

TITLE 18. FRANCHISE TAX BOARD

[Notice Published November 3, 2017]

NOTICE OF PROPOSED RULEMAKING

As required by section 11346.4 of the Government Code, The Franchise Tax Board ("Board") hereby gives notice of its intention to adopt proposed amendments to California Code of Regulations, title 18, sections 25137-1 and 17951-4 as described below, after considering all the comments, objections, and recommendations regarding the proposed action.

PUBLIC HEARING

The Board will hold a public hearing starting at 10:00 a.m. on December 18, 2017 at the Franchise Tax Board Goldberg Auditorium, 9646 Butterfield Way, Sacramento, CA 95827. The auditorium is wheelchair accessible. At the hearing, any person may present statements or arguments orally or in writing relevant to the proposed action described in the Informative Digest. The Board requests but does not require that persons who make oral comments at the hearing also submit a written copy of their comments at the hearing.

To participate in this hearing by telephone, please dial: (877) 923-3149. Enter the participant pass code 2233420, followed by the # sign. Please RSVP by December 11, 2017, by contacting Christy Keith at (916) 845-6080 or Email: Christy.Keith@ftb.ca.gov.

In addition, 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

Any interested person, or his or her authorized representative, may submit written comments relevant to the proposed regulatory action to the Board. The written comment period closes at 5:00 p.m. on December 18, 2017, and the Board will consider only comments received at the Board offices by that time. The Board encourages submission of comments in electronic form, rather than in paper form. Comments may be submitted by email to Craig.Swieso@ftb.ca.gov

Submit comments in paper form to:

Mailing Address

Craig Swieso, Assistant Chief Counsel
Legal Division MS A260
Franchise Tax Board
P.O. Box 1720
Rancho Cordova, CA 95741-1720

Fax:

(916) 843-6080

AUTHORITY AND REFERENCE

Revenue and Taxation Code ("RTC") Section 19503 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 RTC. RTC Section 25137 permits a variance from the allocation and apportionment provisions of the Uniform Division of Income for Tax Purposes Act (UDITPA) when the standard provisions of UDITPA do not fairly reflect a taxpayer's activities in this state. This proposed regulatory action would implement, interpret, and make specific California Code of Regulations, title 18, sections 25137-1 and 17951-4, by establishing appropriate rules for determining the apportionment and allocation rules for partnership income and also for nonresident individuals receiving income from a partnership.

INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW

California Code of Regulations, title 18, (Regulation) section 25137-1 applies to those corporations that conduct business within and without California in a unitary enterprise and are included in a combined report, and own interests in partnerships that also conduct business within and without California. Regulation section 17951-4 applies to individuals who are nonresidents or part-year residents of California for tax purposes, who own interests in partnerships that conduct business within and without California. Since Regulation sections 25137-1 and 17951-4 were last amended, additional factual scenarios have arisen from partnerships that conduct business within and without California. These additional situations are not adequately addressed by the current version of the regulations. With a view to providing affected taxpayers with the proper guidance, Regulation sections 25137-1 and 17951-4 are proposed to be amended to address situations that have arisen.

Regulation section 25137-1(a) is proposed to be modified so that the term "income year" is changed to "taxable year" for consistency with the appropriate statutory terminology and to correct a punctuation error adding a space that was inadvertently omitted between "plus" and "20%" in Example 1 of the subsection.

In addition, Regulation section 25137-1(a) is being revised to indicate that the general rules of Regulation section 25137-1 also apply to lower-tier partnerships. In many instances, partnerships that conduct business within and without California in turn own interests in partnerships that also conduct business within and without California. The proposed amendments to the regulation indicate the rules embedded in it also apply to partnerships conducting business within and without California that are owned, or partially owned, by other partnerships that also conduct business within and without California.

Regulation section 25137-1(a) is further revised to indicate that RTC section 23040 is inapplicable with respect to sourcing income from unitary partnerships. Pursuant to Regulation section 25137-1(g), if a partnership and its corporate partner are not engaged in a unitary business, the distributive share income allocated to the corporate partner is treated as income from a separate trade or business that takes place within and without

California. The regulation is being amended to clarify that the determination of whether the distributive share of income from a non-unitary partnership is treated as apportionable business income or allocable nonbusiness income is based on the activities of the non-unitary partnership and not through the operation of RTC section 23040.

