

## FRANCHISE TAX BOARD

### Title 18, Division 3, California Code of Regulations Amend Article 3. Tax Credits, at Section 23663-1; and Adopt Article 3. Tax Credit, containing new section 23663-6

#### Final Text of Regulations

#### Chapter 3.5. Bank and Corporation Tax (Taxable Years Beginning After 12-31-54) Subchapter 3. Corporation Income Tax Article 3. Tax Credits

##### Section 23663-1 is amended to read:

##### 23663-1. Definitions

**Definitions.** For purposes of Regulations 23663-1 through 23663-56, inclusive, the following definitions shall apply:

- (a) *Adjustment Date.* The term "adjustment date" shall mean the calendar date on which any adjustment under Regulations 23663-2 through 23663-5 is made by either the mailing by the Franchise Tax Board of a notice of corrected credit adjustments under Regulations 23663-2 through 23663-5, including a notice of proposed assessment under Revenue and Taxation Code section 19033, or the date on which the FTB receives a request which is later approved for either a correction of an error under Regulation 23663-4 or to apply Regulation 23663-2 or 23663-3. To the extent a final determination of a notice mailed by the FTB modifies, in whole or in part, the allocations reflected in that notice, then such modifications are treated as if made on the adjustment date on which that notice was mailed.
- (b) *Affiliated Corporation.* The term "affiliated corporation" shall mean any corporation that is a member of the same commonly controlled group within the meaning of Revenue and Taxation Code section 25105 as the assignor.
- (c) *Aggregated Eligible Assignees.* The term "aggregated eligible assignees" shall mean all eligible assignees assigned the same type of identical credits in the same taxable year.
- (d) *Assignee.* The term "assignee" shall mean any corporation (including a successor in interest) to whom an assignor has made an election to assign a credit under Revenue and Taxation Code section 23663, and shall also include any affiliated corporation (including a successor in interest) whose identifying information is listed on the defective assignment.
- (e) *Assignment.* The term "assignment" shall mean any election by an assignor to assign a credit to an assignee under the provisions of Revenue and Taxation Code section 23663. For purposes of Regulations 23663-1 through 23663-5, each election by an assignor to assign any credit to an assignee shall be treated as a separate assignment.
- (f) *Assignor.* The term "assignor" shall mean any taxpayer (including any successor in

interest) who made an election to assign any credit to an assignee.

- (g) *Closed Year*. The term "closed year" shall mean any taxable year for which the Franchise Tax Board determines that it is precluded by law from mailing a notice of proposed deficiency assessment.

(h) *Defective Assignment.*

- (1) The term "defective assignment" shall mean any assignment under Revenue and Taxation Code section 23663 which does not comply with the requirements of Revenue and Taxation Code section 23663, including, but not limited to, any assignment which:
  - (A) fails to clearly identify the taxable year from which the credit to be assigned was earned by the assignor;
  - (B) fails to clearly identify the amount of any credit to be assigned;
  - (C) fails to clearly identify the type of credit intended to be assigned;
  - (D) assigns an amount of credit, or when aggregated with other assignments of the same credit in the same taxable year, which exceeds the amount of the assignor's eligible credits for that taxable year;
  - (E) assigns a credit that is not an eligible credit; or
  - (F) assigns a credit to an assignee who is not clearly identified or who is not an eligible assignee.
- (2) An assignor's intent or purpose in making an assignment is not relevant in determining whether an assignment is a defective assignment.
- (3) *Examples.*

**Example 1:** X reported that it has \$200 of 2010 R & D credits. On its original tax return for the 2010 taxable year, X elects to assign \$100 of the 2010 R & D credits to Y. Subsequently, X discovers that it only had \$120 of 2010 R & D credits. The assignment to Y is a not a defective assignment because X had the \$100 of 2010 R & D credits assigned to Y. The fact that X retained less 2010 R & D credits than it expected does not make the assignment to Y a defective assignment. Therefore, X retained \$20 of 2010 R & D credits and Y received \$100 of 2010 R & D credits.

**Example 2:** Assume the same facts as in Example 1, except that X elects to assign all \$200 of the 2010 R & D credits to Y. Subsequently, X discovers that it had \$300 of 2010 R & D credits. The assignment to Y is a not a defective assignment because X had all \$200 of the 2010 R & D credits assigned to Y. Even if X can demonstrate that X intended to assign all of its 2010 R & D credits to Y, the assignment of 2010 R & D credits to Y will be limited to \$200 of 2010 R & D credits because this is the amount assigned in the valid assignment.

