

**Title 18, Division 3, California Code of Regulations**  
**Amend Article 2.5. Uniform Division of Income for Tax Purposes Act,**  
**Amending section 25137**

**Chapter 3.5. Bank and Corporation Tax**  
**Subchapter 17. Allocation of Income**  
**Article 2.5. Uniform Division of Income for Tax Purposes Act**

**Section 25137 is amended to read:**

§ 25137. Other Apportionment Methods.

(a) Special Rules. In General. Section 25137 provides that if the allocation and apportionment provisions of the Uniform Division of Income for Tax Purposes Act do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for or the Franchise Tax Board may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

- (1) Separate accounting;
- (2) The exclusion of any one or more of the factors;
- (3) The inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state; or
- (4) The employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

Section 25137 permits a departure from the allocation and apportionment provisions of the Uniform Division of Income for Tax Purposes Act only in limited and specific cases.

Section 25137 may be invoked only in specific cases where unusual fact situations (which ordinarily will be unique and nonrecurring) produce incongruous results under the apportionment and allocation provisions contained in these regulations.

In the case of certain industries such as air transportation, rail transportation, ship transportation, trucking, television, radio, motion pictures, various types of professional athletics, and so forth, the foregoing regulations in respect to the apportionment formula do not set forth appropriate procedures for determining the apportionment factors. Nothing in Section 25137 or in this Regulation shall preclude the Franchise Tax Board from establishing appropriate procedures under Sections 25129 to 25136 inclusive, for determining the apportionment factors for each such industry, but such procedures shall be applied uniformly.

(b) Special Rules. Property Factor.

(1) The following special rules for determining the net annual rental rate as provided by California Code of Regulations, title 18, section 25130, subsection (b), are established in respect to the property factor of the apportionment formula:

(A) Subrents. If the subrents taken into account in determining the net annual rental rate under Regulation 25130, subsection (b), produce a negative or clearly inaccurate value for any item of property, another method which will properly reflect the value of rented property may be required by the Franchise Tax Board or requested by the taxpayer.

In no case however shall such value be less than an amount which bears the same ratio to the annual rental rate paid by the taxpayer for such property as the fair market value of that portion of the property used by the taxpayer bears to the total fair market value of the rented property.

**EXAMPLE:**

The taxpayer rents a 10-story building at an annual rental rate of \$1,000,000. Taxpayer occupies two stories and sublets eight stories for \$1,000,000 a year. The net annual rental rate of the taxpayer must not be less than two-tenths of the taxpayer's annual rental rate for the entire year, or \$200,000.

(B) Property of others in general. If property owned by others is used by the taxpayer at no charge or rented by the taxpayer for a nominal rate, the net annual rental rate for such property shall be determined on the basis of a reasonable market rental rate for such property.

(C) Natural resources. Without regard to whether the following property is also described in subsection (b)(1)(B), if a taxpayer enters upon property owned by others for the purpose of extracting natural resources such as timber, oil, gas or hard minerals, and irrespective of whether such entry or extraction is pursuant to an agreement between the holder of the interest in the property and the taxpayer (and also irrespective of whether such relationship is characterized as a profit à prendre or some other relationship), consideration actually paid by the taxpayer to the holder of the interest in the property that constitutes a sharing of current or future production or extraction of the timber, oil, gas or hard minerals from such property (irrespective of the method of payment or how such consideration is characterized, whether as a royalty, advance royalty, rental or otherwise) and consideration actually paid by the taxpayer for the right to enter the property and extract the timber, oil, gas or hard minerals (such as forest management fees, fire protection fees, reforestation or reclamation fees, road maintenance fees, etc.) for the taxable year at issue shall constitute the net annual rental rate. The net annual rental rate shall then be multiplied by eight (8) in accordance with Revenue and Taxation Code section 25130. Improvements shall not be included in the calculation of a net annual rental rate, but are separately accounted for. (See California Code of Regulations, title 18, section 25130, subsection (b)(5).)

