

INITIAL STATEMENT OF REASONS

FOR THE AMENDMENT OF CALIFORNIA CODE OF REGULATIONS, TITLE 18, SECTION 25137

PUBLIC PROBLEM, ADMINISTRATIVE REQUIREMENT, OR OTHER CONDITION OR CIRCUMSTANCE THAT THE REGULATORY ACTION IS INTENDED TO ADDRESS

California Revenue and Taxation Code section ("Section") 25137 permits a taxpayer to petition the Franchise Tax Board ("FTB") for the use of an alternative apportionment method if the standard allocation and apportionment provisions do not fairly reflect the extent of the taxpayer's business activity in California. California Code of Regulations, title 18, section ("Regulation") 25137, subsection (d), currently provides that, in cases deemed appropriate, the three-member Board ("the Board, itself") may elect to hear and decide petitions filed pursuant to Section 25137 instead of having this function performed by the staff, and that consideration of said petitions will be heard in open-session by the Board, itself, at a regularly scheduled meeting.

On September 19, 2000, the FTB adopted FTB Resolution 2000-10 whereby the FTB resolved that for all cases involving the application of Section 25137 in which a taxpayer has requested a hearing before the Board, itself, and where the FTB staff recommended that the petition be denied, such cases are appropriate for consideration by the Board, itself, and will be heard in open session. On December 17, 2017, the FTB provided additional guidance in FTB Resolution 2017-01 whereby the Board, itself, resolved to implement an ex-parte communication rule prohibiting any communication, direct or indirect, regarding any substantive issue related to the petition, between any Board member or his/her staff/representative and either the petitioner, or an employee/representative of the petitioner, or FTB staff, without notice beginning on January 1, 2018.

However, other than the guidance set forth in Regulation 25137, FTB Resolution 2000-10, and FTB Resolution 2017-01, there exists no other formal guidance as to how petitions filed pursuant to Section 25137 are to be considered by the Board, itself. Taxpayers have expressed uncertainty regarding procedures on how to file petitions before the Board, itself, how arguments should be presented by the parties, how hearings should be conducted, and have questioned if there are procedures related to the implementation of the ex-parte communication rule.

SPECIFIC PURPOSE OF THE REGULATORY ACTION

The purpose of the proposed amendments to Regulation 25137 is to give taxpayers certainty by providing procedural guidance for petitions filed with the Board, itself, pursuant to Section 25137. The proposed amendments are intended to be consistent with FTB Resolution 2000-10 and FTB Resolution 2017-01 and will provide clear rules to implement the FTB's guidance provided in these resolutions. Accordingly, the proposed amendments specify the procedural rules and sets deadlines and conditions for filing petitions with the Board, itself. The proposed amendments will also provide

procedures for the briefing process and procedures related to hearings on said petitions, as well as address the application of the ex-parte communication rule. Such procedural guidance will streamline the petition process and ensure consistent application of procedures to all petitions filed pursuant to Section 25137.

BENEFITS ANTICIPATED FROM THE REGULATORY ACTION

The proposed regulatory action will benefit taxpayers, tax practitioners, and the State of California by providing clarity that does not currently exist through guidance for procedures for Section 25137 petitions filed with the Board, itself. The proposed regulatory action will clarify procedural rules related to filing of petitions, provide deadlines, and set forth the conditions under which petitions will be considered by the Board, itself. It will also provide procedural rules for the briefing process, hearings on petitions, and the ex-parte communication rule. The clarity from the proposed regulatory action will reduce confusion for taxpayers and tax practitioners, facilitate tax administration for the State of California by providing clear rules, and effect consistency throughout the petition process. These benefits are the result of goals developed by the FTB with input from interested parties and based on broad statutory authority.

