the Treasury Department has not issued a regulation consistent with the Notice.

On February 17, 2009, the American Recovery and Reinvestment Act of 2009 (ARRA, Public Law 111-5) was enacted. Section 1261 of ARRA revoked Notice 2008-83 on a prospective basis for transactions consummated on or after January 16, 2009, with an exception for transactions for which a binding contract was in existence as of January 16, 2009. ARRA also declared that issuing the Notice was inconsistent with the congressional intent behind IRC section 382(m); that the legal authority to prescribe the Notice was doubtful; and, that the Secretary of the Treasury was not authorized under section 382(m) to provide exemptions or special rules restricted to particular industries or classes of taxpayers. However, ARRA allowed banks to rely upon Notice 2008-83 for federal income tax purposes in the case of transactions consummated before January 16, 2009.

For California tax purposes, RTC section 23051.5, subdivision (d), provides that unless Treasury Department's temporary and final regulations conflict with Part 10 or Part 11 or with FTB regulations, those Treasury regulations would be treated as regulations under Part 10 or Part 11. FTB believes that the Notice was issued as a precursor to a regulation that would conflict with section 382 limitations as applicable to banks.

Notwithstanding the issuance of the federal Notice and the subsequent congressional action in ARRA, FTB conforms to IRC section 382 prior to the Notice. This proposed regulation articulates the position that IRC section 382 limitations are and have always been applicable to banks. To clarify that Notice 2008-83 has no effect for California PIT and CTL purposes, either retroactively or prospectively, this FTB regulation is necessary.

TECHNICAL, THEORETICAL, AND/OR EMPIRICAL STUDIES, REPORTS, OR DOCUMENTS

The Franchise Tax Board is not relying upon any technical, theoretical, or empirical studies, reports or documents.

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

The Franchise Tax Board has determined that there were no alternatives considered which would be more effective in carrying out the purpose of proposed Regulation section 24451 or would be as effective and less burdensome to affected private persons or small business than the proposed regulation. In addition, the proposed regulation pertains to corporate taxpayers ("banks" as defined under federal law) and therefore does not affect private individuals.

ADVERSE ECONOMIC IMPACT ON BUSINESS

The Franchise Tax Board has determined that proposed Regulation section 24451 of Title 18 of the California Code of Regulations will not have a significant overall economic impact on business. The proposed regulation simply makes IRS Notice 2008-83 not applicable to California tax purposes and affects only banks, as defined under federal law.