Regulation section 25137-1(e) is being revised for a textual edit, revising "distributed" to "allocated" to reflect the appropriate statutory terminology used in describing the handling of items of expense under UDITPA.

Regulation section 25137-1(f) is being revised to replace the term "partnership year" with "partnership taxable year" and to replace the obsolete term "income year" with "taxable year," for consistency with the appropriate statutory terminology. In addition this subsection is being revised to explicitly state that this subdivision pertains to the apportionment factors relating to the taxpayer's interest in the partnership.

An additional revision to Regulation section 25137-1(f) pertains to sales between a unitary partnership and other members of the combined reporting group. The regulation is being revised to explicitly state that sales between a unitary partnership and other members of the taxpayer's combined reporting group should not be reflected in the combined reporting group's sales factor.

Regulation section 25137-1(f) is being further amended to specify that a taxpayer's partnership interest for purposes of computing a taxpayer's apportionment factors shall be "determined by the taxpayer's interest in the partnership," which is "determined by the portion of total interest in profits of the partnership assigned to the partner for the taxable year."

Regulation section 25137-1(h) is being revised to adjust the title of the subsection to differentiate it from Regulation section 25137-1(i), and to delete provisions relating to long-term contracts. Instead, the amended regulation provides a reference to Regulation section 25137-2 for the appropriate rules on long-term contracts.

Regulation section 25137-1(i) is being revised to adjust the title of the subsection to differentiate it from Regulation section 25137-1(h)

Regulation section 25137-1(j) is being added to provide that the revisions contained in subdivisions (a), (e), (f), (h), and (i) are applicable only as of the effective date of the amendments to these subsections of the regulation. In other words, the revisions are to be applied prospectively only.

Regulation section 17951-4(d) is being revised to indicate that RTC section 17952 does not apply with respect to an interest in a partnership that conducts business within and without California. The regulation is further being revised to provide that if the partner and the partnership that conducts business within and without California are engaged in a unitary enterprise, then the rules embedded in Regulation section 25137-1 apply for purposes of determining the income from the partnership from California sources attributable to the partner. These changes necessitate renumbering existing provisions of the subdivision. Regulation section 17951-4(f) is being revised to reflect the changes in the references to

Regulation section 17951-4(d), which was revised to reflect the changes mentioned above. Regulation section 17951-4(i) is being revised to add a "t" to the word "he" to convert it to the word "the". Finally, Regulation section 17951-4(j) is being revised to provide that the revisions are applicable only as of the effective date of the amendments to these subsections of the regulation. In other words, the revisions are to only be applied prospectively.

Anticipated Benefits of the Proposed Regulations:

In addition to the benefits mentioned above in providing affected taxpayers with the proper guidance, and addressing new situations that have arisen, the broad objective of the proposed amendments to these regulations is to ensure that taxpayers, their representatives, and the state of California have guidance on how to treat partnerships that are unitary with members of a combined reporting group. The specific benefits anticipated from the proposed amendments to the regulations are the providing of rules pertaining to the types of partnership interests that are applicable, sales between partnerships and other members of the combined reporting group, and how income pertaining to a unitary partnership is sourced.

Consistency and Compatibility with Existing State Regulations:

During the process of developing the regulations, FTB, pursuant to Government Code section 11346.5, subdivision (a)(3)(D), conducted a search of any similar state regulations and has concluded that the Regulations the subject of this notice are neither inconsistent nor incompatible with any existing state regulations. The FTB discovered that California Code of Regulations section 25128.5 exists, which previously provided guidance for unitary partnerships in making a single-sales factor formula election under now repealed underlying statute RTC 25128.5. However, as a result of the repeal of RTC 25128.5, California Code of Regulations section 25128.5 is without effect. Therefore, the regulations the subject of this notice are the only effective regulations that relate to unitary partnerships.

DISCLOSURES REGARDING THE PROPOSED REGULATORY ACTION

The Board has made the following initial determinations:

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: *The pool of taxpayers most affected by these proposed regulation amendments are a small share of the aggregate apportioning taxpayers in California. In researching the few cases where taxpayers had filed tax returns with positions regarding the treatment of a portion of intercompany sales which would be covered by the proposed amended regulations, taxpayers ultimately took filing positions reflecting the treatment of sales and income in a manner consistent with the proposed regulation amendments. Therefore, the Board concludes that the adverse economic impact, including the ability of California businesses to compete with businesses in others states, will not be significant.*