NECESSITY

The proposed amendments to Regulation 25137 ("proposed regulation") are set forth immediately below, with explanations describing the necessity for the suggested changes within each description:

Subsection (d) of the proposed regulation introduces the subject matter of the regulation, streamlines the intended scope of the regulation, and makes minor grammatical changes in order to clarify that the rules provided in this subsection are for petitions filed pursuant to Section 25137 for consideration by the Board, itself. The language regarding the requirement for a written waiver of confidentiality is removed from this subsection and relocated with proposed revisions in subsection (d)(2) for organizational purposes and internal consistency. This subsection, as proposed to be amended, therefore sets forth the parameters of the proposed regulation and is necessary to provide users with clear guidance as to the subsection's scope. Without these changes, the taxpayer community would continue to be less clear on the scope of this regulation, which applies only to requests for the use of an alternative apportionment methodology for consideration by the Board, itself.

Subsection (d)(1) of the proposed regulation contains added definitions of key terms used throughout the regulation. The definitions were included to provide detailed clarity, provide consistency within the regulation, and to avoid redundancy. These amendments are necessary to avoid inconsistent application of the defined terms and to eliminate the need for redefining these terms elsewhere in the proposed regulation, which would make the proposed regulation significantly longer and more difficult to understand.

Subsection (d)(2) of the proposed regulation addresses various newly added procedures, deadlines, and conditions for filing petitions with the Board, itself. This

subsection makes clear that any records submitted to the Board, itself, as well as the decision of the Board, itself, are subject to the California Public Records Act and the Bagley-Keene Act. It also identifies specific due dates for filing petitions and ensures that FTB staff make a determination as to whether an alternative apportionment methodology is appropriate prior to consideration by the Board, itself. To ensure sufficient time for consideration of petitions, the proposed language requires the filing of a joint request to defer proceedings when a taxpayer files an appeal with the Office of Tax Appeals for the taxable years pertaining to the petition. It also requires a taxpayer to 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 Board, itself has made its decision, if a notice of proposed deficiency assessment has not already been mailed with respect to the taxable years pertaining to the petition. In addition, this subsection specifies when and how the notification of the receipt of a taxpayer's petition is to be provided, addresses the briefing schedule, and identifies whether a hearing will be scheduled and how a taxpayer will be notified of said hearing. Without this subsection, taxpayers would not have certainty in determining how and when to file petitions with the Board, itself, how to file briefs with the Board, itself, and what conditions must be met for proper consideration of petitions filed pursuant to Section 25137. This uncertainty could lead to confusion, inconsistency and inefficient use of time for the taxpayer community as well as for the Board, itself. This proposed regulation subsection would provide the necessary clarity and guidance to taxpayers to reduce confusion as well as to facilitate consistent treatment of taxpayers and efficient tax administration for the State of California.

Subsection (d)(3) of the proposed regulation addresses procedures related to hearings before the Board, itself, on petitions filed pursuant to Section 25137. This subsection is added to describe the manner in which opening and reply presentations are to be made by the parties, how and when notifications of witnesses are to be submitted, and specifies that decisions by the Board, itself, will be made during an open session at a regularly scheduled meeting. Without the clarity provided in this subsection, taxpayers would be uncertain as to how the hearings will be conducted, including the order in which presentations are to be made by the parties, allotted time for such presentations, and how witness testimony should be notified and presented at the hearings. This uncertainty could lead to confusion, inconsistency, and inefficient use of time for the taxpayer community as well as for the Board, itself. The clarity from this subsection is necessary to reduce confusion for taxpayers and tax practitioners, facilitate tax administration for the State of California by providing clear rules, and effect consistency throughout the hearing process.

Subsection (d)(4) of the proposed regulation is added to provide for the prohibition of ex-parte communication. This subsection specifies when the ex-parte communication rule does or does not apply as well as provides applicable procedures in the event an ex-parte communication occurs. Without this subsection taxpayers could inadvertently violate Government Code section 11430.10 and would not know how to proceed should a violation of the ex-parte communication rule occur. This subsection would ensure compliance with and provide the proper implementation of the prohibition against ex-parte communications embodied in Government Code section 11430.10.

