

NOTE: This paper is intended only for purposes of facilitating discussion at the Interested Parties Meeting scheduled for November 26, 2018.

EXPLANATION OF DRAFT LANGUAGE

The focus of this Interested Parties Meeting (IPM) for which this document is prepared, will be to discuss the following proposed draft language regarding procedural guidance for petitions and appeals filed pursuant to Title 18, California Code of Regulations (CCR) section 25137(d). In this document, numerically organized introductory statements for the subsections of the proposed amended text are followed by the applicable portion of the proposed amended text with additions underlined, and deletions shown in strikethrough, and thereafter an explanation for the proposed amendment.

1. CCR Section 25137(d) was amended to become an introductory paragraph to the procedural amendments that appear directly below it.

~~(d) In cases deemed appropriate by the Franchise Tax Board it may elect to hear and decide petitions filed pursuant to Section 25137 instead of having this function performed by the FTB staff, as well as hear and decide taxpayer appeals of variance action requests pursuant to regulation section 25137. As a condition to having such petition considered by the Board, the petitioning taxpayer shall waive in writing the confidentiality provisions of Section 19542 with respect to such petition and to any other facts which may be deemed relevant in making a determination. Consideration of said petitions by the Board shall be open session at a regularly scheduled meeting.~~

The first proposed change to Section 25137(d) is to add the abbreviation "FTB" before the word "staff" for clarity as to whose staff performs the function of hearing and deciding appeals of variance. Another addition is to specify that the Franchise Tax Board may "hear and decide taxpayer appeals of variance action requests pursuant to regulation section 25137." This new language was added to make clear that the Board itself may choose to hear and decide appeals of variance actions instead of FTB staff. In summation, it is now specifically stated that the Three-member board may hear and decide initial petitions filed pursuant to Section 25137 as well as appeals of variance action requests.

The third change to Section 25137(d) is to delete "As a condition to having such petition considered by the Board, the petitioning taxpayer shall waive in writing the confidentiality provisions of Section 19542 with respect to such petition and to any other facts which may be deemed relevant in making a determination." This condition, worded a little differently, has been relocated to Section 25137(d)(2)(B) with other provisions regarding filing an appeal of a variance action. The wording was changed to make the provision more succinct. The relocation to Section 25137(d)(2)(B) was made for better organization of regulation Section 25137(d) overall. The sentence "Consideration of said petitions by the Board shall be open session at a regularly scheduled meeting" has been reworded and relocated Section (d)(3)(H).

2. CCR Section 25137(d)(1) is added to provided definitions of key terms used throughout the regulation.

(1) Definitions

- (A) "FTB staff" means staff employed by the Franchise Tax Board.
- (B) "Board member staff" means staff employed by any of the three members of the Franchise Tax Board.
- (C) "Brief" means a written document containing an argument or arguments supporting a party's position. A brief may, but is not required to, include citations to specific laws, regulations, or other authorities. A brief may be in the form of a letter, other informal writing, or formal legal writing. Briefs are subject to the requirements identified in these regulations.
- (D) "Ex-parte communication" means communication between one of the three-members of the Franchise Tax Board and/or Board member staff, and the petitioner and/or his or her representative, or FTB staff.
- (E) "Open session at a regularly-scheduled meeting" means the open session of a Franchise Tax Board regularly meeting
- (F) "Three-member board" means California Franchise Tax Board as defined by California Government Code section 15700.
- (G) To "make a record" means to memorialize in writing the identity of who initiated the inadvertent ex-parte communication, and all parties to the appeal who were entitled to participate. The record made must reflect the general substance of what was discussed and the response of any Franchise Tax Board member and/or the Board member's staff. If any documents are provided or exchanged, they must be identified, copied and made part of the record.
- (H) "Variance action" means a taxpayer filed petition for an alternative apportionment methodology pursuant to Section 25137, or FTB staff imposition of an alternative apportionment methodology pursuant to Section 25137, to which the taxpayer objects.

These definitions are self-explanatory. They are designed to provide detailed clarity for key words used throughout the regulation, provide consistency within the regulation, and avoid redundancy.

3. Section 25137(d)(2) was added to address procedures for when a variance action has been filed with FTB staff.

(2) In the event a variance action has been filed with FTB staff by a taxpayer, the following procedures shall apply:

This introductory paragraph was added to provide the procedures that apply when a taxpayer files a variance action with FTB staff.

