RE: ANNOUNCEMENT RE WATER'S-EDGE ELECTION

In the near future, the Franchise Tax Board will issue proposed regulations prescribing the treatment to be accorded transactions between members of a unitary business. Set forth below is a description of the proposed treatment as it will apply to taxpayers electing water's-edge combination. This announcement is being made at this time to assist taxpayers in determining whether they wish to elect.

A water's-edge election made pursuant to Section 25111 of the Bank and Corporation Tax Law will cause gains or losses from intercompany transactions, except those between entities which are included in the combined report required to be filed pursuant to Section 25110 of the Revenue and Taxation Code, which were deferred in prior year combined reports to be taken into account in computing California tax.

Such gains or losses which cease to be deferred shall be subject to apportionment by the apportionment factor of the income year immediately preceding the income year of the election unless either the taxpayer or the Board determines that the deferred portion of gain or loss should be apportioned on the basis of the apportionment factor for the income year in which the deferred intercompany transaction took place. The Board will not require that the apportionment percentage of the year of the transaction be used unless such percentage varies by more than 10 percent from the apportionment percentage of the year immediately preceding the election and the total additional income apportioned to the California activities of all of the taxpayers exceeds $100,000.

The apportioned gains or losses shall be included in income on a pro rata basis for each of the five income years to which the original election applies.

DRAFTING INFORMATION

The principal author of this notice is Claudia K. Land, Supervising Counsel, Franchise Tax Board Legal Division. For further information regarding this notice, contact Ms. Land at P.O. Box 1468, Sacramento CA, 95812-1468.

NOTE: ((---)) = Indicates obsolete information.