

INITIAL STATEMENT OF REASONS FOR THE  
ADOPTION OF CALIFORNIA CODE OF REGULATIONS,  
TITLE 18, SECTION 25137(c)(1)(D)

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

The proposed regulation is intended to specify the proper sales factor treatment for gross receipts generated by a taxpayer's treasury function. A treasury function involves the pooling, management, and investment of intangible assets for the purpose of satisfying the cash flow needs of the trade or business, such as providing liquidity for a taxpayer's business cycle. The proper amount to include in the sales factor from this activity has been the subject of numerous litigation cases. While these cases have consistently concluded that the inclusion of gross receipts from a treasury function is distortive and may be remedied under the authority of section 25137 of the Revenue and Taxation Code, they have been decided based on the facts and circumstances of each case. This has led to uncertainty for taxpayers and the Franchise Tax Board, as each taxpayer must determine whether their facts are similar enough to the case law to apply the court's holding to its particular circumstances. Taxpayers have requested a more uniform approach to this issue, which will provide certainty regarding the proper sales factor treatment for this activity.

SPECIFIC PURPOSE OF THE REGULATIONS

This proposed regulation would provide rules relating to the sales factor treatment of gross receipts generated by a taxpayer's treasury function.

NECESSITY

Currently the Franchise Tax Board does not have a regulation addressing the sales factor treatment of a treasury function, which has led to numerous litigation cases regarding this issue. This regulation will eliminate the need for endless litigation and provide taxpayers with guidance and certainty on this issue. The Franchise Tax Board has an obligation to regulate when it seeks to prescribe rules of general application.

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

The staff of the Franchise Tax Board held several interested parties meetings to discuss two recent decisions by the California Supreme Court, Microsoft Corporation v. Franchise Tax Board (2006) 39 Cal.4th 750, and General Motors Corporation v. Franchise Tax Board (2006) 39 Cal 4<sup>th</sup> 773. Comments at those meetings supported the adoption of a regulation. The analysis by the California Supreme Court in Microsoft was based under the statute that authorizes this regulation, and statements made by the court in its decision support the use of a standardized approach. The staff of the

Franchise Tax Board, in addition, relies upon (1) the two recent California Supreme Court cases cited above; (2) other pending cases in litigation, including two others which resulted in appellate decisions which were vacated by the California Supreme Court; (3) cases before the Board of Equalization, both decided and pending; (4) other cases pending in the administrative process that have raised this issue; (5) existing model regulations promulgated by the Multistate Tax Commission; and (6) actions taken by other states to address this issue.

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

The Franchise Tax Board has determined that there were no alternatives considered which would be more effective in carrying out the purpose of the proposed regulation or would be as effective as and less burdensome to affected private persons or small businesses than the proposed regulation. In addition, the proposed regulation pertains to corporate taxpayers and therefore does not affect private individuals.

#### ADVERSE ECONOMIC IMPACT ON BUSINESS

The Franchise Tax Board has determined that proposed Regulation section 25137(c)(1)(D) will not have a significant overall economic impact on business. The regulation is a codification of existing Franchise Tax Board administrative policy.