**Example 3:** Assume the same facts as in Example 1, except that X discovers that X has no credits and the election to assign credits to Y was meant to have been made by its affiliate, E, the entity that had \$200 of 2010 R & D credits. No credits are transferred because the assignment of credits from X to Y was a defective assignment, and E did not elect to assign any credits. Therefore, E retained all \$200 of 2010 R & D credits, and Y received no 2010 R & D credits.

**Example 4:** Assume the same facts as in Example 1, except that X can demonstrate with contemporaneous evidence, such as emails, correspondence, memos and tax preparation workpapers, that X intended to

assign no credits to Y and, instead, meant to assign the \$100 of 2010 R & D credits to M. Pursuant to paragraph (2), X's intent to assign to M is not relevant in determining whether the assignment is a defective assignment. Accordingly, the assignment of credits to Y is not a defective assignment. Therefore, X retained \$20 of 2010 R & D credits, Y received \$100 of 2010 R & D credits, and M received no credits.

**Example 5:** Assume the same facts as in Example 1, except that on X's original tax return for the 2010 taxable year, X did not elect to assign any credits, but Y's Form 3544A states that Y received \$100 of 2010 R & D credits from X in 2010. An assignment of credits in 2010 did not occur because X did not make an election to assign credits on its original tax return. Therefore, X retained \$200 of 2010 R & D credits and Y received no credits.

- (i) *Effective Date of the Adjustment.* The term "effective date of the adjustment" shall mean the date an allocation or reduction pursuant to Regulations 23663-2 through 23663-5 is treated as having occurred, which date shall be the same date that an assignor or eligible assignee would otherwise have retained or received the credits if the original assignment had reflected such an allocation.
- (j) *Election.* The term "election" shall mean an irrevocable election by an assignor to assign to an assignee a credit under the rules of Revenue and Taxation Code section 23663, in the form and manner specified by the FTB in forms and instructions, including FTB Form 3544 (and any successor form thereto).
- (k) *Eligible Assignee.* The term "eligible assignee" shall mean any affiliated corporation that is properly treated as a member of the same combined reporting group under Revenue and Taxation Code sections 25101 or 25110 as the assignor, determined as of (i) in the case of credits earned in taxable years beginning before July 1, 2008, June 30, 2008 and the last day of the taxable year of the assignor in which the eligible credit is assigned, or (ii) in the case of credits earned in taxable years beginning on or after July 1, 2008, the last day of the first taxable year in which the credit was allowed to the assignor and the last day of the taxable year of the assignor in which the eligible credit is assigned.
- (l) *Eligible Credit.* The term "eligible credit" shall mean any credit earned by a taxpayer (i) in a taxable year beginning on or after July 1, 2008, or (ii) in a taxable year beginning before July 1, 2008, provided that such pre-July 1, 2008 credit is eligible to be carried forward to the taxpayer's first taxable year beginning on or after July 1, 2008 under the provisions of Part 11 of the Revenue and Taxation Code.
- (m) *FTB.* The term "FTB" shall mean Franchise Tax Board.
- (n) *First Contact.* The term "first contact" shall mean the date the initial audit contact as defined in Regulation 19032 occurs for any assignor or assignee with respect to any taxable year in which an assignment of credits is made or in which credits which were the subject of an assignment are claimed.
- (o) *Identical Credit.* The term "identical credit" shall mean any credit that:
  - (1) is allowed under the same section of the Revenue and Taxation Code as any other credit,

- (2) is originally allowed in the same taxable year, and
  - (3) in the case of certain credits, such as credits for activities in enterprise zones, program areas or similar geographic-based credits, is a credit based on activity in the same enterprise zone or program area.
- (p) *Parties to a Defective Assignment.* The term "parties to a defective assignment" shall mean the assignor and each potential assignee for all defective assignments the assignor made of the same type of identical credit in the same taxable year as the defective assignment.

Note: Authority cited: Sections 19503 and 23663, Revenue and Taxation Code.  
Reference: Section 23663, Revenue and Taxation Code.

