

## 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., on July 13, 1998, at the Franchise Tax Board, 9645 Butterfield Way, Sacramento, California, 95827 to consider the amendment of Sections 25111 and 25111-1 in Title 18 of the California Code of Regulations pertaining to the manner of making a water's-edge election. The hearing will be conducted by an employee of the Franchise Tax Board (the Board) who will prepare a report to be submitted to the three-member Franchise Tax Board for its consideration and direction as to the adoption of any proposed amendments. 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.

The report will be submitted to the three-member Franchise Tax Board at its next meeting which is tentatively scheduled for August 4, 1998. It is anticipated that the Board will take action on the proposed amendments at that meeting.

### WRITTEN COMMENT PERIOD

Written comments will be accepted until 5:00 p.m., July 13, 1998. 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 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. The proposed regulatory action interprets, implements, and makes specific Sections 25111 and 25111-1 of the Revenue and Taxation Code.

### INFORMATIVE DIGEST/PLAIN ENGLISH OVERVIEW:

The proposed amendments to the regulations are intended to allow a water's-edge election in circumstances where there is objective evidence that an election was intended, that there was evidence of an

intent to contract, and that the non-compliance with the provisions of the current regulation was unintentional.

Current subsection (a) of the regulations is silent with respect to circumstances to be considered in determining whether an election has been made. Subsection (a) of the regulations is amended to incorporate contract standards of substantial performance as evidence of whether a valid contract is present. "Substantial performance" is defined and examples are provided of the type of objective evidence which supports a finding of substantial performance. New language is also added to provide that corporate entities whose disallowed water's-edge elections are validated as a result of these amendments to the regulation, which are acquired by another entity and file on a non-water's-edge basis, will be deemed to have terminated their election.

Subsection (c) of the regulations provides for a common parent election. Subsection (c) and (d) of the regulations are amended to provide that an election by a common parent corporation is controlling over any other actions by subsidiaries of the common parent. Examples of the operation of this amendment are provided.

Subsection (e) of the current regulation does not contain a definition of an "original return" except by example. The example provides that in the circumstances of returns filed pursuant to an extension, the first filed return is the original return. Subsection (e) of the regulations is amended, in the case of a return filed pursuant to an extension, to define "original" as the last return filed prior to the extended due date. This results in defining original return in the case of an extension in the same manner as it is defined for purposes of a return filed by the statutory due date. The definition of "original" return when a return is filed pursuant to an extension is consistent with federal Internal Revenue Code authorities. The examples are modified accordingly.

Clarifying, nonsubstantive amendments are proposed with respect to subsection (g) of the regulations. A clarifying nonsubstantive, amendment is also proposed with respect to subsection (i) of Regulation Sections 25111 and 25111-1.

The water's-edge election provisions are unique to state law, and there is no comparable provisions of federal law which can be adopted by reference or with which the proposed amendments to the regulation are in conflict.

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.

Adverse Economic Impact on business including the ability of California businesses to compete with businesses in other states: None.

Cost to directly affected private persons/businesses potential: None

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.

Effect on small business: The need to consider making a water's-edge election exists almost exclusively for businesses which conduct operations in both California and foreign countries through multiple corporate entities. It is unlikely that any taxpayer contemplating making a water's-edge election would be a small business when all of its activities are considered.

Significant effect on housing costs: None.

CONSIDERATION OF ALTERNATIVES:

In accordance with Government Code Section 11346.5(a)(12), 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 Board has determined that the alternatives to the adoption of the proposed amendments to the regulations are either the amendment of the underlying statutes, or the likelihood of litigation with respect to whether various contracts should have been invalidated. It has been determined that neither of these alternatives would be more effective or less burdensome than adoption of the proposed amendments. In addition, 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 Board has determined that it is not feasible to draft the text of the proposed amendments to Regulation Sections 25111 and 25111-1 in plain English due to the technical nature of the regulations. However, a noncontrolling plain English summary of the text of the proposed regulations, as well as the initial statement of reasons and all information upon which the proposed regulatory action is based, as well as the express terms of the proposed action, are available upon request from the agency officer named below.

The express terms of the proposed regulatory action, as well as the initial statement of reasons and all information upon which the proposal is based, are available upon request from the agency officer named below.

In addition, a copy of the proposed amendments will be available via the internet at <http://www.ftb.ca.gov>.

#### CHANGE OR MODIFICATION OF ACTIONS:

The proposed regulatory action may be adopted by the three-member Franchise Tax Board after consideration of any comments received during the comment period.

The proposed amendments may also be adopted with modifications if the changes are nonsubstantive or the resulting changes in the proposed amendments to the regulations are 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. In that circumstance, the text of the regulations as proposed to be 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 regulations 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, including sign language, 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 (916) 845-3306 (E-Mail: [colleen\\_berwick@ftb.ca.gov](mailto:colleen_berwick@ftb.ca.gov)), or by mail to the Legal Branch, Attn: Colleen Berwick, P.O. Box 1720, Rancho Cordova, CA 95741-1720.