

INITIAL STATEMENT OF REASONS FOR THE
ADOPTION OF AMENDMENTS TO
CALIFORNIA CODE OF REGULATIONS,
TITLE 18, SECTIONS 25130 AND 25137, SUBSECTION (B)(1)

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

Currently, California Code of Regulations, title 18, section 25137, subsection (b)(1), does not address how taxpayers should treat, for property factor purposes, royalty and other payments made for timber, oil, gas and hard mineral interests located on the property of someone other than the taxpayer. The regulation also contains certain words and phrases that are undefined.

Additionally, California Code of Regulations, title 18, section 25130, contains rules for valuing property owned by a taxpayer or rented by a taxpayer for property factor purposes. These rules do not coordinate with or reference the rules set forth in California Code of Regulations, title 18, section 25137, subsection (b)(1).

Both regulation sections contain minor formatting errors.

SPECIFIC PURPOSE OF THE REGULATION

The addition to the existing regulation, California Code of Regulations, title 18, section 25137, subsection (b)(1), will apply to taxpayers who use property owned by third parties to extract natural resources such as timber, oil, gas or hard minerals, but who either pay no rent or a nominal rent for use of that property. The proposed addition calculates the net annual rental rate to be included in the property factor by including only those payments required to be made by the taxpayer to the holder of an interest in the property, multiplied by eight.

Regulations adopted to implement UDITPA provide for an adjustment of the standard apportionment formula under certain circumstances. The amendments provide for treating royalty and other payments made for timber, oil, gas and hard mineral interests located on the property of someone other than the taxpayer as rent for property factor purposes. The amendments reflect the Franchise Tax Board's current administrative practice, as set forth in Franchise Tax Board Legal Ruling 97-2, December 17, 1997, that such payments constitute fair rental values and provide appropriate property factor representation for the assets at issue.

California Code of Regulations, title 18, section 25130, will be amended to refer to and coordinate with California Code of Regulations, title 18, section 25137, subsection (b)(1).

NECESSITY

The proposed amendments to the regulations are needed to provide guidance to taxpayers in computing the property factor in certain special circumstances.

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

In drafting the proposed regulation, the Franchise Tax Board relied upon Revenue and Taxation Code sections 25130 and 25137, California Code of Regulations, title 18, sections 25130 and 25137, subsection (b)(1), and Franchise Tax Board Legal Ruling 97-2, December 17, 1997.

Other than the items described in the preceding paragraph, the Franchise Tax Board did not rely upon any technical, theoretical, or empirical studies, reports or documents in proposing adoption of the proposed amendments to the regulation.

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

In accordance with Government Code section 11346.5, subsection (a)(13), the Franchise Tax Board has determined that no alternative considered by it would be more effective in carrying out the purpose for which the action is proposed nor would be as effective and less burdensome to affected private persons than the proposed regulatory action. In addition, the proposed regulation pertains to corporate taxpayers with operations in multiple states. As a result, it does not affect private persons or most small businesses.

ADVERSE ECONOMIC IMPACT ON BUSINESS

The proposed regulatory action will not have a significant adverse economic impact on business.