(A) The taxpayer, and/or its representative, may present facts and assertions pertaining to the variance action in person to FTB staff who will hear and decide the variance action.

This subsection is added to provide that a taxpayer requesting a variance action of FTB staff may present facts and arguments in person to FTB staff who will hear and decide the variance action. FTB staff believes that it would be beneficial to all parties, especially the taxpayer, to allow the taxpayer to bring its facts and arguments in person to the FTB staff who are going to hear and decide the variance action. Taxpayers expressed at the first IPM in June 2017 that they would prefer to advocate their own cases and not rely on a FTB staff person to convey the taxpayer's facts and argument to FTB staff who are going to hear and decide the variance action.

(B) If a variance action initiated by the taxpayer pursuant to Section 25137 is not granted by FTB staff, either in whole or in part, or if the variance action was imposed by FTB staff requiring employment of an alternative apportionment methodology in a manner to which the taxpayer objects, the taxpayer may appeal the variance action to the Board, itself.

This language is added to specifically provide that when a taxpayer objects to the decision of FTB staff on the variance action, the taxpayer may appeal that decision to the Board, itself. This is segue to the procedures for appealing the variance action.

4. Section 25137(d)(2) was added to address how a taxpayer can appeal a FTB staff-issued variance action decision to which the taxpayer objects to the Board, itself.

(3) In the event the taxpayer desires to appeal a variance action to the Board, itself, the following procedures shall apply:

This is the introductory paragraph to the following procedures.

(A) The taxpayer must waive, in writing, the confidentiality provisions of Section 19542 with respect to such variance action, which waiver must be sent to the Franchise Tax Board Chief Counsel.

This established provision is relocated here, with small textual edits for internal consistency, from section 25137(d) above for organizational purposes, to place it with all procedures that

apply to appeal a variance action. This subsection mandates that the taxpayer must waive in writing the confidentiality provisions of Revenue and Taxation Code Section 19542 in connection with the variance request and any other relevant facts.

(B) To file an appeal under this regulation, the taxpayer must submit a brief, as provided for within this section, within sixty (60) calendar days of being notified in writing by FTB staff that a variance action initiated by the taxpayer filing a petition pursuant to Section 25137 was denied, in whole or in part, by FTB staff, or a variance action was imposed by FTB staff requiring employment of an alternative apportionment methodology. After the taxpayer has submitted its opening brief, FTB staff has thirty (30) days to submit its opening brief. Thereafter, the taxpayer has fifteen (15) days to submit a reply brief. Further briefing may be required by the Franchise Tax Board. All briefs are subject to the following rules:

This language is added to provide the date by which a taxpayer must appeal a variance action decision. Staff believes that 60 days from the date of notification of FTB staff's unfavorable decision for a taxpayer to file an appeal is reasonable and allows a taxpayer a reasonable amount of time to make the decision to appeal the variance action and file an appeal brief with the Franchise Tax Board Chief Counsel.

This provision also sets out the timing of the briefing for an appeal before the Three-member board: FTB staff has thirty (30) days to file its opening brief and the taxpayer has fifteen (15) days to reply to that brief. Also, it advises taxpayers that the Franchise Tax Board may need additional briefing. This ordering of filing briefs and their timing is patterned after California Office of Tax Appeals (OTA) and standard Superior Court rules.

1. Briefs are limited to double-spaced thirty (30) pages and 12 point font per inch of paper.

This provision is added to provide standard formatting rules for briefs, and is based on OTA regulations and standard Superior Court rules.

2. Reply briefs are limited to double-spaced fifteen (15) pages and 12 font per inch of paper.

This provision is also added to provide standard formatting rules for briefs, and is based on OTA regulations and standard Superior Court rules.

3. All briefing must be filed by the parties with the Franchise Tax Board Chief Counsel.

This provision is added to provide rules for briefs, and states the person and the location where a taxpayer is to submit its briefs.

(C) Upon submittal of the taxpayer's opening appellate brief and the written waiver of the confidentiality provisions of Section 19542 with respect to such variance action and to any other facts that may be deemed relevant by the three-member board in making a decision on the variance action, the Franchise Tax Board's Executive Officer, or the Executive Officer's designee, shall notify the Three-member board of the taxpayer's request to have the Board, itself hear and decide the appeal of the variance action.

