State of California
Franchise Tax Board

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FTB NOTICE 2009-01

Subject: Disclosure of Deferred Intercompany Stock Account (DISA) Balance on California Corporate Tax Returns

PURPOSE

The purpose of this Notice is to remind taxpayers of their annual disclosure requirement regarding deferred intercompany stock account (DISA) transactions, and advise taxpayers that Franchise Tax Board (FTB) Form 3726 – DISA and Capital Gain Information -- has been provided to satisfy this disclosure requirement.

BACKGROUND

California Revenue & Taxation Code (CRTC) section 25106 provides that dividends between members of the same unitary combined reporting group that are paid from income that was included in the unitary combined report are eliminated for all tax purposes. However, as addressed below, there can still be collateral tax consequences relating to distributions between members of the same unitary combined reporting group.

More than seven years ago, the FTB promulgated a regulation that provides guidance with respect to the tax treatment of intercompany transactions between members of the same unitary combined reporting group.[1] These regulations contain provisions addressing distributions between unitary combined reporting group members. CCR section 25106.5-1, subsection (b)(8), states:

> Deferred Intercompany Stock Account ("DISA"). DISA[2] is the accounting mechanism that a distributee corporation, which is a member of the combined reporting group, will use to report and track non-dividend distributions[3] in excess of its adjusted

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[1] See California Code of Regulations (CCR), title 18, §§ 25106.5-1, et seq. This regulation is applicable for tax years beginning on or after January 1, 2001.

[2] CCR §25106.5-1, subsection (f)(1)(B), contains the specific rules relating to DISAs. It also includes two examples pertaining to DISAs.

[3] Internal Revenue Code (IRC) §§ 301, 311 and 312 address distributions and earnings and profits, respectively. Pursuant to CRTC § 24451, California conforms to these IRC provisions.

> basis in the stock of the distributing subsidiary corporation, which is a member of the same combined reporting group, until this intercompany item is required to be taken into account pursuant to this regulation. The balance of each DISA account must be disclosed annually on the taxpayer's return.

With respect to disclosing a DISA balance on the annual tax return, CCR section 25106.5-1, subsection (j)(7), states:

> If the taxpayer fails to disclose its DISA balance on its annual tax return, the staff of the Franchise Tax Board may, in its discretion, require the amounts in the undisclosed DISA accounts to be taken into account in part or in whole in any year of such failure.

Disclosing DISA Balances – Form 3726

To assist taxpayers in complying with their annual disclosure requirement, the FTB has issued Form 3726 - DISA and Capital Gain Information. In conjunction with Form 3726, Forms 100 and 100WE have been revised to include a question asking whether taxpayers have a DISA balance and, if so, the amount of that balance. An appropriately completed Form 3726 must be included with a taxpayer's 2008 original return and every year thereafter, if a member of the combined group has a DISA balance.

For years 2001 through 2007, taxpayers who have not yet fulfilled their disclosure obligation on the original return can fulfill their disclosure obligation by submitting a Form 3726 disclosing their DISA balances for each of those prior years. An amended return does not need to be filed. However, taxpayers should file an amended return if they discover that a prior triggering event has occurred that would have required taking into income the relevant DISA amount. If taxpayers satisfy their disclosure obligations as indicated in this notice, the previously undisclosed balances will not be included in income due to the prior nondisclosures.

The Form 3726 disclosing a taxpayer's DISA account for prior years, except those years open to assessment under the applicable statute of limitations, should be submitted by May 31, 2009. Form 3726 disclosures must be made on a specific entity basis. This means the company that received the distribution and the company that made the distribution must be identified. Accordingly, the name and California Corporation Number, or Federal Employer Identification Number, for each specific distributor and distributee must be provided.

Additionally, the name and California Corporation Number of the key corporation[4] must also be provided.

[4] See CCR § 25106.5-11.

Please mail Form 3726 and any supplemental schedules to: P.O. Box 942867-2222, Sacramento, CA, 94267-2222. If there are any questions regarding satisfying the disclosure requirement, contact Michael Halahan at (714) 567-7109.

Consequences for Failure to Disclose

If the prior DISA balances for years 2001 through 2007 are not reported as income due to the occurrence of a triggering event described in CCR section 25106.5-1, subsection (f)(1)(B), or disclosed as required, then pursuant to CCR section 25106.5-1, subsection (j)(7), the undisclosed balances may be accelerated by the FTB and required to be taken into income. This could result in additional tax liability and the imposition of various penalties, including the accuracy-related penalty under CRTC section 19164 and the large corporate underpayment penalty under CRTC section 19138.

The principal author of this notice is Craig Swieso of the Franchise Tax Board, Legal Division. For further information regarding this notice, contact Mr. Swieso at the Franchise Tax Board, Legal Division, P.O. Box 1720, Rancho Cordova, CA 95741-1720.