

# California – Proposed regulation to clarify treatment of defective credit assignments

December 13, 2013

## In brief

On December 5, 2013, the Franchise Tax Board (FTB) held an Interested Parties Meeting (IPM) to discuss a proposed regulation regarding California Revenue and Taxation Code (CRTC) section 23663, which permits the assignment of credits among members of the same combined reporting group. The proposed regulation provides default rules and examples (available [here](#)) that address the treatment of defective credit assignments. The purpose of this IPM was to elicit public input on this proposed structural framework before the FTB releases draft language in April 2014. Interested parties should consider getting involved and providing input in the regulatory process. Input received by January 7, 2014, may be considered by the FTB before the draft regulation is released.

## In detail

CRTC section 23663 permits the assignment of credits among members of the same combined reporting group. A proper assignment is reflected on California Form 3544, Election to Assign Credit Within Combined Reporting Group, which is filed with the original return. Because a proper election to assign credits is irrevocable, taxpayers are left with no clear recourse to fix defective elections. To ease the consequences of improper or 'noncompliant assignments,' the proposed regulation would provide default allocation rules for defective assignments, procedures for correcting clerical errors, and the ability

for taxpayers to request relief from the default rules.

### Default rules

- If an assignment is noncompliant solely because an assignor's available credits are less than the amount assigned to an eligible assignee(s), the assignor's actual credits shall be allocated to the eligible assignee in order to give as full an effect to the original assignment as possible. As needed, the FTB will correct the assignment of credits to multiple assignees by reducing the total assigned credits among the assignees

based on the ratio of the original assignments.

- If an assignment is noncompliant because the assignor's available credits are less than the amount of credits assigned to an eligible assignee(s) and the assignee(s) claimed the credits in a year for which the statute of limitations (SOL) is closed, the amount of credits claimed by the assignee in the barred closed year are allocated to the assignee for that year (essentially preserving the original assignment), and remaining credits are

reallocated to the assignor. The remaining credits are then allocated to the eligible assignee(s) based first on the ratio of credits claimed, and if eligible credits remain, based on the ratio of credits assigned.

- Other than as provided below, if an assignment is noncompliant for any reason other than insufficient available credits, including but not limited to an ineligible assignee or assignor, then the assignment shall be treated as if it had not been made.
- Whenever a credit is claimed in a year for which the SOL is closed, and the assignment of such credit was made to an ineligible assignee, then the assignment is treated as if it was never made. However, the amount of the assignor's credits will be reduced by the amount of credits claimed in the closed years to avoid allowing duplicate use of the same credit amount. The FTB referred to this as "prejudicing the interests of the government."

#### **Alternative allocation available under certain circumstances**

If an assignment is defective, then the above default rules shall apply unless the defect is attributable to a clerical error or if the taxpayer seeks relief from the default rules in good faith and without prejudice to the government.

#### **Correction of clerical errors**

If an assignment is defective because of an error on the face of the assignment form, then a correction of the clerical error would be available if: (1) the assignment on the form is fully completed, (2) the assignor acted reasonably and in good faith in making the assignment (same

presumption as above applies), (3) the interests of the government are not prejudiced, and (4) there is clear and convincing evidence demonstrating the assignor's intended entry on the form.

#### **Good faith request for relief from the default provisions**

Finally, if the FTB applies the default rules and the assignor feels the default rules do not accomplish the desired result, as long as the assignor has acted in good faith and the result does not prejudice the government, then the taxpayer can request another alternative allocation and/or correction.

#### **The takeaway**

While there are default rules in place, taxpayers may request an alternative treatment if they desire a different outcome. However, this treatment is subject to FTB approval.

Commentators were concerned about the reasonable and good faith presumptions. The FTB stressed that the presumption was in place to emphasize the clear legislative intent that assignments are to be made on the original return, and when made, are irrevocable. The FTB did not provide clear guidance as to how or if this presumption could be rebutted.

Commentators were also concerned about the clear and convincing evidence standard for correcting clerical errors. The FTB did not provide a clear answer. However some examples were discussed, such as: (1) looking at which entities actually claimed the credit on subsequent filings; (2) looking to the California Form 3544-A, List of Assigned Credit Received and/or Claimed by Assignee, that assignees are required to file to determine the assignor's intent; (3) whether the assignee believed it was

assigned a credit and acted accordingly; and (4) consistency between the California Forms 3544 and 3544-A.

Many of the rules and examples discussed at this IPM were in response to controversies FTB has already seen on return filings. California taxpayers with potential or ongoing FTB controversies with respect to credit assignments should pay special attention to the FTB's proposed regulation under CRTS section 23663. Although the proposed regulation allows taxpayers to apply treatments different than the default rules, such treatments must be requested and approved by the FTB. Since the FTB has not yet drafted regulatory language, interested taxpayers should consider getting involved and providing input in the regulatory process.

#### **Let's talk**

If you have questions regarding the proposed regulation discussed above, or would like to provide any input in this regulatory process, please contact one of the following individuals:

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