



10.16.2017

FTB NOTICE 2017- 04

SUBJECT: Extension of FTB Notice 2016-02 - Treatment of Existing Water's-Edge Elections After the Addition of Subdivision (b) of Revenue and Taxation Code Section 23101 Results in a Unitary Foreign Affiliate Becoming Subject to Tax in California

PURPOSE

To extend the treatment set forth in FTB Notice 2016-02 to include those foreign affiliates that become California taxpayers solely due to California Revenue and Taxation Code ("R&TC") section 23101(b) in a taxable year beginning on or before December 31, 2017.

BACKGROUND

R&TC section 25113 and the regulations thereunder address the effect on water's-edge elections arising from composition changes to the water's-edge combined reporting group due to mergers, acquisitions, consolidations, and disaffiliations. No statute or regulation addresses the effect on an election when the status of a non-electing unitary foreign affiliate changes from non-taxpayer to taxpayer due to the amendment of California's "doing business" standard that added R&TC section 23101, subdivision (b), in 2011.

On September 9, 2016, the Franchise Tax Board ("FTB") issued FTB Notice 2016-02 to provide administrative guidance on the treatment of a water's-edge election when a unitary foreign affiliate became a California taxpayer due to the enactment of R&TC section 23101(b). FTB Notice 2016-02 provides the background and legal framework to illustrate the issue at hand. This Notice adheres to and incorporates by reference FTB Notice 2016-02 in all respects, except the specific date constraints listed as conditions for FTB Notice 2016-02 to apply. FTB Notice 2016-02 applies only to a group of taxpayers with a valid water's-edge election in effect on or before September 9, 2016, and only to unitary foreign affiliates that become taxpayers in California in a taxable year ending on or before December 31, 2016.

Notice 2017-04 modifies the date constrictions found under FTB Notice 2016-02 to include unitary foreign affiliates that become California taxpayers for taxable years beginning on or before December 31, 2017 solely due to the change in law per R&TC section 23101(b).

TREATMENT OF ELECTIONS

The FTB will apply the following treatments, as already stated in FTB Notice 2016-02, and reiterated below:

- (1) When a unitary foreign affiliate has income derived from or attributable to sources within the United States as described in R&TC section 25110, subdivision (a)(2)(A)(i) ("United States Income") both before and after the beginning of a taxable year in which the affiliate becomes a taxpayer solely due to the addition of R&TC section 23101, subdivision (b), the deemed election provisions of R&TC section 25113, subdivision (b)(4), shall apply.
- (2) When a unitary foreign affiliate does not have United States Income either before or after the beginning of a taxable year in which the unitary foreign affiliate becomes a taxpayer solely due to the addition of R&TC section 23101, subdivision (b), the affiliate would never have been includable in the water's-edge combined report under R&TC section 25110(a)(2)(A)(i) despite its status as a taxpayer under R&TC section 23101, subdivision (b). However, in order to give effect to the objective intent of the taxpayers' unitary group to maintain an effective water's-edge election, the unitary foreign affiliate shall be deemed to have made an election as of the taxable year in which it became a taxpayer. The commencement date of the deemed water's-edge election shall be the same as the commencement date of the electing taxpayers of the existing water's-edge combined reporting group. In such circumstances, the foreign affiliate may be included in the group return of the existing water's-edge combined reporting group for administrative convenience.
- (3) When a unitary foreign affiliate does not have United States Income before, but has United States Income after, the beginning of a taxable year in which the affiliate becomes a taxpayer solely as a result of the addition of R&TC section 23101, subdivision (b), the unitary foreign affiliate will be deemed to have made an election as of the taxable year in which it becomes a taxpayer. The commencement date of the deemed water's-edge election shall be the same as the commencement date of the electing taxpayers of the existing water's-edge combined reporting group.

CONDITIONS FOR THIS NOTICE TO APPLY

The treatment of elections outlined above is limited to situations in which all of the following conditions apply:

- (A) a group of taxpayers made a valid water's-edge election before the date of FTB Notice 2017-04, and
- (B) at the time the existing water's-edge election was made, a foreign affiliate that was unitary with the electing water's-edge combined reporting group members could not make a water's-edge election because the affiliate was not subject to tax in California, and

- (C) the unitary relationship between the members of the water's-edge combined reporting group and the foreign affiliate remained continuously in effect between the time the valid water's-edge election was made and the time the unitary foreign affiliate became a taxpayer, and
- (D) the unitary foreign affiliate of the water's-edge combined reporting group became a taxpayer in a taxable year beginning on or before December 31, 2017 due solely to the addition of R&TC section 23101(b), such that, had the foreign affiliate been a taxpayer member of a self-assessed combined reporting group at the time the water's-edge election was made, the foreign affiliate would have been required by statute or regulation to make a water's-edge election in order for the water's-edge election to have been valid.

If all of these conditions are satisfied, the FTB will not seek to terminate the water's-edge election of the water's-edge combined reporting group that is unitary with the foreign affiliate that is now a taxpayer, but will apply the treatments outlined in paragraphs (1) through (3), above.

Except as provided in this Notice and FTB Notice 2016-02, all other provisions of law relating to the determination of the income derived from or attributable to sources within this state pursuant to a water's-edge election shall remain in full force and effect.

The principal author of this Notice is Elizabeth Rodoni of the Franchise Tax Board, Legal Division. For further information regarding this Notice, contact Ms. Rodoni at P.O. Box 1720, Rancho Cordova, CA 95741-1720.