This provision is added to denote that once the taxpayer submits its opening brief and a written waiver of confidentiality, the Franchise Tax Board Executive Officer or his or her designee must notify the Three-member board of the Taxpayer's request to have the Three-member board hear and decide the appeal. This notification is important because it notifies the Three-member board of the appeal, which triggers application of ex-parte communication rules, detailed below.

(D) If a notice of proposed deficiency assessment, within the meaning of Section 19057(a), has not been mailed to the taxpayer with respect to the tax year pertaining to the variance action, the taxpayer must agree in writing if requested by the Franchise Tax Board to an extension of the statute of limitations for the mailing of the notice of proposed deficiency assessment up until 180 days after the appeal of the variance action has been heard and decided by the Board, itself.

This provision was added to provide that if a Notice of Proposed Deficiency Assessment has not been issued to the taxpayer with respect to the tax year of the variance action, then, if the Franchise Tax Board requests it, the taxpayer must agree in writing to extend the statute of limitations for 180 days after the appeal of the variance action has been heard and decided by the Three-member board. This extension is important because at the time the taxpayer brings a variance request, it may be early in the audit process and the Franchise Tax Board may not have the issues developed sufficiently to issue a Notice of Proposed Deficiency Assessment. Several commentators at the June 2017 IPM agreed that extending the statute of limitations would be fair to the Franchise Tax Board if the audit of the case had not yet been fully developed but the taxpayer wanted to submit a variance request early in the audit.

(E) Upon notification by the Executive Officer as provided above in subsection (3)(C), the Franchise Tax Board shall set a hearing in an open session at a Three-member board meeting to hear and decide the taxpayer's appeal of the variance action. The taxpayer will be notified in writing by the Franchise Tax Board of the hearing date.

This provision is added to provide that the Franchise Tax board shall schedule the appeal to be heard in an open session at a Three-member board meeting, and that the taxpayer will

be notified in writing of that hearing date. This is patterned after OTA regulations and standard Superior Court provisions.

(F) The parties to the appeal have thirty minutes (30) to present their respective positions and the taxpayer has fifteen (15) minutes to reply. Presentations of the parties at the hearing shall occur as follows:

1. The taxpayer shall first make its opening presentation.
2. FTB staff shall make its opening presentation immediately following the taxpayer's opening presentation.
3. The taxpayer shall make its reply presentation immediately following FTB staff's presentation.

This addition is drafted to provide time allotted to oral presentations, denoting that a taxpayer and FTB staff will alternate making opening presentations of thirty (30) minutes each, and that the taxpayer will have fifteen (15) minutes for its rebuttal argument. These provisions are supported by similar OTA and Superior Court provisions.

(G) Witnesses. A party wishing to have an expert or percipient witness or witnesses testify, must notify the Franchise Tax Board and the other party to the proceeding no later than fifteen (15) days prior to the hearing date, of the identity of the witness or witnesses, the general nature of the expected testimony, and the expected duration of the testimony at the hearing.

This addition is drafted to provide the procedural rules for a witness to testify. It addresses the amount of notice to be given the Franchise Tax Board and other parties before the witness testimony, including a summation of the expected testimony, and the expected amount of time the testimony will take. These provisions are typical for legal matters in Superior Courts of Law and administrative law proceedings.

(H) The Three-member board shall render its decision on the variance action during an open session, when the three-member board has reached its decision.

Because the Franchise Tax Board and its members are subject to the Bagley-Keene Act, set forth at California Government Code Sections 11120 through 11132, in connection with all communications, this provision was added to make it clear that rendering a decision on a variance action must be done in open session.

5. Section 25137(d)(4) was added to provide details about application of the Ex-parte communication rules to variance actions and to appeals of variance actions before the Three-member board.

(4) Applicability of Ex-parte Communication Rules

(A) Ex-parte communication rules do not apply during the pendency of a variance action that is before FTB staff or the Three-member board.

This provision is added to provide that ex-parte communication rules are not applicable to those variance actions that are before FTB staff or the Three-member board, if the Board itself chose to hear and decide a variance action at the petition stage. This is important because ex-parte communication rules do apply to appeals filed by taxpayers to the Three-member board, as detailed below.

(B) Ex-parte communication rules apply during the pendency of any appeal to the Franchise Tax Board of a variance action as follows: There shall be no communication, direct or indirect, regarding any substantive issue relating to the appeal between any Franchise Tax Board member or Board member staff, appellant or appellant's employee or representative, and/or FTB staff, without notice and opportunity for all parties to participate in the communication.