Subsection (d)(5) creates an applicability date provision which provides that the proposed amendments to subsection (d) of the regulation are applicable prospectively only. Without the addition of an applicability date provision, it would be unclear when the new amendments to Regulation 25137 will apply.

TECHNICAL, THEORETICAL, AND/OR EMPIRICAL STUDIES, REPORTS OR DOCUMENTS

In drafting the proposed regulatory action, the FTB primarily relied on Section 25137, FTB Resolution 2000-10, and FTB Resolution 2017-01. The FTB also relied on suggestions from members of the public obtained through the Interested Parties Meeting ("IPM") process. The FTB did not rely upon any other technical, theoretical, or empirical studies, reports or documents in proposing the revisions to the regulations.

ALTERNATIVES TO THE PROPOSED REGULATORY ACTION THAT WOULD LESSEN ANY ADVERSE IMPACT ON AFFECTED PRIVATE PERSONS OR SMALL BUSINESSES

In accordance with the requirements of Government Code section 11346.2, subdivision (b)(4) that the FTB consider alternatives to the proposed regulatory action that would be less burdensome and equally effective in achieving the purpose of the regulation or would lessen any adverse impact on small business. FTB staff conducted four IPMs and published a Twenty Day Notice, whereby FTB staff solicited feedback regarding the proposed regulation language.

A preliminary IPM was held on June 30, 2017 to provide the public with an opportunity to discuss and provide comments on potential amendments to Regulation 25137, subsection (d). FTB staff explained the purpose of the regulatory action and the public responded positively to receiving additional guidance by way of amendments to the regulation. Numerous topics were discussed, including whether the proposed regulation should address any conditions that taxpayers would need to meet before filing a Section 25137 petition, what constitutes a valid petition, whether to adopt formal time limits and other procedural rules for oral presentations and witness testimonies, the consistent application of any rules to all parties, reconsiderations of petitions by the Board, itself, and the potential need for waivers of any statute of limitations. A summary of the first IPM was thereafter made available to the public.

The second IPM was held on November 26, 2018. FTB staff presented draft proposed regulation language, as well as an explanation of the proposed regulation language, based on consideration of comments received from the first IPM. The proposed regulation language was generally acceptable to the interested parties in attendance. FTB staff explained that the proposed regulation would address when a request for a variance from the standard allocation and apportionment method could be made and discussed the procedural aspects of petitioning the Board, itself, upon receiving an adverse determination from FTB staff. A number of comments were raised by participants about the conditions under which the Board, itself, would hear and decide petitions and whether an appeal could be made directly with the Office of Tax Appeals

or the superior court. Other comments dealt with issues pertaining to witness testimonies, ex-party communications, and waivers of confidentiality. The summary of the second IPM, along with explanation of the draft proposed regulation language, was thereafter made available to the public.

The third IPM was held on December 4, 2019 to further elicit public input regarding the potential amendments to Regulation 25137, subsection (d). FTB staff and interested parties in attendance discussed in detail certain aspects of the petition process; including acknowledgment procedures, timelines for the filing of petitions, briefing rules, ex-parte communications, scheduling of witnesses and hearings, and procedures for issuing decisions by the Board, itself. FTB staff clarified that the proposed regulation procedures apply to petitions filed with the Board, itself, and not to requests made with FTB staff. However, FTB staff noted that any petition would need to be reviewed by FTB staff before a petition would be considered by the Board, itself. Other comments dealt with the discretion of the Board, itself, to deny petitions, the waiver of confidentiality, and the applicability date of the proposed regulation. The summary of the third IPM, along with explanation of the draft proposed regulation language, was thereafter made available to the public.