EXAMPLE: On December 31, 2000, a taxpayer engaged in the paper products business enters into a 50-year forest management agreement with a government entity to commence January 1, 2001, that allows it to extract 100,000 cords of timber per year from forests owned by that government entity. In exchange for the right to enter the government's land and extract timber, the taxpayer agrees to pay a royalty fee of \$10.00 per cord extracted, plus a \$10,000 per year access fee, \$10,000 fire protection fee for any fires caused by the taxpayer, and an additional reforestation fee of 10 percent of the royalty fee paid. The forest management agreement also requires the taxpayer to make \$1 million worth of improvements to an existing mill facility owned by the government entity. In taxable year 2001, the taxpayer extracts 50,000 cords and does not cause any fires to occur. It also makes the \$1 million in improvements to the existing mill facility. The taxpayer therefore pays the government entity the \$10,000 access fee, \$500,000 in royalty fees (\$10.00 per cord times 50,000 cords), and an additional \$50,000 for the reforestation fee (10 percent of the \$500,000 royalty fee). Under these facts, the taxpayer is entitled to claim \$560,000 as the net annual rental rate. The taxpayer reports \$4,480,000 (\$560,000 multiplied by 8) for property factor purposes for this property for taxable year 2001. In addition, the taxpayer reports the \$1 million in improvements in the property factor as property owned by the taxpayer in accordance with California Code of Regulations, title 18, section 25130, subsection (b)(5), for taxable year 2001.

(D) Definitions. For purposes of subsection (b) the following definitions apply.

1. A "reasonable market rental rate" shall mean the rate at which a lessor is willing to lease and a lessee is willing to pay in an open and competitive marketplace for the property.
2. A "nominal rate" shall mean a token payment compared to a rental rate at which a lessor is willing to lease and a lessee is willing to pay in an open and competitive marketplace for the property.
3. "Agreement" shall mean contract, lease or similar arrangement for the use of property.

(c) Special Rules--Sales Factor.

(1) The following special rules are established in respect to the sales factor of the apportionment formula:

(A) Where substantial amounts of gross receipts arise from an occasional sale of a fixed asset or other property held or used in the regular course of the taxpayer's trade or business, such gross receipts shall be excluded from the sales factor. For example, gross receipts from the sale of a factory, patent, or affiliate's stock will be excluded if substantial. For purposes of this subsection, sales of assets to the same purchaser in a single year will be aggregated to determine if the combined gross receipts are substantial.

1. For purposes of this subsection, a sale is substantial if its exclusion results in a five percent or greater decrease in the sales factor denominator of the taxpayer or, if the taxpayer is part of a combined reporting group, a five percent or greater decrease in the sales factor denominator of the group as a whole.

2. For purposes of this subsection, a sale is occasional if the transaction is outside of the taxpayer's normal course of business and occurs infrequently.

(B) Insubstantial amounts of gross receipts arising from incidental or occasional transactions or activities may be excluded from the sales factor unless such exclusion would materially affect the amount of income apportioned to this state. For example, the taxpayer ordinarily may include or exclude from the sales factor gross receipts from such transactions as the sale of office furniture, business automobiles, etc.

(C) Where the income producing activity in respect to business income from intangible personal property can be readily identified, such income is included in the denominator of the sales factor and, if the income producing activity occurs in this state, in the numerator of the sales factor as well. For example, usually the income producing activity can be readily identified in respect to interest income received on deferred payments on sales of tangible property (Regulation 25134, sub. (a)(1)(A)) and income from the sale, licensing or other use of intangible personal property (Regulation 25136, sub. (b)(4)).

Where business income from intangible property cannot readily be attributed to any particular income producing activity of the taxpayer, such income cannot be assigned to the numerator of the sales factor for any state and shall be excluded from the denominator of the sales factor. For example, where business income in the form of dividends received on stock, royalties received on patents or copyrights, or interest received on bonds, debentures or government securities results from the mere holding of the intangible personal property by the taxpayer, such dividends and interest shall be excluded from the denominator of the sales factor.

