Ciro Immordino
Franchise Tax Board
Legal Division MS-A260
P.O. Box 1720
Rancho Cordova, CA 95741-1720

August 28, 2017

Dear Mr. Immordino:

Thank you for submitting the standardized regulatory impact assessment (SRIA) and the summary (Form DF-131) for the proposed regulation Assignment of Credits Among Affiliated Members of the Same Combined Reporting Group, as required in California Code of Regulations, title 1, section 2002(a)(1). Comments provided are based on the SRIA and drafts of the Initial Statement of Reasons, Notice of Proposed Rulemaking, and regulatory text provided as of May 9, 2017.

The proposed regulation would allow members of a combined corporate tax reporting group to reassign tax credits to affiliated members of the same group under certain conditions rather than having the initial assignments be irrevocable. The SRIA estimates the reassigned credits would total more than $250 million in 2010, falling to around $85 million in 2014. The analysis identifies an initial fiscal impact of $39 million and an ongoing fiscal impact of around $5 million per year. The divergence between reassigned credit totals and fiscal impacts is partially attributed to the complexities of calculating tax payments given credit assignments, and partially attributed to the expectation that the reassignments were largely the result of errors that should now be less common. The economic costs to the California economy of $7-10 million for this regulation are solely based on the revenue loss, as corporations are assumed not to change their hiring or investment practices even if they pay less in taxes.

Finance generally concurs with the methodology used to estimate annual impacts under the proposed regulation and alternatives, with four exceptions.

First, the estimate of revenue losses must be calculated on the basis of all information to date, and include the impacts of corporations learning to use the flexibility in the proposed regulation. The current approach by the FTB to estimating an average rate removes outliers and assumes a high degree of learning will yield a declining impact. However, most revenue impacts are driven by a few large taxpayers, so discarding large observations, or indeed any observations, may severely underestimate the revenue loss from the proposed regulation. In addition, most corporations take a few years to learn how best to manage their tax liabilities given new regulations, and the revenue impact would likely grow, as shown in the last few years of data about reassignments. Given this data the SRIA must contain analysis of state revenue losses on the high side, for example, no adjustment to credit assignments involved and a rising annual rate based upon the most recent years of data.

Second, the SRIA assumption that there are no investment or job creation benefits as a result of more flexible usage of tax credits runs contrary to the rationale for providing tax credits in the first place. The SRIA states proposed regulatory amendments do not affect prior investment decisions of taxpayers, but it does not acknowledge the new framework may positively affect taxpayers' future investment decisions which improve the California economy. While there may be unique circumstances for this regulation that would support this assumption, these circumstances must be explained in greater detail or an analysis of benefits must be included.

Third, a required element of SRIAs is analysis of alternatives to proposed regulations. The goal of alternatives analysis is to document the range of regulatory options considered and rationale behind tradeoffs made in the development of proposed regulations. The SRIA contains two smaller or less comprehensive regulatory alternatives, which is less helpful for identification of tradeoffs made in development of the regulations. FTB provides no quantification of economic impacts of these alternatives. As noted above, a lack of quantified benefits or costs limits ability to make well-informed evaluations of alternative and proposed regulations. To better highlight tradeoffs across alternatives, FTB must provide a quantitative assessment that includes a more comprehensive and a less comprehensive alternative to the proposed regulations.

Fourth, the SRIA must include the cost savings from fewer disputes for state government. It identifies that regulations will improve administrative efficiency for FTB, but claims no cost savings to the FTB as a result of this increased efficiency. An environment in which there is less contention for at least some audit findings of defective assignments of tax credits should lead to less time being spent disputing audits and reduced litigation associated with those disputes. These improved efficiencies in tax administration should result in cost savings to the FTB.

These comments are intended to provide sufficient guidance outlining revisions to the SRIA. The SRIA, a summary of Finance's comments, and any responses must be included in the rulemaking file that is available for public comment. Finance understands that the proposed regulations may change during the rulemaking process. If any significant changes to the proposed regulations result in economic impacts not discussed in the SRIA, please note that the revised economic impacts must be reflected on the Standard Form 399 for the rulemaking file submittal to the Office of Administrative Law. Please let us know if you have any questions regarding our comments.

Sincerely,

Irena Asmundson
Chief Economist

cc: Ms. Panorea Avdis, Director, Governor’s Office of Business and Economic Development
Ms. Debra Cornez, Director, Office of Administrative Law
Ms. Selvi Stanislaus, Executive Officer, Franchise Tax Board
Ms. Jozel Brunett, Franchaise Tax Board
Mr. Scott Reid, Franchaise Tax Board
Mr. Lee Gobuty, Franchaise Tax Board
Mr. Allen Prohofsky, Franchaise Tax Board
Ms. Christy Keith, Franchaise Tax Board