The fourth IPM was held on August 11, 2020. FTB staff presented draft proposed regulation language, along with an explanation of the draft proposed regulation language, and received input from the public. FTB staff explained that the intent of the proposed regulation was to be consistent with FTB Resolutions 2000-10 and 2017-01 which provide the circumstances under which Section 25137 petitions will be considered by the Board, itself. After consideration of public comments, FTB staff determined that the filing of a Section 25137 petition would not be deemed an administrative remedy that would be required to be exhausted before a taxpayer could seek further administrative or judicial relief. FTB staff addressed a number of comments which were raised regarding disclosure of information and FTB closed-session meetings. FTB staff explained that any records submitted to the Board, itself, for consideration during an open meeting, as well as any decision of the Board, itself, would be subject to the California Public Records Act and the Bagley-Keene Act, unless otherwise provided. Other comments dealt with deadlines for filing petitions, notification of the hearing date, and appeals made directly to the Office of Tax Appeals. The summary of the fourth IPM, along with explanation of the draft proposed regulation language, was thereafter made available to the public.

Finally, after consideration of comments arising from the August 11, 2020 IPM, a Twenty-Day Notice containing revisions to the draft proposed regulation language was noticed and posted to FTB's Regulatory Activity page on December 29, 2020. Based on comments received in response to the Twenty-Day Notice, FTB staff made one minor revision to the proposed regulation language by replacing the word "within" to "by the later of" in subsection (d)(2)(B) to provide additional clarity.

The alternative to adopting the proposed regulatory action is the status quo, which would not provide taxpayers improved guidance on the procedural rules, deadlines and conditions for filing petitions with the Board, itself, or procedures for the briefing process

and procedures related to hearings on said petitions, as well as the application of the ex-parte communication rule. The FTB has determined that no alternative has been identified or been brought to the attention of the FTB that would be more effective in resolving the ambiguity in the regulation. The FTB is not aware of alternative actions that would be as effective as the proposed amendments and less burdensome to affected business than the proposed regulatory action or would be more cost-effective to affected businesses in implementing the statutory policy or other provisions of law.

Accordingly, the FTB has determined that there were no alternatives considered which would be more effective in carrying out the purpose of the proposed regulatory action or would be less burdensome with respect to affected private persons or small businesses than the proposed regulatory action.

ECONOMIC IMPACT ASSESSMENT

Creation or Elimination of Jobs within the State

The proposed regulation would not impact employment in California. No jobs would be created or eliminated due to this regulation. Under Section 25137 the taxpayer may petition for the use of an alternative apportionment method if the standard allocation and apportionment provisions do not fairly reflect the taxpayer's business activity in California. The proposed regulation applies in limited specific circumstances and merely provides procedural guidance for such petitions which serve to clarify and streamline the petition process. For these reasons, the FTB does not anticipate any changes in the number of jobs in California as a result of adopting the proposed regulation.

Creation of New or Elimination of Existing Businesses within the State

The proposed regulation would not impact the creation of new businesses or cause the elimination of existing businesses in California. The proposed regulation is intended to provide clarity to existing law for taxpayers by providing procedural guidance for petitions filed pursuant to Section 25137. Because the proposed regulation does not impact the taxation of business activity in the state, the FTB does not anticipate any impact on businesses in California.

Expansion of Businesses Currently Doing Business within the State

The proposed regulation will not have an impact on the expansion of businesses currently doing business in California. The proposed regulation is intended to provide clarity to existing law for taxpayers by providing procedural guidance for petitions filed pursuant to Section 25137. Because it does not impact the taxation of business activity

in California, the FTB does not anticipate any impact on expansion of businesses doing businesses in California.

Benefits to the Health and Welfare of California Residents, Worker Safety, and the state's Environment

The proposed regulation would not in any way impact the welfare of California residents, worker safety, or the state's environment.

ADVERSE ECONOMIC IMPACT ON BUSINESS

The proposed regulation would not have an adverse economic impact on California businesses. The proposed regulation provides procedural guidance for petitions filed pursuant to Section 25137. The clarifications made to the regulation will streamline the application process for a small number of multistate taxpayers who submit petitions to the Board, itself, to use an alternative apportionment method.