



chair **John Chiang**
 member **Jerome E. Horton**
 member **Michael Cohen**

State of California
Franchise Tax Board

06.18.14

Information Letter 2014-02

Subject: **Re: Chief Counsel Ruling Request – ***** – IRC Section 338(h)(10) Election**

Dear *** *****:

This letter is in response to your correspondence dated January 30, 2014, in which you requested a Chief Counsel Ruling "regarding the California corporation franchise and income tax consequences of the proposed transaction." The proposed transaction involved an election under Section 338(h)(10) of the Internal Revenue Code together with a distribution of certain unwanted assets prior to the sale. Specifically, you asked whether California would follow certain Treasury Regulations regarding the federal tax treatment of a distribution of stock prior to the sale.

As noted in FTB Notice 2009-08, FTB will not rule where "[s]tate and federal law on the issue are the same and the application of federal law is dispositive of the issue." In such situations, California treatment is predicated on the federal treatment, and FTB's policy is to follow the federal determination on the issue.

While we decline to issue a Chief Counsel Ruling addressing the specific factual scenario presented in your request, we are providing you with our general explanation of how conformity to the Internal Revenue Code applies generally, and when federal regulations, rulings and guidance are persuasive authority for California franchise and income tax purposes.

California Conformity to Internal Revenue Code

In general, when California's Revenue and Taxation Code applies some section, subchapter, or some portion thereof of the Internal Revenue Code, for purposes of Part 10 (commencing with Section 17001, Part 10.5 (commencing with Section 18401), or Part 11 (commencing with Section 23001) of Division 2 of the Revenue and Taxation Code, it is often modified or revised for California purposes. For example, Revenue and Taxation Code section 24451 applies Subchapter C of Chapter 1 of Subtitle A of the Internal Revenue Code "except as otherwise provided."

To understand our general conformity to that portion, or any portion, of the Internal Revenue Code we begin by looking to Revenue and Taxation Code sections 23051.5

and 17024.5, which explain that the term "Internal Revenue Code" means such Code as of the "specified date" for the applicable taxable year. For example, subparagraph (O) of paragraph (1) of subdivision (a) of Revenue and Taxation Code section 17024.5 states that for taxable years beginning on or after January 1, 2010, the term "Internal Revenue Code" means the Internal Revenue Code as enacted on January 1, 2009. To the extent that amendments are made after that specified date, they would not apply for purposes of the Revenue and Taxation Code unless such application was otherwise provided for.

Such general conformity, assuming California law did not provide for a specific exception, necessarily means that our law must pick up ancillary definitions to which those sections refer to, even where we don't generally conform to those definitions under statute. Thus, for example, if the characterization of "foreign" or "domestic" was relevant for federal purposes such as application of Subchapter C, the federal definition of such terms would apply even where the Revenue and Taxation Code does not specifically adopt the sections of the Internal Revenue Code which define those terms.

As discussed above, where California law and federal law are the same, we generally do not issue rulings on the issue. Rather, to the extent a federal ruling is provided, such federal ruling on the issue is equally applicable for California purposes.

Federal Rulings and Guidance

As explained below, it is well settled that where federal law and California law are the same, federal rulings dealing with the Internal Revenue Code are persuasive authority in interpreting the California statute. *J. H. McKnight Ranch v. FTB* (2003) 110 Cal.App.4th 978, at fn.1, citing *Calhoun v. Franchise Tax Bd.* (1978) 20 Cal.3d 881, 884.

Where the California Revenue and Taxation Code conforms to the Internal Revenue Code, federal administrative guidance applicable to the Internal Revenue Code shall, insofar as possible, govern the interpretation of conforming state statutes, with due account for state terminology, state effective dates, and other obvious differences between state and federal law.

Federal administrative guidance may include: federal revenue rulings, notices, revenue procedures, announcements, and other published administrative guidance promulgated by the U.S. Treasury or the Internal Revenue Service (IRS). Private letter rulings will only be considered federal administrative guidance with respect to the particular taxpayer for whom the ruling was issued; otherwise, federal administrative guidance does not include private letter rulings or any other administrative guidance issued by the Commissioner or Chief Counsel of the IRS with respect to a particular taxpayer.

Federal administrative guidance shall not apply to the California Tax and Revenue Code (R&TC) under the following circumstances:

(1) Where the related R&TC section is substantively different than the federal statute.

Example: R&TC section 17143 relating to nontaxable interest income is substantively different than its IRC counterpart, section 103. Thus, any federal administrative guidance relating to IRC section 103 cannot be relied on to interpret R&TC section 17143.

(2) Where the R&TC conforms to an IRC section that is modified after the California specified conformity date, any federal administrative guidance issued that relies in whole or in part on the modification is inapplicable for California purposes.

Example: For taxable years beginning on or after January 1, 2005, and before January 1, 2009, California conformed by reference to the January 1, 2005 version of subchapter C of Chapter 1 of Subtitle A of the Internal Revenue Code "except as otherwise provided." In 2006 Congress amended IRC section 355 by adding a paragraph (3) to subsection (b) of section 355. As a result, any federal guidance relating to the 2006 federal amendment is not applicable for a 2008 California tax return. As a result of our non-conformity, qualification under section 355 may be different for California tax purposes than under federal law. A Chief Counsel Ruling may be appropriate in such circumstances. (See e.g. FTB Chief Counsel Ruling 2009-01 and 2009-02).

(3) Where the federal administrative guidance conflicts with California statutes or regulations.

When applying the Internal Revenue Code, regulations promulgated in final form or issued as temporary regulations shall be applicable as regulations under Part 10 and Part 11 of Division 2 of the Revenue and Taxation Code to the extent they do not conflict with such Parts of Division 2 of the Revenue and Taxation Code. (See subdivision (d) of Rev. & Tax. Code §§ 17024.5 and 23051.5.) However, FTB may issue regulations that deviate from federal regulations issued under the federal section to which California conforms. This would most likely occur, for example, where a federal regulation (not the federal statute) specified a sourcing rule that directly conflicts with an existing California sourcing rule or principle.

Please be advised that the tax law discussed in this letter is considered a well-established interpretation or principle of tax law. This letter is provided for general information only and is not intended nor shall be considered "written advice from the Board" within the meaning of Section 21012 of the Revenue and Taxation Code.

Douglas K. Powers
Tax Counsel IV

cc: *****