This subsection is added to provide that ex-parte communication rules apply during the pendency of all appeals before the Three-member board. It also sets forth the various communications that are prohibited. This is important because in a traditional legal context, ex-parte communications are communications between the judiciary or administrative law judge and the parties and their representative without all parties present. Ex-parte communications are prohibited by the California State Bar, California Rules of Professional Conduct 7-108(B). That law is based on the concept of fairness that every communication must be in the presence of every party, so that no one will be disadvantaged by an impermissible communication with the trier of fact on a substantive issue without the ability to respond to that communication. The ex-parte communication provisions of this rulemaking action follow the law and the spirit of FTB Resolution 2017-01, which identified the policy that the Three-member board would follow in connection with ex-parte communications.

(C) Applicability of the ex-parte communication rules ends when the Franchise Tax Board renders its decision on the appeal of a variance action.

This provision is added to provide that when the Three-member board issues a decision on the appeal of a variance action, the ex-parte communication rules no longer apply.

(D) Permitted communications between the Franchise Tax Board, FTB staff, and the taxpayer and/or its employees and/or representatives during the pendency of an appeal of a variance action include:

This is an introductory paragraph to "permitted communications".

1. Briefs and oral presentations at open session are not ex-parte communications, and are permitted communications.

This provision is added to clarify that permitted communications include briefs and oral presentations. These types of communications are permitted because in courts of law and administrative proceedings, these items are part of the public record for the case at issue. Because briefs and oral presentations are part of the public record and open to the public, they are not considered impermissible communications.

2. Ex-parte communications are permitted provided that the communication does not pertain to any matters within the variance action, but instead involves communication between the taxpayer, the representative, the board member or Board member staff, and FTB staff that only relates to the scheduling of a future discussion about the substantive matters of the variance action. If this is the goal of such an ex-parte communication, then:

This provision is added to provide that if ex-parte communications are solely for the purposes of setting a future meeting about the substantive matters of the variance action, then the provisions below apply. In this limited circumstance it is not considered an ex-parte communication for the parties and the Three-member board and Board member staff to discuss specifics of setting up a meeting because there is no substantive issue being discussed between a party or their representative and one Board member or Board member staff.

- a. The Franchise Tax Board member and/or Board member staff shall invite all parties and/or their representatives to participate in a scheduled telephonic discussion or in person meeting as soon as practicable. Any communication for purposes of setting up this scheduled future discussion or in person meeting shall only concern the scheduling and not the substance of the subject variance request. All parties and/or their representatives and the Franchise Tax Board member and/or Board member staff shall work together and make a reasonable effort to find a mutually agreeable date, time, and place to hold the telephonic discussion or in person meeting. If the parties cannot agree on a date, time, and place to hold the telephonic discussion or in person meeting, then the meeting shall not be held.

This provision is added to provide that communications for purposes of setting up a future meeting to discuss the substance of the variance request must include all parties and their representatives, with everyone making a reasonable effort to find a mutually agreeable date, time and place. Since no substantive information is discussed, this is a permitted communication.

- b. All parties must be given the opportunity to participate in a telephonic discussion or attend an in person meeting scheduled at a mutually agreeable place, date, and time. Regardless of whether all parties actually participate in the telephonic discussion or attend the in person meeting, the Franchise Tax Board member and/or Board member's staff participating in the telephonic discussion or attending the in person meeting must:

This provision was added to provide that notwithstanding whether all parties attend the meeting, the Board member or Board member's staff must follow the instructions within the regulation, as detailed below, for documenting the meeting. The purpose of documenting the meeting is to provide the substance of the communication that can be shared with those who did not attend.

- i. Document in writing substantive matters discussed at the telephonic discussion or in person meeting.

This subdivision is provided to denote that all substantive matters discussed at the meeting must be documented in writing. Again, this encourages sharing documentation of substantive matters discussed at a communication.

