

## TITLE 18. FRANCHISE TAX BOARD

As required by section 11346.4 of the Government Code, this is notice that a public hearing has been scheduled to be held at 10:00 a.m., Monday, January 12, 2008, at 9646 Butterfield Way, Town Center, Golden State Room B, Sacramento, California, to consider amendment of section 25111 and adoption of section 25113 under Title 18 of the California Code of Regulations, pertaining to a water's-edge election.

An employee of the Franchise Tax Board will conduct the hearing. Interested persons are invited to present comments, written or oral, concerning the proposed regulatory action. It is requested, but not required, that persons who make oral comments at the hearing also submit a written copy of their comments at the hearing.

Government Code section 15702, subdivision (b), provides for consideration by the three-member Franchise Tax Board of any proposed regulatory action if any person makes such a request in writing.

### WRITTEN COMMENT PERIOD

Written comments will be accepted until 5:00 p.m., January 12, 2008. All relevant matters presented will be considered before the proposed regulatory action is taken. Comments should be submitted to the agency officer named below.

### AUTHORITY & REFERENCE

Section 19503 of the Revenue and Taxation Code authorizes the Franchise Tax Board to prescribe regulations necessary for the enforcement of Part 10 (commencing with section 17001), Part 10.2 (commencing with section 18401), Part 10.7 (commencing with section 21001) and Part 11 (commencing with section 23001) of the Revenue and Taxation Code. Section 25113 authorizes the Franchise Tax Board to prescribe any regulations that are necessary or appropriate to implement the purposes of that section. The proposed regulatory action interprets, implements, and makes specific section 25113 of the Revenue and Taxation Code, and makes necessary amendments to section 25111 to conform to statutory changes made to section 25111 of the Revenue and Taxation Code.

### INFORMATIVE DIGEST/PLAIN ENGLISH OVERVIEW

In 1988, the California Legislature adopted Revenue and Taxation Code section 25110, et seq., which allowed California taxpayers that were members of a unitary group to "elect to account for and determine their income derived from California sources by considering only the income and apportionment factors" of certain affiliated corporations, which are generally only the domestic members of the unitary group, which is called the "water's-edge" method.

Originally, taxpayers that wanted to utilize the water's-edge method of combined reporting were required to enter into a contract with the Franchise Tax Board for an 84-month period. The requirements for satisfying the terms of the contract were contained in Revenue and

Taxation Code section 25111 and the regulations promulgated thereunder. For taxable years beginning on or after January 1, 2003, the provisions for making a water's-edge election were substantially changed when Revenue and Taxation Code section 25113 was enacted and Revenue and Taxation Code section 25111 was amended. Revenue and Taxation Code section 25113 replaced the contract provided for in Revenue and Taxation Code section 25111 with a statutory election, which is also to be made for an 84-month period.

To date, there have been no regulations promulgated with respect to Revenue and Taxation Code section 25113. However, the Franchise Tax Board issued FTB Notice 2004-2 to address transition issues between the two statutes. Proposed regulation section 25113 incorporates some of the examples found in that Notice.

Revenue and Taxation Code sections 25111 and 25113 both provide that taxpayers that have a valid election for taxable years beginning before January 1, 2003 will continue to file on a water's-edge basis and will be deemed to have elected under the new rules for taxable years beginning on or after January 1, 2003. However, the election commencement date under the new rules will continue to be the start date as originally elected under the old rules. Existing regulation section 25111 is proposed to be amended to reflect this statutory change.

Proposed regulation section 25113 has a definition section that incorporates some of the definitions of regulation section 25111, such as "water's-edge group," and "original return." Proposed regulation section 25113 also provides definitions for terms found in Revenue and Taxation Code section 25113, such as "timely filed," "commencement date," "net book value," "parent corporation," "business assets," and "common parent election."

