



## **California Franchise, Income and Sales and Use Tax Developments**

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### **I. Deductibility of Dividends/Expense Attribution**

#### **A. *Farmer Bros. v. FTB*, 108 Cal. App. 4th 976 (2003), cert. denied, \_\_\_ U.S. \_\_\_, 124 S. Ct. 1411 (2004)**

1. California Court of Appeal held California Revenue and Taxation Code (RTC) § 24402 unconstitutional under the Commerce Clause. RTC § 24402 allows a dividend received deduction for dividends from noninsurance companies. Similar to RTC § 24410 which was previously held to be unconstitutional in *Ceridian*, the deduction under RTC § 24402 is limited by the payor's presence in California as determined by its apportionment factors. The Court held that such a limitation violated the Commerce Clause.
2. A full dividends received deduction was allowed by the Court subject to the ownership limitations contained in RTC § 24402(b).
3. California Supreme Court denied review. The United States Supreme Court denied the Franchise Tax Board's (FTB) petition for a writ of certiorari on February 23, 2004.
4. FTB Policy Regarding Post-*Farmer Bros.*
  - a. For years ended prior to December 1, 1999, taxpayers will be allowed a full dividends received deduction subject to the ownership limitations contained in RTC § 24402(b). The expense attribution provisions of RTC § 24425 will be applied.

- (i) For water's edge taxpayers, a full dividends received deduction will be allowed under RTC § 24402 rather than a 75 percent deduction under RTC § 24411. Further, no foreign investment interest offset will be applied. Rather, the expense attribution provisions of RTC § 24425 will be applied.

- b. For years ending on or after December 1, 1999, no deduction will be allowed under RTC § 24402. The FTB will attempt to identify all taxpayers who have claimed a deduction under RTC § 24402 and will disallow that deduction.

- (i) For water's edge taxpayers, the 75 percent dividends received deduction will be allowed.

#### **B. *Ceridian Corporation v. FTB*, 85 Cal. App. 4th 875 (2000)**

1. Court of Appeal held that RTC § 24410, which allowed a dividend received deduction for dividends received from an insurance company, was unconstitutional under the Commerce Clause of the U. S. Constitution. RTC § 24410 allowed a deduction only where the payee was commercially domiciled in California. Under RTC § 24410, the deduction was further limited by the payor's presence in California as determined by its apportionment factors. The Court held both restrictions violated the Commerce Clause since they favored domestic (California) corporations over their foreign competitors.
2. Case also raises the retroactive versus prospective remedy issue. While *Ceridian* was allowed a full deduction and accordingly obtained its refund, the Court left open the remedy with respect to other taxpayers.
3. FTB Policy Regarding Post-*Ceridian*.
  - a. For years ended prior to December 1, 1997, taxpayers will be allowed a full deduction for insurance company dividends. However, the

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expense attribution provisions of RTC § 24425 will be applied.

- b. For years ending on or after December 1, 1997, no deduction will be allowed for insurance company dividends. The FTB will attempt to identify all taxpayers who have claimed a deduction under RTC § 24410 and will disallow that deduction.

#### 4. Assembly Bill No. 263

- a. On September 29, 2004, legislation was enacted which would reverse FTB's policy statement.
  - (i) For years ending on or after December 1, 1997 and beginning before January 1, 2004, taxpayers may elect to claim an 80 percent dividends received deduction and no expense attribution would be allowed.
    - (a) Taxpayers must make a retroactive irrevocable election.
    - (b) At least 80 percent of each class of stock of the insurance company must be owned.
    - (c) Election would apply only to taxable years during the election period for which the statute of limitations is open or if the statute has closed for any taxable year, to taxable years for which a final tax determination has not been made because of a dispute over the dividends received deduction or the expenses related to that deduction.
    - (d) Elections made by filing amended returns which must be filed within 180 days following the effective date of the legislation.
  - (ii) For years beginning on or after January 1, 2003, a dividends received deduction (percentage not yet inserted) would be allowed. No restriction on the use of expense attribution.
    - (a) Deduction would be equal to 80% of the qualified dividends ( increases to 85% in 2008).
    - (b) Dividend deduction may be reduced if insurance company overcapitalized ("anti-stuffing").
    - (c) Deductions disallowed to non-insurer for specified expenses paid or incurred to the insurer if the amount paid would constitute income to the insurer if the insurer were subject to California franchise tax.
    - (d) Certain transfers of property to insurers in an exchange described in various IRC provisions

and which would otherwise result in non-recognition of gain will be deemed taxable events.