- ii. Provide the documentation and copies of any materials shared by the parties, the Franchise Tax Board member, and/or Board member staff participating in the telephonic discussion or attending the in person meeting to all parties to the appeal and their representatives within fifteen (15) days of the telephonic discussion or in person meeting. If any party is absent from the telephonic discussion or in person meeting, the Franchise Tax Board member and/or the Board member staff must provide an opportunity for the absent party or parties to respond to the documentation and any materials supplied for the telephonic discussion or in person meeting within fifteen (15) days of the telephonic discussion or in person meeting. The documentation of specific matters discussed must be in sufficient context and detail to allow the absent party or parties the opportunity to respond to any matters discussed at the telephonic discussion or in person meeting in writing and/or submit any other

materials for consideration he or she may wish to provide to the Board member and/or Board member staff. Any such writing or material must also be supplied at the same time to the opposing party or its representatives within ten (10) days before the hearing.

This provision is added to denote that materials shared at the meeting where substantive matters about the appeal are discussed must be provided to those parties that did not participate in the meeting at least ten (10) days before the hearing. The provision also provides that parties that did not participate in the meeting must be given an opportunity to respond. These provisions have been created to encourage fairness between the parties and the Three-member board who have had an otherwise unpermitted ex-parte contact.

(E) When there has been an ex-parte communication, the Franchise Tax Board member and/or Board member staff must make a record of the ex-parte communication and provide it to the Franchise Tax Board members present at the Franchise Tax Board's open meeting where the Franchise Tax Board will consider the appeal of the variance action. If any documents are provided or exchanged, copies must be provided to all parties and/or their representatives within fifteen (15) days of the telephonic discussion or in person meeting.

This provision is added to state that the Franchise Tax Board member or Board member staff must make a record of the ex-parte communication and provide it to all Franchise Tax Board members at the open meeting where the Franchise Tax Board will hear the appeal. Documents shared at the ex-parte communication must be provided to all parties within fifteen (15) days of the meeting. Again, this provision is to ensure that all parties, and their representatives, and Board members and Board member staff are provided all records and documents exchanged during the ex-parte communication. This provision's purpose is in the interest of fairness notwithstanding ex-parte communications.

(F) In the event a Franchise Tax Board member and/or or the Board member staff have an inadvertent ex-parte communication with any party to the appeal of a variance action, then the Franchise Tax Board member and/or or the Board member staff must make a record of that ex-parte communication. If any documents are provided or exchanged, they must be identified, made part of the written record, and copies provided to all parties and/or their representatives at the Franchise Tax Board's open meeting where the Franchise Tax Board will hear and decide the appeal of the variance action. The preparation and distribution of such documents are subject to the requirements of Government Code section 11125.2(c).

This provision is added to address inadvertent ex-parte communication. There must be a record and copies of documents provided to all parties and their representatives at the open meeting where the Franchise Tax Board will hear and decide the appeal of the variance action. This is very similar to all provisions about sharing the ex-parte communication substantive information and documents.

(G) Because the Bagley-Keene Act, set forth at California Government Code Sections 11120 through 11132, prohibits a Franchise Tax Board member from sharing any written or oral information received during an ex-parte communication, even if the communication is inadvertent, with any other Franchise Tax Board member except at a duly noticed open meeting of the Franchise Tax Board, the Franchise Tax Board member involved in an ex-parte communication must report that communication at the formal hearing, where the Franchise Tax Board will hear and decide the appeal of a variance action. The Franchise Tax Board member must disclose the ex-parte communication on the record to the public, and other Franchise Tax Board members, and distribute the writing memorializing the communication as summarized above to the other Franchise Tax Board members, as well as make available all documents exchanged or provided during the ex-parte communication. The preparation and distribution of the documents between the Franchise Tax Board members are subject to the provisions of Government Code section 11125.1(c).

The provision is added because the Bagley-Keene Act, applicable to the Franchise Tax Board, provides that documents and oral communications are shared between Board members only at open meetings.

(H) The Franchise Tax Board staff must include a short summary of the ex-parte communication in the minutes of the Franchise Tax Board open meeting at which the ex-parte communication is disclosed.

This provision is added to ensure that Franchise Tax Board staff perform the ministerial act of keeping a record of the ex-parte communication disclosure in the minutes of the Franchise Tax Board meeting.

(5) Applicability date. The revisions to this subsection prospectively apply to variance actions and appeals of variance actions filed on or after the effective date of these changes.

This suggested change was added to provide the specific date for which the amendments to the regulation promulgated by this rulemaking action will be applicable. The addition makes it clear that the new provisions of subsection (d) apply only prospectively to variance actions and appeals of variance actions filed after the revisions become effective.