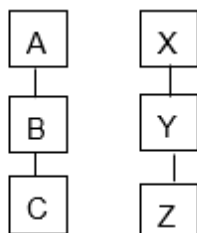
**Section 23663-6 is adopted to read:**

**23663-6. Corporate Reorganizations and Other Corporate Restructurings**

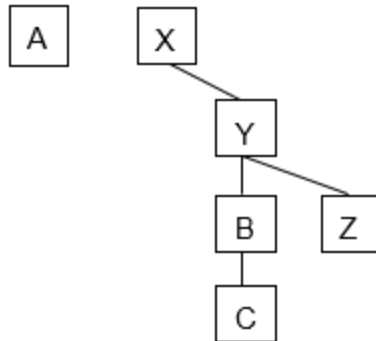
- (a) *In general.* The purpose of this regulation is to provide rules regarding the assignment of credits following corporate reorganizations and other corporate restructurings.
- (b) *Eligible Credit.* For purposes of Revenue and Taxation Code section 23663(b)(2), "any credit earned by the taxpayer" includes any credit allowed to the taxpayer for any reason other than that the credit was sold or assigned to the taxpayer pursuant to Revenue and Taxation Code section 23663, or any other section which permits the sale or assignment of credits.
- (c) *Eligible Assignee.* In addition to the requirements set forth in Revenue and Taxation Code section 23663(b)(3), an eligible assignee is a taxpayer that:
  - (1) In the case of credits earned in taxable years beginning before July 1, 2008, was a member of the same combined reporting group as the taxpayer that was allowed the credit as of June 30, 2008; or
  - (2) In the case of credits earned in taxable years beginning on or after July 1, 2008, was a member of the same combined reporting group as the taxpayer that originally earned the credit as of the last day of the taxable year in which the credit was originally earned.

**Example 1 – Assignor acquired by another combined reporting group.**

In 2010, A, B and C are members of the same combined reporting group, with A owning 100 percent of B, and B owning 100 percent of C. X, Y and Z are members of an unrelated combined reporting group, with X owning 100 percent of Y, and Y owning 100 percent of Z. The ownership structures of A, B and C, as well as X, Y, and Z, are illustrated by the following diagram:



B earns credits in 2010, which are neither used against its tax, nor assigned in either 2010 or 2011. In 2012, B and C are acquired by the X-Y-Z group in a tax-free "B" reorganization so that thereafter B is wholly owned by Y. The ownership structure of remaining entity A, and entities X, Y (with acquired entities B and C), and Z, is illustrated by the following diagram:



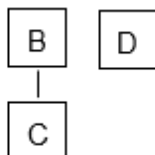
In 2013, B wants to assign its credits that it earned in 2010. C is the only eligible assignee for B's 2010 credits because C is the only entity that was in B's combined reporting group both in 2010 (the year the credits were earned) and in 2013 (the year of the assignment).

**Example 2 – Spin-off.**

B and C are members of the same combined reporting group, with B owning 100 percent of C. C earns credits in 2010, which are neither allowed against its tax nor assigned in either 2010 or 2011. The ownership structure of B and C is illustrated by the following diagram:



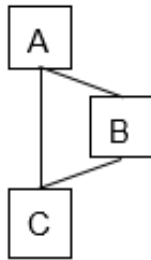
In 2012, D was formed and spun off from B, with B contributing assets to D in exchange for D stock, which qualified as a "D" reorganization under Internal Revenue Code section 368(a)(1)(D). D's stock was distributed to B's shareholders in a tax-free Internal Revenue Code section 355 transaction. The ownership structure of B, C and D thereafter is illustrated by the following diagram:



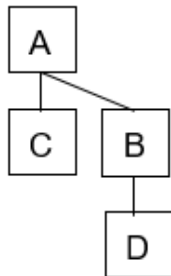
In 2013, C wants to assign the credits that it earned in 2010 to D. However, because D did not exist in 2010, D was not in the same combined reporting group as C when C earned the credits, and so, D is not an eligible assignee.

