STATE OF CALIFORNIA — DEPARTMENT OF FINANCE

MAJOR REGULATIONS STANDARDIZED REGULATORY IMPACT ASSESSMENT SUMMARY

DF-131 (NEW 11/13)

STANDARDIZED REGULATORY IMPACT ASSESSMENT SUMMARY

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1. Statement of the need for the proposed major regulation.

California Revenue and Taxation Code ("RTC") section 23663 permits the assignment of credits among affiliated members of the same combined reporting group. RTC section 23663 was added by Section 10 of AB 1452 (Stats. 2008, ch. 763) and is specifically operative for assignments made in taxable years beginning on or after July 1, 2008, and first permits assigned credits to be claimed against the "tax" of the assignee in taxable years beginning on or after January 1, 2010. The statute specifies that credits may only be assigned to an "eligible assignee", which is generally defined in RTC section 23663, subdivision (b), paragraph (3) as an affiliated corporation which is a member of the same combined group as the assignor in both the taxable year the credits were earned and the taxable year the credits are assigned to the assignee.

An assignment is made as an election on a taxpayer's original tax return on Form FTB 3544 and is irrevocable under RTC section 23663, subdivision (c). In some situations taxpayers have made defective elections, such as when the taxpayer's total credits available to be assigned are later determined to be less than the taxpayer thought it had when the original tax return was filed. This often happens when credits have been adjusted at audit. Another example is when an assignee was not a member of the same combined reporting group as the assignor on the dates required under the statute. Because the assignment election is irrevocable, taxpayers are left with uncertainty and no recourse regarding the consequences of such defective elections, and the Franchise Tax Board ("FTB") has not yet established any standards to apply in adjusting such defective elections.

2. The categories of individuals and business enterprises who will be impacted by the proposed major regulation and the amount of the economic impact on each such category.

The proposed regulation affects only corporations that are part of a combined reporting group for tax purposes in which at least one member generates more tax credits than that member can use. It is estimated that the net impact on these taxpayers in the first year will be a reduction in tax liability for prior tax years of about $40 million and ongoing reductions of about $5 million per year. It is believed that these adjustments to prior year tax liability will not have any impact on current economic activity of these corporations.

3. Description of all costs and all benefits due to the proposed regulatory change (calculated on an annual basis from estimated date of filing with the Secretary of State through 12 months after the estimated date the proposed major regulation will be fully implemented as estimated by the agency).

It is estimated that the proposed regulation would result in a reduction in tax revenue of approximately $40 million in the first 12 months after implementation. The ongoing reduction in revenue is estimated at around $5 million and general economic effect is expected to be minor.

Adoption of the regulation would also likely improve California's "business climate" and will benefit taxpayers, tax practitioners, and the state of California by providing clarity that does not currently exist in connection with the treatment of a defective election to assign credits. The proposed regulations would give taxpayers certainty as to how credits are allocated when a defective election occurs. The proposed regulations also give effect to the statute's intent of allowing a combined reporting group to benefit from a group member's credits by giving taxpayers flexibility in determining how credits are allocated when there is agreement between the parties involved in the defective election. Finally, the proposed regulations give taxpayers one year to correct certain errors in defective elections. However, these effects cannot be quantified.

4. Description of the 12-month period in which the agency estimates the economic impact of the proposed major regulation will exceed $50 million.

It is estimated that more than $50 million of credits with defective assignments will be resolved in the 12-month period after the regulation becomes effective.

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5. Description of the agency's baseline:

The baseline assumption is that absent the proposed regulation, taxpayers will not be allowed to reduce their tax using tax credits which are defectively assigned. Based on the most recent data, the total value of defective assignments vary between $15 million and $86 million between 2009 and 2014. To determine a baseline--the actual impact of defective assignments—the frequency and dollar amount of these erroneous assignments must be known. Due to fluctuations in the frequency and magnitude of defective tax credit assignments, the revenue impact could vary widely, and the baseline may be unreliable.

6. For each alternative that the agency considered (including those provided by the public or another governmental agency), please describe:
   a. All costs and all benefits of the alternative
   b. The reason for rejecting alternative

Two alternatives were considered. The first removed proposed Regulation section 23663-4 from the proposed regulations, thereby removing the one-year self-correction window. The second alternative removed proposed Regulation section 23663-2, thereby ensuring all defectively assigned credits would stay with the assignor instead of assigning the credits the assignor has to the assignee. The relative impacts of these alternatives are minor and unlikely to impact GDP, personal income, private investment or other economic indicators. (See SRIA for more detail.)

These alternatives were rejected because they would delay the use of the credits until after the audit process was completed, and frustrate the purpose of R&T section 23663 which is to allow credits to be used against the tax liability of other combined group members.

7. A description of the methods by which the agency sought public input. (Please include documentation of that public outreach).

FTB held the following three public Interested Party meetings and issued the following 60-day notice:
First Interested Parties Meeting held at 10 am on October 1, 2012.
Second Interested Parties Meeting held at 1.30 pm on December 5,2013.
Third Interested Parties Meeting held at 1.30 pm on June 12, 2014.
FTB also solicited written comments from the public prior to and during these meetings.
On August 29, 2014, FTB released minor modifications to the draft regulatory language based on comments received at the June 12, 2014 interested parties meeting. The public was given 60 days to review and provide comments on these revisions.

8. A description of the economic impact method and approach (including the underlying assumptions the agency used and the rationale and basis for those assumptions).

The key assumptions for the economic impact analysis are:
Changes in the ability of taxpayers to use tax credits generated many years earlier will not affect their economic activity in those earlier years.
Allowing taxpayers to utilize more tax credits will have limited impact on current economic activity when those changes are small relative to corporations' readily available cash resources.

Agency Signature	Date
Jennifer Osborn for	7-23-17
Agency Head (Printed)	
Jennifer osborn for Marybel Batjer	