

FTB NOTICE

California Franchise Tax Board - Legal Division



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FTB NOTICE 93-7

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Subject: EFFECT OF SENATE BILL 671 ON WATER'S-EDGE ELECTION

Senate Bill 671 (Stats. 1993, Ch. __) made significant changes to the water's- edge statutory provisions including elimination of the election fee, and elimination of the Franchise Tax Board's ability to disregard a water's-edge election. The election is now made for a period of 84 months. The Domestic Disclosure Spreadsheet (Spreadsheet) has been replaced by an information return that must be filed by both water's-edge and worldwide taxpayers. The information return requires significantly less information to be provided than is currently disclosed on the Spreadsheet. The Franchise Tax Board will be adopting regulations to implement the changes made by SB 671 effective for income years beginning on or after January 1, 1994. In the interim, there are several issues taxpayers filing on a water's-edge basis or making a water's-edge election should be aware of for 1993 and 1994 filings.

1. All contracts entered into for income years beginning prior to January 1, 1994, will be terminated. Many water's-edge taxpayers filed elections for calendar year 1988 (or fiscal years beginning in 1988) and immediately filed a notice of intent not to renew their contracts. These contracts expired for calendar year 1992 (or fiscal years beginning in 1992). If a taxpayer wishes to continue filing on a water's-edge basis for calendar year 1993 (or fiscal years beginning in 1993), they will have to make a new water's-edge election. A water's-edge election for calendar year 1993 (or fiscal years beginning in 1993) will be effective for that income year only.
2. Because SB 671 terminates water's-edge elections still in existence for the income years beginning on or after January 1, 1994, for any period remaining on the contracts, all taxpayers wanting to file on a water's-edge basis for calendar year 1994 (or fiscal years beginning in 1994) must make a new election. The manner in which a water's-edge election is made under the new law has not changed. Each California taxpayer making a water's edge election must be covered by a signed contract attached to the original return.
3. The Spreadsheet has been replaced with an information return. The information return requires all taxpayers to identify the ultimate corporate parent and those affiliates owned, directly or indirectly, more than 20% by the parent if total assets for the taxpayer and its related banks and corporations exceed \$200 million. The information return is due every three years, starting with income years beginning on or after January 1, 1994. The requirement to file the Spreadsheet for income years

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

beginning prior to January 1, 1994, has not been changed as a result of SB 671.

4. Legislative Counsel has issued an informal opinion clarifying that the repeal of section 25115, the annual fee, is not effective until the calendar year 1994 (or fiscal years beginning in 1994). Thus, the payment of the water's-edge election fee is required for elections in effect through calendar year 1993 (or fiscal years beginning in 1993).
5. When a taxpayer elects water's-edge for its income year beginning on or after January 1, 1994, an information return filing will not be required if a Spreadsheet has been filed for any of the three income years immediately preceding the income year beginning on or after January 1, 1994, unless there is a substantial change in the taxpayer's business activities. The information return filing requirement for the following third income year would then be determined by reference to the income year for which the last Spreadsheet was filed by the taxpayer. For example, if a taxpayer filed a Spreadsheet for income year ending December 31, 1993 and elects water's-edge for income year ending December 31, 1994, then the next information return would be due with respect to the income year ending December 31, 1996, assuming there are no short period return filings.

DRAFTING INFORMATION

The principal author of this notice is Benjamin F. Miller, Counsel, Multistate Tax Affairs. For further information regarding this notice, contact Mr. Miller at the Franchise Tax Board, Legal Division, P.O. Box 1468, Sacramento, CA 95812-1468.