**Example 3 – Split-off.**

A, B and C are members of the same combined reporting group, with A owning 100 percent of B, and A and B each owning 50 percent of C. B earns credits in 2010, which are neither allowed against its tax nor assigned in either 2010 or 2011. The ownership structure of A, B and C is illustrated by the following diagram:



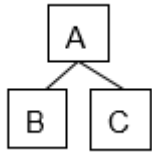
In 2012, D is formed and is split off of C, with C contributing assets to D for D's shares in a D reorganization under Internal Revenue Code section 368(a)(1)(D). C distributes D's shares to B in complete redemption of B's interest in C in a transaction that qualified under Internal Revenue Code section 355. As a result, A owns 100 percent of B and C, and B owns 100 percent of D. The ownership structure of A, B, C and D thereafter, is illustrated by the following diagram:



In 2013, B wants to assign the credits it earned in 2010 to D. However, since D was not in B's combined reporting group in 2010 because it was not in existence, D is not an eligible assignee.

**Example 4 – Split-up.**

A, B and C are part of the same combined reporting group in 2010, with A owning 100 percent of B and 100 percent of C. A and B earn credits in 2010. The ownership structure of A, B and C is illustrated by the following diagram:



In 2012, A distributes B and C's shares to A's shareholders in complete redemption of their A shares. As a result, A ceases to exist, and any credits it owned from prior years are extinguished because Internal Revenue Code section 381 does not apply. The ownership structure of remaining entities B and C, is illustrated by the following diagram:

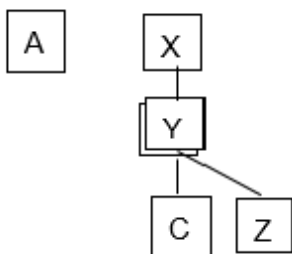


B and C continue to be in the same combined reporting group because they retain the same ownership and meet all other unitary requirements. C is an eligible assignee of the credits B earned in 2010 because C was part of B's combined reporting group at the end of the taxable year that the credits were allowed, and at the end of the taxable year that the credits were assigned.

- (d) Pre-Reorganization Credits. For purposes of determining whether a potential assignee meets the requirements of subsection (c) of this regulation and Revenue and Taxation Code sections 23663(b)(3)(A)(i) and (b)(3)(B)(i), when an assignor receives another taxpayer's credits as a result of a reorganization or other corporate restructuring, the taxpayer that originally earned the credits will be treated as the assignor. However, for any credits earned in taxable years beginning before July 1, 2008, the assignor will be the taxpayer that was allowed the credits as of the taxable year which includes the date of June 30, 2008.

**Example 5 – Pre-Reorganization Credits.**

Assume the same initial facts as in Example 1, except that both B and C earned credits in 2010 and in 2012 B was instead merged into Y in a tax-free "A" reorganization under Internal Revenue Code section 368(a)(1)(A). Y is the surviving entity, and the credits B earned in 2010 are now Y's credits. As a result, X owns 100 percent of Y, and Y owns 100 percent of C and Z. The ownership structure of remaining entity A, and the X-Y-C-Z combined reporting group (with B merged into Y as represented by the layered boxes) is illustrated by the following diagram:

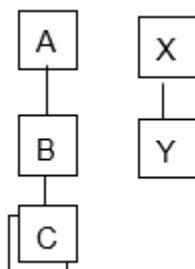




In 2013, Y wants to assign credits earned by B before the merger that are now held by Y. C is the only eligible assignee for the credits B earned in 2010 because B is the deemed assignor and C is the only entity that was in B's combined reporting group in 2010 (the year the credits were earned) and in Y's combined reporting group in 2013 (the year of the assignment). However, while Y may assign the credits B earned in 2010 to C under these facts, C cannot assign any of the credits C earned in 2010 to X, Y or Z because X, Y and Z were not in C's combined reporting group when C earned its credits.

**Example 6 – No eligible assignees for the assignment of pre-merger credits.**

Assume the same initial facts as in Example 1, except that Z also earned credits in 2010 and does not use the credits against its tax nor assigns them in either 2010 or 2011. In 2012, the A-B-C group acquires Z by having Z merge into C, with C as the surviving corporation. The ownership structure of A, B, and C (with acquired entity Z merged into C as represented by the layered boxes), and remaining entities X, and Y, is illustrated by the following diagram:

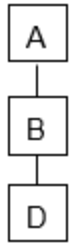


After the merger, C holds credits Z earned before the merger. C has none of its own credits. C cannot assign credits Z earned before the merger to A or B because neither A nor B were in the same combined reporting group as Z, the deemed assignor, in 2010. However, A and B can assign credits they earned before the merger to C (assuming subsection (f) of this regulation does not apply).