(D) The numerator and denominator of the sales factor shall exclude interest and dividends from intangible assets held in connection with a treasury function of the taxpayer's unitary business as well as the gross receipts and overall net gains from the maturity, redemption, sale, exchange or other disposition of such intangible assets.

1. "Treasury function" is the pooling, management, and investment of intangible assets for the purpose of satisfying the cash flow needs of the trade or business, such as providing liquidity for a taxpayer's business cycle, providing a reserve for business contingencies, business acquisitions, etc. A treasury function includes the use of futures contracts and options contracts

to hedge foreign currency fluctuations. A treasury function does not include a taxpayer's trading function that engages in futures and option transactions for the purpose of hedging price risk of the products or commodities consumed, produced, or sold by the taxpayer. A taxpayer principally engaged in the trade or business of purchasing and selling intangible assets of the type typically held in a taxpayer's treasury function, such as a registered broker-dealer, is not performing a treasury function with respect to income so produced.

2. This subsection shall not apply to entities that apportion their income under the rules of regulation 25137-4.2.

3. This subsection is applicable to taxable years beginning on or after January 1, 2007.

(d) In cases deemed appropriate by the Franchise Tax Board, itself, it may elect to hear and decide petitions filed pursuant to Section 25137 instead of having this function performed by the Franchise Tax Board staff. ~~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 Franchise Tax Board, itself, shall be in open session at a regularly scheduled meeting.

(1) Definitions. For purposes of subsection (d) the following definitions apply.

(A) "Brief" means a written document containing an argument or arguments supporting a party's position.

(B) "Ex-parte communication" means any communication concerning a petition to or from the Franchise Tax Board, itself, or Franchise Tax Board member staff, outside the presence of either Franchise Tax Board staff or the taxpayer without notice to all parties.

(C) "Franchise Tax Board member staff" means staff employed by any of the three members of the Franchise Tax Board.

(D) "Franchise Tax Board staff" means staff employed by the Franchise Tax Board and does not include any Franchise Tax Board member staff.

(E) "Open session at a regularly scheduled meeting" means the open session of a regularly scheduled meeting of the Franchise Tax Board.

(F) "Petition" means a request by a taxpayer for the Franchise Tax Board, itself, to consider an alternative apportionment methodology pursuant to Section 25137 at an open session at a regularly scheduled meeting.

(G) "Variance action" means a taxpayer's request for Franchise Tax Board staff to allow the taxpayer to use an alternative apportionment methodology pursuant

to Section 25137 or a Franchise Tax Board staff imposed alternative apportionment methodology.

(2) Petitions. The following shall apply to petitions filed pursuant to this subsection:

(A) Any records submitted to the Franchise Tax Board, itself, by either the taxpayer or the Franchise Tax Board staff, as well as the decision of the Franchise Tax Board, itself, shall be open to public inspection pursuant to the California Public Records Act, Government Code section 6253 and the Bagley-Keene Act, Government Code section 11125.1. Any records of the Franchise Tax Board staff that are not submitted to the Franchise Tax Board, itself, shall remain confidential pursuant to Revenue and Taxation Code section 19542.

(B) The taxpayer shall file its petition with the Chief Counsel of the Franchise Tax Board explaining why its requested alternative apportionment methodology pursuant to Section 25137 is appropriate or why Franchise Tax Board staff's imposed alternative apportionment methodology is not appropriate. Such petition shall be filed within:

1. Sixty (60) calendar days from the date of a written adverse variance action determination by Franchise Tax Board staff;

2. One hundred twenty (120) calendar days from the date of a claim for refund filed pursuant to Revenue and Taxation Code section 19301 in which the alternative apportionment methodology is relevant to the taxable years in the claim for refund;

