INITIAL STATEMENT OF REASONS FOR
PROPOSED REGULATION SECTION 24465-3,
RELATING TO TRANSFER OF APPRECIATED PROPERTY TO INSURER

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

The proposed regulation is designed to implement subdivision (c) of Revenue and Taxation Code (RTC) section 24465, pertaining to 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).

SPECIFIC PURPOSE OF THE REGULATION

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.

The proposed language for this regulation addresses –

- The type and amount of data that is required to be reported;
- When and how the annual statement is to be filed; and
- Records retention.

NECESSITY/PROBLEM THE REGULATION INTENDS TO ADDRESS

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.

BENEFITS OF THE REGULATION

The regulation as proposed provides appropriate guidance regarding the annual statement prescribed in RTC section 24465, subdivision (c). The Franchise Tax Board will save resources by receiving timely notifications rather than having to physically track transferred property. There are no benefits of the regulation to the health and welfare of California residents, worker safety, and the state's environment.

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

In drafting the proposed regulation, the Franchise Tax Board primarily relied upon RTC section 24465, and existing Internal Revenue Code provisions (including Treasury Regulations promulgated thereunder) relating to corporate transactions. As a result, the Franchise Tax Board did not rely upon any other technical, theoretical, or empirical studies, reports or documents in proposing the adoption of this regulation.

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

In accordance with the requirement of Government Code section 11346.5, subdivision (a)(13), that the Franchise Tax Board consider alternatives to the proposed regulatory action, staff of the Franchise Tax Board conducted two interested parties meetings.

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.[1]

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.

As a result, the regulation as proposed provides appropriate guidance regarding the annual statement prescribed in RTC section 24465, subdivision (c), and the Franchise Tax Board has determined that no alternative would lessen any adverse impact on private persons or

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

small businesses. The proposed regulation would benefit taxpayers, tax practitioners, and the State by providing clarity about the information required on the annual statement.

ECONOMIC IMPACT ANALYSIS

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.

The regulation as proposed provides appropriate guidance regarding the annual statement prescribed in RTC section 24465, subdivision (c). The Franchise Tax Board will save resources by receiving timely notifications rather than having to physically track transferred property.

Pursuant to Government Code section 11346.3, subdivision (b), the Franchise Tax Board has made the following assessments regarding the proposed regulation:

Creation or Elimination of Jobs Within the State

Since RTC section 24465 is an anti-abuse provision and the proposed regulation only impacts certain entities that transfer appreciated property to insurers, there are no effects on the creation or elimination of jobs within the state.

Creation of New or Elimination of Existing Businesses Within the State

Since RTC section 24465 is an anti-abuse provision and the proposed regulation only impacts certain entities that transfer appreciated property to insurers, there will be no effect on the creation of new businesses or elimination of existing businesses within the state.

Expansion of Businesses or Elimination of Existing Businesses Within the State

Since RTC section 24465 is an anti-abuse provision and the proposed regulation only impacts certain entities that transfer appreciated property to insurers, there will be no effect on the expansion of businesses or the elimination of existing business within the state.

ADVERSE ECONOMIC IMPACT ON BUSINESS

Since RTC section 24465 is an anti-abuse provision and the proposed regulation only impacts certain entities that transfer appreciated property to insurers, the Franchise Tax Board has determined that there will be no adverse economic impact on business.