

## **TITLE 18. FRANCHISE TAX BOARD**

As required by Government Code section 11346.4, this is notice that a public hearing has been scheduled to be held at 1:00 p.m., on March 29, 2011 at the Franchise Tax Board, 9646 Butterfield Way, Town Center Golden State Room A/B, Sacramento, CA, to consider the adoption of California Code of Regulations ("CCR"), title 18, section 25128.5. (All references to CCR in this Notice are references to sections in CCR, title 18.) The Franchise Tax Board proposes to adopt this regulation under authority granted in Revenue and Taxation Code ("RTC") sections 19503 and 25128.5. The Board proposes to adopt CCR section 25128.5 to provide guidance to multi-state taxpayers on how to make a single-sales factor method election.

An employee of the Franchise Tax Board will conduct the hearing, and a report will be submitted to the three-member Franchise Tax Board for its consideration, along with a recommendation as to whether the three-member Board should hold a hearing on the proposed regulatory action. 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. If a written request is received, the three-member Franchise Tax Board will consider the proposed regulatory action prior to adoption.

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.

### **WRITTEN COMMENT PERIOD**

Written comments will be accepted until 5:00 p.m., March 29, 2011. 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**

The Franchise Tax Board proposes to adopt CCR section 25128.5 pursuant to the rulemaking authority provided by RTC section 19503, which relates to the enforcement of Part 11 of the RTC (sections 23001, et seq.) Additionally, RTC section 25128.5, subdivision (c), gives the Franchise Tax Board explicit authority to issue any necessary or appropriate regulations. The proposed regulation interprets, implements, and makes specific RTC section 25128.5.

### **INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW**

Taxpayers that have business activities within and without California are required to determine the amount of income properly attributed to activities in California. Previous to the enactment of RTC section 25128.5, pursuant to RTC section 25128, the standard apportionment rules applied. Accordingly, the taxpayer's respective property, payroll and twice its sales factor percentages were combined and divided by four. (In some instances the sales factor is not doubled and the combined ratios are only divided by three.) Thereafter, apportionable business income is multiplied by the resulting apportionment factor percentage to determine the amount of California-sourced taxable business income.

RTC section 25128.5 was enacted in 2009. It allows taxpayers to elect to apportion their business income to California based solely on the sales factor. However, RTC section 25128.5 does not

include guidance on how the election is made. RTC section 25128.5, subdivision (c), allows the Franchise Tax Board to issue regulations regarding the election.

## **SPECIFIC PROPOSAL**

Subsection (a) defines terms contained within the regulation. These definitions were modeled on RTC section 25113, which relates to water's edge elections of apportioning taxpayers.

Subsection (b)(1) addresses the time and manner of making a valid election. For the election to be valid, it must be made on an original timely filed return and every member of the combined reporting group must make the election. An example is provided.

Subsection (b)(2) generally states that if any member of a combined reporting group files a separate return without making the election, then every member of the combined reporting group will be treated as if it had not made the election.

Subsection (b)(3) contains a rule regarding when a combined reporting group that has one or more entities that conduct qualified business activities may make the election. This subsection is necessary to address questions involving combined reporting groups that include one or more entities that meet the definition in RTC section 25128, subdivision (c). These qualified business activities include agricultural, extractive, savings and loan, and banking or financial activities. Examples are provided

Subsection (b)(4)(A) addresses a deemed election involving a corporation which previously was not considered a taxpayer, but subsequently is determined to be a taxpayer. Subsection (b)(4)(B) addresses a deemed election involving a corporation which was previously not considered a combined reporting group member, but is subsequently determined to be a combined reporting group member. Examples are provided.

Subsection (b)(5) addresses making the election after forced de-combination at audit. Decombined taxpayers are allowed a period of time to file amended returns with the election. An example is provided.

Subsection (b)(6) allows a taxpayer that is engaged in more than one apportioning trade or business to make separate elections for each trade or business.

Subsection (b)(7) provides the procedure for making a valid election. Generally the tax must be computed using the single-sales factor apportionment method and the taxpayer completes Part B of schedule R-1 of the California form 100.

Subsection (b)(8) requires the election to be made on a timely filed original return and provides examples to illustrate the requirement.

Subsection (c)(1) addresses affiliated corporations engaged in two distinct unitary businesses. Each distinct unitary business may make an election with respect to one or more of the businesses, but need not elect for all of the businesses. An example is provided.

Subsection (c)(2) addresses the treatment of distributive shares of income from unitary partnerships when the combined reporting group has made an election. Examples are provided

Subsection (c)(3) addresses changes in affiliation during the year. Generally, special rules are not needed for changes in affiliation because this is an annual election and group membership is known at the end of each taxable year. Statutes and regulations already in place provide the necessary guidance. Examples are provided.

Subsection (d) identifies the years to which the regulation applies.

## **DISCLOSURES REGARDING THE PROPOSED REGULATORY ACTION**

Mandates 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.

Cost to directly affected private persons/businesses potential: The 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: The Board is required to assess any impact the regulations may have on the creation or elimination of jobs in the State of California, the creation of new businesses, the elimination of existing businesses, and the expansion of businesses currently operating in the state. The Board has made an initial determination that the proposed regulation will not have an effect on any of the above, but invites interested parties to comment on this issue.

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

Significant effect on the expansion of business currently doing business within the state: None.

Effect on small business: The department has made an initial determination that the adoption of the proposed regulation will not affect small businesses as generally multi-state corporations are not considered small businesses and this proposed regulation will apply only to multi-state corporations. However, the Board invites public comments on the question of economic impact on small businesses.

Significant effect on housing costs: The Board is not aware of any significant effect on housing costs that will be incurred by reasonable compliance with the proposed regulation.

## **CONSIDERATION OF ALTERNATIVES**

In accordance with Government Code section 11346.5, subdivision (a)(13), the Board has determined that no reasonable alternative considered by the Board or that has otherwise been identified and brought to the attention of the Board would be more effective in carrying out the purpose of this proposed regulation or would be as effective and less burdensome to affected private persons than the proposed action.

## **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, 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 identified 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 nonsubstantial 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 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](mailto:colleen.berwick@ftb.ca.gov). In addition, all questions on the substance of the proposed regulation can be directed to Laurie McElhatton; Telephone (916) 845-6916. This notice, the initial statement of reasons and express terms of the proposed regulation are also available at the Franchise Tax Board's website at [www.ftb.ca.gov](http://www.ftb.ca.gov).