3. Sixty (60) calendar days from the date of a protest filed pursuant to Revenue and Taxation Code section 19041 in which the alternative apportionment methodology is relevant to the taxable years being protested;

4. Five (5) calendar days from the date of an appeal filed with the Office of Tax Appeals in which the alternative apportionment methodology is relevant to the taxable years on appeal;

5. Sixty (60) calendar days from the date of a letter of rejection by the Settlement Bureau of the Franchise Tax Board in which the alternative apportionment methodology is relevant to the taxable years at settlement; or

6. Sixty (60) calendar days from the date of applicability as specified in subsection (d)(5) of this regulation.

(C) Within sixty (60) calendar days from the date of the taxpayer's petition, the Executive Officer of the Franchise Tax Board, or the Executive Officer's designee, shall notify the Franchise Tax Board, itself, of the receipt of the taxpayer's petition.

(D) Within sixty (60) calendar days from the date of the taxpayer's petition, or the date of Franchise Tax Board staff's determination as specified in subsection

(2)(E), whichever is later, the Chief Counsel of the Franchise Tax Board shall notify the taxpayer of the receipt of the taxpayer's petition in writing, which shall include a briefing schedule as specified in subsection (2)(H).

(E) If Franchise Tax Board staff have not previously made a determination on the request to use an alternative apportionment methodology which is the subject of the taxpayer's petition before the Franchise Tax Board, itself, the Chief Counsel of the Franchise Tax Board shall ensure Franchise Tax Board staff determines whether the alternative apportionment methodology is appropriate.

(F) If the taxpayer files an appeal with the Office of Tax Appeals for the taxable years in which the alternative apportionment methodology is relevant to the taxable years on appeal, the taxpayer and Franchise Tax Board staff shall file a joint request to defer proceedings with the Office of Tax Appeals pending a decision by the Franchise Tax Board, itself.

(G) If a notice of proposed deficiency assessment, within the meaning of Revenue and Taxation Code section 19057(a), has not been mailed to the taxpayer with respect to the taxable years pertaining to the petition, the taxpayer shall agree in writing to an extension of the statute of limitations for the mailing of the notice of proposed deficiency assessment, until one-hundred and eighty (180) calendar days after the Franchise Tax Board, itself, has made its decision during an open session at a regularly scheduled meeting.

(H) Taxpayer shall submit its opening brief to the Chief Counsel of the Franchise Tax Board within sixty (60) calendar days from the date of the document notifying the taxpayer of the receipt of the taxpayer's petition.

After the taxpayer has submitted its opening brief, Franchise Tax Board staff shall have thirty (30) calendar days to submit its opening brief. Thereafter, the taxpayer shall have thirty (30) calendar days to submit a reply brief. Further briefing may be required by the Franchise Tax Board, itself. All briefs are subject to the following requirements:

1. Opening briefs are limited to double-spaced thirty (30) pages and twelve (12) point font per inch of paper.
2. Reply briefs are limited to double-spaced fifteen (15) pages and twelve (12) point font per inch of paper.
3. All briefs must be filed by the parties with the Chief Counsel of the Franchise Tax Board.

(I) Upon completion of briefing, the Franchise Tax Board, itself, may schedule a hearing during an open session at a regularly scheduled meeting to consider the taxpayer's petition. The taxpayer shall be notified in writing by the Chief Counsel of the Franchise Tax Board of the hearing date.

(3) Hearings. The following shall apply to hearings on petitions filed pursuant to this subsection:

(A) The parties shall each have twenty (20) minutes to present their respective positions and an additional ten (10) minutes for the taxpayer's reply. The Franchise Tax Board, itself, has the discretion to allow additional time. Presentations of the parties at the hearing shall occur as follows:

1. The taxpayer shall make its opening presentation.
2. Franchise Tax Board staff shall make its opening presentation following the taxpayer's opening presentation.
3. The taxpayer shall make its reply presentation following Franchise Tax Board staff's opening presentation.