- (e) *F Reorganizations.* If a taxpayer would be an eligible assignee but for a reorganization under Internal Revenue Code section 368(a)(1)(F) that occurs after credits were earned, then the taxpayer will be treated as an eligible assignee for purposes of this section and Revenue and Taxation Code section 23663(b)(3).

**Example 7 – F Reorganization.**

Assume the same initial facts as in Example 1, except that in 2012, C, previously an Ohio corporation, reincorporates as D, a Nevada corporation, in a transaction that qualifies as an "F" reorganization under Internal Revenue Code section 368(a)(1)(F). As a result, A owns 100 percent of B, and B owns 100 percent of D, and C ceases to exist as a separate entity. The ownership structure of entities A, B, and D, is illustrated by the following diagram:

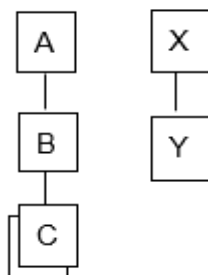


In 2013, B wants to assign its credits to D. Subsection (e) of this regulation applies, and D is an eligible assignee as to A and B for purposes of this section and Revenue and Taxation Code section 23663.

- (f) *Ineligible Assignee.* A member of the combined reporting group is not an eligible assignee for purposes of Revenue and Taxation Code section 23663(b)(3) if:
- (1) The member is the surviving entity in a reorganization or other corporate restructuring with an entity that was not a member of the combined reporting group when the assignor's credits were earned; and
  - (2) In the reorganization or restructuring, the member acquired assets (including real, personal, tangible, and intangible property) used in conducting its trade or business, with an aggregate fair market value that exceeds 80 percent of the aggregate fair market value of the total assets of the trade or business being conducted by the member immediately after the acquisition. For purposes of this paragraph only, the following rules shall apply:
    - A. The determination of the relative fair market values of the acquired assets and the total assets shall be made as of the time immediately after the acquisition.
    - B. Any acquired assets that constituted property described in Internal Revenue Code section 1221(a)(1) in the hands of the transferor shall not be treated as assets acquired from an existing trade or business, unless those assets also constitute property described in Internal Revenue Code section 1221(a)(1) in the hands of the acquiring taxpayer (or related person).

**Example 8 – Ineligible assignee.**

Assume the same initial facts as in Example 1, except in 2010, C is an operating business with minimal business assets, and Z is an operating business with significant business assets. In 2012, B acquires Z by having Z merge into C, with C as the surviving corporation, in a transaction that qualifies as an "A" reorganization under Internal Revenue Code section 368(a)(1)(A). The fair market value of C's assets immediately before the merger are less than 20% of the fair market value of C's total business assets immediately after the merger. The ownership structure of entity A, B and C (which merged with Z and is the surviving entity, as represented by the layered boxes) and entities X, and Y, is illustrated by the following diagram:



B wants to assign credits to C in 2013. However, C is not an eligible assignee for purposes of this section and Revenue and Taxation Code section 23663 because the fair market value of C's assets immediately prior to the merger with Z was less than 20% of the fair market value of C's assets immediately after the acquisition.

- (g) Limitations. For purposes of applying Revenue and Taxation Code section 23663, any limitations on the allowance of any credit against the tax that would apply to the assignor in the absence of an assignment shall also apply to the same extent to the allowance of that assigned credit against the tax of the assignee.

**Example 9 – Application of credit limitations.**

Assume the same initial facts as in Example 1, except that B earned credits in 2010 pursuant to Revenue and Taxation Code section 23622.7 (the "EZ Credits"). The EZ Credits are allowed against B's tax subject to the limitation in Revenue and Taxation Code section 23622.7(j).

In 2013, B assigns the EZ Credits to C. After B assigns the EZ Credits to C, the EZ Credits are allowed against C's tax subject to the limitation in Revenue and Taxation Code section 23622.7(j), since the same limitation would have applied to B's use of the credits if B had not assigned the EZ Credits to C.

Note: Authority cited: Sections 19503 and 23663, Revenue and Taxation Code.  
Reference: Section 23663, Revenue and Taxation Code.