#### C. *American General Realty Investment Corp., Inc.* Case No. 156726 (SBE, June 25, 2003)

1. In a summary decision, the State Board of Equalization (SBE) concluded that the FTB properly disallowed under RTC § 24425, a portion of the interest expenses incurred by the taxpayer's unitary financial and real estate subsidiaries on the theory that the interest expenses were indirectly traceable to insurance company dividends which were deductible under *Ceridian*.
2. Case pending in San Francisco Superior Court (No. CGC 03425690).

#### D. *Mercury General Corporation*, Case No. 145450 (SBE, June 25, 2003)

1. In a letter decision similar to *American General*, the SBE affirmed the FTB's disallowance of the deduction of administrative expenses and interest expenses under RTC § 24425 on the theory that the expenses were indirectly traceable to insurance company dividends which were deductible under *Ceridian*.
2. Petition for rehearing pending.

#### E. *Beneficial California, Inc.*, Case No. 203445

1. Case involves the issue whether any portion of the taxpayer's interest expense should be disallowed under RTC § 24425. The taxpayer contends that no interest expense should be disallowed since the FTB has not shown the requisite connection between the interest expense and the insurance company which paid the deductible dividends in question.
2. Case awaits oral argument before the SBE.

## II. Anti-Tax Shelter Legislation

### A. Senate Bill No. 614 and Assembly Bill No. 1601

1. New anti-tax shelter legislation enacted in October 2003, generally effective January 1, 2004, but may apply to certain transactions entered into prior to that date.

2. Generally conforms to existing federal law regarding tax shelter registration, list maintenance and disclosure of reportable transactions.
3. Provides for various penalties in connection with the use of tax shelters, including enhanced penalties for noneconomic substance transaction understatements (up to 40%) and reportable transaction understatements (up to 30%).
4. Also provides for penalties aimed at tax shelter promoters, advisers and return preparers.
5. Extends the statute of limitations to eight years for proposed deficiency assessments relating to abusive tax avoidance transactions.
6. Directs the FTB to identify and publish California "listed transactions," pursuant to which the FTB issued Chief Counsel Announcement 2003-1 on December 31, 2003 identifying certain REIT and RIC transactions as listed transactions for California purposes.
7. Provides for a "voluntary compliance initiative" (VCI) for the period January 1, 2004 through April 15, 2004 during which eligible taxpayers voluntarily may pay all tax and interest due as a result of their use of tax shelter for taxable years beginning before 2003 to avoid tax shelter penalties.
8. In excess of \$1.2 billion was collected by the FTB under VCI.