(B) A party seeking to have an expert or percipient witness testify must notify the other party to the proceeding in writing no later than fifteen (15) calendar days after the filing of the taxpayer's reply brief, of the identity of the witness, the general nature of the expected testimony, and the expected duration of the testimony at the hearing. The Executive Officer of the Franchise Tax Board, or the Executive Officer's designee, shall notify the Franchise Tax Board, itself, of any witness, the general nature of the expected testimony, and the expected duration of the testimony at the hearing.

(C) The Franchise Tax Board, itself, shall render its decision on the taxpayer's petition during an open session a regularly scheduled meeting.

(4) Ex-parte Communication Rule. Except as provided by this regulation, there shall be no ex-parte communication regarding any substantive issue in the petition without notice and opportunity for all parties to participate in the communication.

(A) The ex-parte communication rule beginning with the notification to the taxpayer and the Franchise Tax Board, itself, of the receipt of the taxpayer's petition, continues while the petition is pending with the Franchise Tax Board, itself, and terminates when the Franchise Tax Board, itself, renders a decision. The Executive Officer of the Franchise Tax Board, or the Executive Officer's designee, shall notify the Franchise Tax Board, itself, of the applicability of the ex-parte communication rules to the petition.

(B) The ex-parte communication rule does not apply during the pendency of a variance action that is before Franchise Tax Board staff.

(C) The ex-parte communication rule does not apply to communications between the Franchise Tax Board, itself, or Franchise Tax Board member staff, Franchise Tax Board staff, and the taxpayer or its representatives during the pendency of a petition if the communication only relates to the scheduling of a future discussion



of the petition, and which only involves one member of the Franchise Tax Board itself, at a time. In such case:

1. The Franchise Tax Board member or Franchise Tax Board member staff shall invite all parties or their representatives, but no other Franchise Tax Board members, to participate in a scheduled telephonic discussion or in-person meeting as soon as practicable.

2. Any communication for purposes of arranging this scheduled discussion or in-person meeting shall only concern the scheduling and not the substance of the petition.

3. All parties or their representatives and the Franchise Tax Board member or Franchise Tax Board member staff shall coordinate to make a reasonable effort to arrange 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 by five (5) calendar days before the scheduled telephonic discussion or in-person meeting, then the meeting shall not occur.

4. If the telephonic discussion or in-person meeting has been scheduled and one of the parties does not participate or attend, then the telephonic discussion or in-person meeting may proceed and will not be considered an ex-parte communication.

5. Regardless of whether all parties actually participate in the telephonic discussion or attend the in-person meeting, the Franchise Tax Board member or Franchise Tax Board member staff participating in the telephonic discussion or attending the in-person meeting must:

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

b. Provide to all parties or their representatives to the petition, but not to other Franchise Tax Board members, within ten (10) calendar days from the date of the telephonic discussion or in-person meeting, the documentation pertaining to the substantive matters addressed and copies of any materials distributed by any of the parties participating in the telephonic discussion or attending the in-person meeting. If any party does not participate in the telephonic discussion or in-person meeting, that party shall have twenty (20) calendar days from the date of the telephonic discussion or in-person meeting to respond to the substantive matters discussed and the materials distributed. Such written response shall be provided to the opposing party.

(D) In the event an ex-parte communication occurs, the Franchise Tax Board member or Franchise Tax Board member staff shall document in writing the

substance of the ex-parte communication and shall provide it to the other Franchise Tax Board members and the parties to the petition during the open session at a regularly scheduled meeting when the petition is considered by the Franchise Tax Board, itself.

(5) Applicability Date. The amendments to subsection (d) are applicable only as of the effective date of the amendments to this subsection of the regulation.

Note: Authority cited: Section 19503, Revenue and Taxation Code.

Reference: Sections 6253 and 11125.1, Government Code. Sections 19041, 19301, 19507(a), 19542, and 25137, Revenue and Taxation Code.