

Senate Bill No. 788

CHAPTER 306

An act to amend Section 25114 of the Revenue and Taxation Code, relating to taxation.

[Approved by Governor October 5, 2007. Filed with
Secretary of State October 5, 2007.]

LEGISLATIVE COUNSEL'S DIGEST

SB 788, Cogdill. Corporation tax law: water's-edge: administration.

Existing law provides that, in the case of a business with income derived from, or attributable to, sources both within and without this state, the income is apportioned between this state and other states and foreign countries for tax purposes in accordance with a specified formula based on the property, payroll, and sales within and without this state, except as otherwise provided. Existing law permits certain taxpayers, as provided, to elect to determine their income under a water's-edge election and requires the Franchise Tax Board to examine the annual filings of those taxpayers for any potential noncompliance, and, if the noncompliance is found, to conduct a detailed examination of those filings, regardless of the net revenue benefit to the state, as specified.

This bill would permit the Franchise Tax Board to conduct audits of those annual returns on a discretionary rather than mandatory basis and would apply to audits commenced on or after the effective date of this bill.

The people of the State of California do enact as follows:

SECTION 1. Section 25114 of the Revenue and Taxation Code is amended to read:

25114. (a) The Franchise Tax Board, for purposes of administering the provisions of this article, shall examine all returns filed by taxpayers subject to these provisions.

(b) (1) In any case of two or more organizations, trades, or businesses, whether or not organized in the United States and whether or not affiliated, owned or controlled directly or indirectly by the same interests, the Franchise Tax Board may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among these organizations, trades, or businesses, if the board determines that the distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of these organizations, trades, or businesses. In the case of any transfer, or license, of intangible property, within the meaning of Section 936(h)(3)(B) of the Internal Revenue Code, the income with

respect to that transfer or license shall be commensurate with the income attributable to the intangible property.

(2) In making distributions, apportionments, and allocations under this section, the Franchise Tax Board shall generally follow the rules, regulations, and procedures of the Internal Revenue Service in making audits under Section 482 of the Internal Revenue Code. Any of these rules, regulations, and procedures adopted by the Franchise Tax Board shall not be subject to review by the Office of Administrative Law.

(3) If the Internal Revenue Service has conducted a detailed audit pursuant to Section 482 of the Internal Revenue Code or Subchapter N of Chapter 1 of Subtitle A of the Internal Revenue Code and has made adjustments pursuant to those provisions, it shall be presumed, to the extent that the provisions relate to the determination of the amount of income and factors required to be taken into account pursuant to Section 25110, that no further adjustments are necessary for this state's purposes. If the Internal Revenue Service has conducted a detailed audit pursuant to Section 482 of the Internal Revenue Code or Subchapter N of Chapter 1 of Subtitle A of the Internal Revenue Code and has made or proposed no adjustments to the transactions examined, it shall be presumed, to the extent that the provisions relate to the determination of the amount of income and factors required to be taken into account pursuant to Section 25110, that no adjustment is necessary for this state's purposes. These presumptions apply to all Internal Revenue Service audit determinations, including determinations made by the Appeals and Competent Authority. These presumptions shall be overcome if the Franchise Tax Board or the taxpayer demonstrates that an adjustment or a failure to make an adjustment was erroneous, if it demonstrates that the results of such an adjustment would produce a minimal tax change for federal purposes because of correlative or offsetting adjustments or for other reasons, or if substantially the same federal tax result was obtained under other sections of the Internal Revenue Code. No inference shall be drawn from an Internal Revenue Service failure to audit international transactions pursuant to Section 482 of the Internal Revenue Code or Subchapter N of Chapter 1 of Subtitle A of the Internal Revenue Code and it shall not be presumed that any of those transactions were correctly reported.

(c) The amendments made to this section by the act adding this subdivision shall apply to examinations commenced by the Franchise Tax Board on or after the effective date of that act. An examination will be considered commenced when a taxpayer is first contacted by the Franchise Tax Board concerning any examination with respect to the taxpayer's return.