### III. Apportionment Formula

#### A. Sales Factor

1. Gross receipts from treasury function activities. Numerous suits for refund pending. One court of appeal and two trial court decisions in favor of exclusion of gross receipts from the sales factor. One trial court decision in favor of inclusion of gross receipts.
  - a. *General Motors Corporation v. FTB*, 120 Cal. App. 4<sup>th</sup> 114 (2004).
    - (i) Court of Appeal concluded that gross receipts from treasury function activities are not to be included in the sales factor.
    - (ii) Case also involves issues relating to use of research credits by a unitary group and the deductibility of withholding taxes on intercompany dividends, royalties and interest.
      - (a) The Court concluded that the credits can only be used by the member of the unitary group which generated the credit, not the entire group.
      - (b) With respect to the deductibility of withholding taxes, the Court concluded such taxes were on income and thus nondeductible.
    - (iii) Petition for Review filed with the California Supreme Court.
  - b. *Microsoft Corporation v. FTB*, San Francisco Superior Court No. CGC-01-400444 (September 9, 2003).
    - (i) Trial court held that gross proceeds from the sale of marketable securities must be included in the sales factor.
    - (ii) Trial court also held that the FTB did not prove that inclusion of the proceeds in the sales factor would be distortive under RTC § 25137.
    - (iii) Case pending in the Court of Appeal.
  - c. *Toys R Us, Inc. v. FTB*, Sacramento Superior Court No. 01 AS 04316 (August 21, 2003).
    - (i) Trial court concluded that the term "gross receipts" in RTC §§ 25120 and 25134 does not include the return of capital from the taxpayer's investment in short-term paper and thus only the interest earned from those investments is includible in the sales factor.
    - (ii) In dicta, the court held that if the return of capital was included in the sales factor, RTC § 25137 would apply.
    - (iii) Case pending in the Court of Appeal.
  - d. *Limited Stores, Inc. v. FTB*, Alameda Superior Court No. C-837723 (April 11, 2003).
    - (i) Trial court concluded that the return of principal must be excluded from the gross receipts generated by the taxpayer's sale of short-term financial investments and thus from the sales factor.
    - (ii) In dicta, court held that the inclusion of gross receipts would be distortive.
    - (iii) Case pending in the Court of Appeal.

e. *Montgomery Ward and Co., Inc.*, Case No. 133828 (SBE, October 3, 2002)

- (i) In a summary decision, the SBE held that inclusion of the return of capital portion of the taxpayer's sales of various financial investments resulted in a distortion of the formula and thus those receipts were to be excluded.
- (ii) Case pending in San Diego Superior Court (No. GIC 802767).

f. *Colgate-Palmolive Co.*, Case No. 152028 (SBE, November 12, 2002)

- (i) In a summary decision, the SBE concluded that the taxpayer's gross receipts from its investment activity were not includible in the sales factor due to the fact the taxpayer failed to prove that it engaged in any income producing activities. The taxpayer employed independent contractors to perform the vast majority of the investment activities, while its own personnel performed de minimis investment activity. Under Regulation 25136(b), the work performed by independent contractors is not an income producing activity.
- (ii) Case pending in Sacramento Superior Court (No. 03AS00707).

g. *Polaroid Corporation*, Case No. 62415 (SBE, May 28, 2003)

- (i) In a summary decision, the SBE concluded that the inclusion of gross proceeds from sales of securities prior to maturity was distortive and thus not includable.
- (ii) Case also involved the question whether proceeds from the Kodak patent infringement litigation should be included in the sales factor. The SBE concluded that the entire proceeds were to be included in the denominator and a portion thereof, based on the taxpayer's California sales factor, was to be included in the numerator.
  - (a) The SBE granted the taxpayer's petition for rehearing to reconsider this issue.

## 2. FTB Legal Ruling 2003-3

- a. On December 4, 2003, the FTB issued a legal ruling to address the issue when income-producing activity exists with respect to a business income dividend so that the dividend is includible in the sales factor.

b. The FTB concluded that a dividend payee that participates in the management and operations of the dividend payor is engaged in income-producing activity with respect to the dividend so that the dividend is includible in the payee's sales factor.

c. Departure from the FTB's position set forth in its Multistate Audit Technique Manual Section 7562.

d. May become quite relevant in post-*Ceridian* and post-*Farmer Bros.* years where the FTB is disallowing deductions for RTC § 24410 and RTC § 24402 dividends.

## B. Property Factor

### 1. *Quick & Reilly, Inc.*, Case No. 202953 (SBE, March 9, 2004)

a. The SBE concluded that margin loans that were applied for at offices in California are includible in the numerator of the property factor of a financial corporation under Regulation 25137-4.1.

### 2. Proposed Regulations 25130 and 25137 (b)(1)

- a. Proposed amendments to government-owned property factor regulation.
- b. Amendments reflect to some extent FTB Legal Ruling 97-2.

## C. Distortion

### 1. *Weyerhaeuser Company*, Case Nos. 104355 and 246164

- a. Case involves distortion issues pertaining to the taxpayer's timber activities in the State of Washington vis-à-vis its activities in California.
- b. Other issues include the proper inclusion of gross receipts from the taxpayer's treasury function in the sales factor, the inclusion of a proper value for government-owned property in the property factor and various MIC issues.
- c. Case being briefed. Oral argument scheduled for late 2004 or early 2005.

