

TITLE 18. FRANCHISE TAX BOARD

The Franchise Tax Board will not hold a hearing unless requested by interested persons or their representatives at least 15 days before the close of the written comment period. Any request for a public hearing should be submitted to the officer named below.

However, if a public hearing is requested, it will be held at 10:00 a.m., on April 22, 2009, at 9646 Butterfield Way, Town Center Grizzly Bear Room, Sacramento, California, to consider amendment of Regulation section 25114 under Title 18 of the California Code of Regulations, pertaining to a water's-edge election.

If a hearing is held, it will be posted on our website and notification will be mailed to individuals on our mailing list. You may also contact the persons named below to confirm.

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., April 22, 2009. 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. The proposed regulatory action will implement, interpret, and make specific amendments to section 25114 of the Revenue and Taxation Code.

INFORMATIVE DIGEST/PLAIN ENGLISH OVERVIEW

Previously, Revenue and Taxation Code section 25114, subdivision (a), required the Franchise Tax Board to examine the returns filed by taxpayers pursuant to the water's-edge rules. If the Franchise Tax Board then determined that there was potential noncompliance, it was required to conduct a detailed examination under the federal transfer pricing rules of Internal Revenue Code section 482, unless the Internal Revenue Service was examining the taxpayer for the same years and issues. This detailed examination was required to be conducted notwithstanding the "potential net revenue benefit to the state."

On October 5, 2007, the Governor signed SB 788, Stats. 2007, ch. 306, which amended Revenue and Taxation Code section 25114. Under amended Revenue and Taxation Code

section 25114, the Franchise Tax Board is still required to review all returns filed by taxpayers pursuant to the water's-edge rules. However, the amendments to Revenue and Taxation Code section 25114 have deleted the requirement for the Franchise Tax Board to conduct a detailed examination in cases of potential noncompliance. The decision to conduct a detailed audit, including a transfer pricing audit, has been left to the discretion of the Franchise Tax Board Audit staff. If a decision to conduct a transfer pricing audit is made, the Franchise Tax Board must still conduct the audit under the federal transfer pricing rules of Internal Revenue Code section 482, unless the Internal Revenue Service is examining the taxpayer for the same years and issues.

The proposed amendments to the existing regulation are necessary to conform to the statutory changes requiring examinations of returns filed by taxpayers that have made a water's-edge election. In addition, consistent with the language of Revenue and Taxation Code section 25114, proposed amendments to Regulation section 25114 shall apply to examinations commenced by the Franchise Tax Board on or after January 1, 2008. The proposed amendments specify that an examination will be considered commenced when a taxpayer is first contacted by the Franchise Tax Board concerning any examination with respect to the taxpayer's return.

Questions have arisen as to how to reconcile the term "examine" in subdivision (a) with the term "examination" in subdivision (c) of Revenue and Taxation Code section 25114 without requiring an audit of every water's-edge taxpayer or contact with every water's-edge taxpayer. The proposed amendments set forth a definition of examine and examination in order to address this question.

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. The Franchise Tax Board has been required to conduct a detailed examination on all water's-edge tax returns when it has found potential noncompliance since 1988 when water's-edge elections first became part of the Revenue and Taxation Code. Revenue and Taxation Code section 25114 was amended to make the decision to conduct a detailed examination discretionary rather than mandatory. The amendments to this regulation should reduce the effect on businesses currently doing business in California by eliminating the requirement that mandatory examinations be conducted by the Franchise Tax Board.

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 Division, P.O. Box 1720, Rancho Cordova, CA 95741-1720; Telephone (916) 845-3306; Fax (916) 845-3648; E-Mail: colleen.berwick@ftb.ca.gov. In addition, all questions on the substance of the proposed regulations can be directed to Karen Smith at Telephone (916) 845-3347 or Email: Karen.smith@ftb.ca.gov. 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.