Proposed regulation section 25113 provides examples of the statutory election rules for taxpayers to use in both electing the water's-edge method and in terminating their water's-edge election. Examples are provided to illustrate situations when a water's-edge election is automatically terminated, terminated at the discretion of the taxpayer or when an electing taxpayer may request Franchise Tax Board consent to terminate its water's-edge election for good cause prior to the expiration of the 84-month period. Also, the proposed regulation provides guidance and examples on re-electing the water's-edge method after a taxpayer terminates its prior election.

#### DISCLOSURES REGARDING THE PROPOSED REGULATORY ACTION

Mandate on local agencies and school districts: None.

Cost or savings to any state agency: None.

Cost to any local agency or school district which must be reimbursed under Part 7, commencing with Government Code section 17500, of Division 4: None.

Other non-discretionary cost or savings imposed upon local agencies: None.

Cost or savings in federal funding to the state: None.

Significant statewide adverse economic impact directly affecting business including the ability of California businesses to compete with businesses in other states: None.

Potential cost impact on private persons or businesses affected: The Franchise Tax Board is not aware of any cost impacts that a representative private person or business would necessarily incur in reasonable compliance with the proposed action.

Significant effect on the creation or elimination of jobs in the state: None.

Significant effect on the creation of new businesses or elimination of existing businesses within the state: None.

Significant effect on the expansion of businesses currently doing business within the state: None. Corporations have been making water's-edge elections since 1988. Revenue and Taxation Code section 25113 merely changed the method of making the election and clarified numerous issues relating to the election that arose over the years. This regulation should not affect businesses currently doing business in California.

Effect on small business: The regulation is generally utilized by large multinational corporations and not small businesses.

Significant effect on housing costs: None.

#### CONSIDERATION OF ALTERNATIVES

In accordance with Government Code section 11346.5, subdivision (a)(13), the Board must determine 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 than the proposed regulatory action.

The proposed regulatory action pertains to corporate taxpayers and therefore does not affect private persons.

#### AVAILABILITY OF STATEMENT OF REASONS AND TEXT OF PROPOSED REGULATIONS

An initial statement of reasons has been prepared setting forth the facts upon which the proposed regulatory action is based. The statement includes the specific purpose of the proposed regulatory action and the factual basis for determining that the proposed regulatory action is necessary.

The express terms of the proposed text of the regulation and the initial statement of reasons and the rulemaking file are prepared and available upon request from the agency contact person named in this notice. When the final statement of reasons is available, it can be obtained by contacting the agency officer named below, or by accessing the Franchise Tax Board's website mentioned below.

## CHANGE OR MODIFICATION OF ACTIONS

The proposed regulatory action may be adopted after consideration of any comments received during the comment period.

The regulation may also be adopted with modifications if the changes are nonsubstantive or the resulting regulation is sufficiently related to the text made available to the public so that the public was adequately placed on notice that the regulation as modified could result from that originally proposed. The text of the regulation as modified will be made available to the public at least 15 days prior to the date on which the regulation is adopted. Requests for copies of any modified regulation should be sent to the attention of the agency officer named below.

## ADDITIONAL COMMENTS

If you plan on attending or making an oral presentation at the regulation hearing, please contact the agency officer named below.

The hearing room is accessible to persons with physical disabilities. Any person planning to attend the hearing who is in need of a language interpreter or sign language assistance, should contact the officer named below at least two weeks prior to the hearing so that the services of an interpreter may be arranged.

## CONTACT

All inquiries concerning this notice or the hearing should be directed to Colleen Berwick at the Franchise Tax Board, Legal Branch, P.O. Box 1720, Rancho Cordova, CA 95741-1720; Telephone (916) 845-3306; Fax (916) 845-3648; E-Mail: [colleen.berwick@ftb.ca.gov](mailto:colleen.berwick@ftb.ca.gov). In addition, all questions on the substance of the proposed regulation can be directed to Karen Smith; Tel.: (916) 845-3347. The notice, initial statement of reasons and express terms of the regulation are also available at the Franchise Tax Board's website at [www.ftb.ca.gov](http://www.ftb.ca.gov).