Potential cost impact to directly affected private persons/business: *The proposed amendments will have no impact on a private person. The Board has no reason to believe that the proposed amendments will increase or decrease the cost of doing business in the State of California because the regulations are already in place, and the proposed modifications will assist businesses by providing clarity that does not currently exist with respect to unitary partnerships. The proposed amendments to the regulations clarifies existing Board practices. Providing clearer administrative guidance may reduce the cost of taxpayer compliance but is not expected to result in any additional costs. Based on the analysis above, 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.*

Effect on small business: *The Board has determined that the proposed amendments to the regulation do not affect small businesses. Businesses that conduct multistate business in a partnership form are usually large multistate businesses that do business both within the state of California and outside the state of California.*

Significant effect on housing costs: *None.*

RESULTS OF THE ECONOMIC IMPACT ASSESSMENT

The Board concludes that (1) there is no expected impact on the creation or elimination of jobs within California as a result of the proposed amendments, (2) there is no expected impact on the creation, or elimination in the number of existing businesses within California as a result of the proposed amendments, (3) there is no expected impact on the expansion of businesses currently doing business within California as a result of the proposed amendments, and (4) as described above, the benefits to the health and welfare of California residents include providing affected taxpayers with the proper guidance, addressing new situations that have arisen, and ensuring that taxpayers, their representatives, and the state of California have guidance on how to treat partnerships that are unitary with members of a combined reporting group.

CONSIDERATION OF ALTERNATIVES

In accordance with Government Code section 11346.5, subdivision (a)(13), the Board must determine that no reasonable alternative it considered or that has otherwise been identified

and brought to the attention of the Board 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 action or would be more cost-effective to affected private persons and equally effective in implementing the statutory policy or other provision of law.

The Board invites interested persons to present statements or arguments with respect to alternatives to the proposed regulations at the scheduled hearing or during the written comment period.

CONTACT PERSONS

Inquiries concerning the proposed administrative action may be directed to:

Craig Swieso, Assistant Chief Counsel
Legal Division MS A260
Franchise Tax Board
P.O. Box 1720
Rancho Cordova, CA 95741-1720
Telephone: (916) 845-5244; Facsimile (916) 843-6080

The backup contact person for these inquiries is:

Christy Keith
Legal Division MS A260
Franchise Tax Board
P.O. Box 1720
Rancho Cordova, CA 95741-1720
Telephone: (916) 845-6080

Please direct requests for copies of the proposed text (the "express terms") of the regulations, the initial statement of reasons, the modified text of the regulation, if any, or other information upon which the rulemaking is based to Ms. Keith at the above address or send the request by email to Christy.Keith@ftb.ca.gov.

AVAILABILITY OF TEXT OF PROPOSED REGULATIONS, INITIAL STATEMENT OF REASONS, AND RULEMAKING FILE

The Board will have the entire rulemaking file available for inspection and copying throughout the rulemaking process at its office at the above address. As of the date this notice is published in the Notice Register, the rulemaking file consists of this notice, the proposed text of the regulation, and the initial statement of reasons. Copies can be obtained on the Franchise Tax Board's website at www.ftb.ca.gov or by contacting Ms. Keith at the address, phone number or email address listed above.

AVAILABILITY OF CHANGED OR MODIFIED TEXT

After holding the hearing and considering all timely and relevant comments received, the Board may adopt the proposed regulations substantially as described in this notice. If the Board makes modifications sufficiently related to the originally proposed text, it will make the modified text (with the changes clearly indicated) available to the public for at least 15 days before the Board adopts the regulations as revised. Copies of the modifications will be published on the Franchise Tax Board's website at www.ftb.ca.gov and mailed to anyone who submitted written or oral comments at the public hearing; to anyone who submitted written comments to the Board's offices; and to anyone who has expressed an interest in receiving the modification information. Please send requests for copies of any modified regulations to the attention of Ms. Keith at the address or email address indicated above. The Board will accept written comments on the modified regulations for 15 days after the date on which they are made available.

AVAILABILITY OF THE FINAL STATEMENT OF REASONS

Upon its completion, copies of the Final Statement of Reasons will be published on the Franchise Tax Board's website at www.ftb.ca.gov and may also be obtained by contacting Ms. Keith at the above address or email address.

AVAILABILITY OF DOCUMENTS ON THE INTERNET

Copies of the Notice of Proposed Action, the Initial Statement of Reasons, and the text of the proposed regulations can be accessed through our website at www.ftb.ca.gov.