## IV. Manufacturers Investment Tax Credit

### A. *Save Mart Supermarkets*, 2002-SBE-002 (SBE, February 6, 2002)

- 1. On February 6, 2002, the SBE issued a rare formal opinion in the first manufacturers'

investment tax credit (MIC) case to reach the Board. This was the first in a series of taxpayer victories in MIC cases in 2002 and 2003.

2. The case involved the issue of whether Save Mart was a qualified taxpayer with respect to its bakery and meat processing activities.
  - a. Both activities are described in Division D of the SIC Manual.
3. The Franchise Tax Board (FTB) argued that Save Mart was not a qualified taxpayer because “its primary activity” was retail (not manufacturing) and therefore should be assigned SIC Code 5411. As SIC Code 5411 is not in the manufacturing section of the SIC Manual, Save Mart did not meet the statutory requirement.
4. Save Mart argued that it was a qualified taxpayer under the plain meaning of the statute and that the FTB’s “qualified taxpayer” regulation (23649-3) was invalid because it imposed restrictions not contemplated by the MIC statute. Under that regulation, the FTB required that the taxpayer be classified or assigned a manufacturing SIC Code while the statute only requires that the taxpayer’s activities be “described in” the manufacturing section of the SIC Manual.
5. Save Mart further argued that even if Regulation 23649-3 was somehow valid, Save Mart was a qualified taxpayer because it satisfied the three requirements under Regulation 23649-3(b)(1)(B), the “separate establishment” test.
6. The SBE agreed with Save Mart and overturned the FTB’s qualified taxpayer regulation (23649-3).
7. The SBE specifically held that the MIC statute should be liberally construed in favor of taxpayers in order to effectuate the purposes of the legislation, i.e., to encourage manufacturing in the State.
8. On September 3, 2003, the California Legislative Counsel issued an opinion that concluded that the SBE did not have the authority in *Save Mart* to declare an FTB regulation invalid. The opinion is not binding.

**B. *Jon and Rita Minnis and Milpitas Materials Company*, 2002-SBE-003 (SBE, June 20, 2002)**

1. In the second MIC case to reach the SBE, the SBE concluded in another formal opinion, that a cement mixer truck, comprised of a truck chassis and mixer barrel, constituted a single integrated piece of manufacturing equipment and thus the entire truck was qualified property for purposes of the MIC.
2. The SBE rejected the FTB’s attempt to bifurcate the truck into two components—manufacturing (mixing drum) which qualified for the MIC and transportation (chassis) which did not.
3. The SBE refused to follow FTB Legal Ruling 2001-4.

**C. *Bronco Wine Company*, 2002-SBE-006 (SBE, September 12, 2002)**

1. The SBE again ruled against the FTB in the third MIC case to be heard.
2. The SBE concluded that wine tanks which had a capacity of 215,000 gallons were qualified property for purposes of the MIC. The SBE relied on the fact that the tanks could be moved and placed in productive use without damaging the property during the move.
3. The FTB had taken the position that smaller wine tanks qualified as tangible personal property but that the larger wine tanks were “inherently permanent structures” under *Whiteco Industries, Inc. v. Commissioner*, 65 T.C. 664 (1975).

**D. *California Steel Industries, Inc.*, 2003-SBE-001-A (SBE, July 9, 2003)**

1. In an Opinion on Petition for Rehearing by the new Board, the SBE once again rejected the FTB’s position.
2. The SBE held that payments made to third party contractors that are directly allocable to qualified property and are capitalized, constitute qualified property for purposes of the MIC.

**E. *Baxter Healthcare Corporation*, Case No. 140712 (SBE, May 28, 2003)**

1. In a summary decision, the SBE confirmed its decision in *California Steel* regarding the capitalized labor issue.
2. The SBE also held that payments made to in-house engineers which are directly allocable to qualified property and are capitalized, constitute qualified property for purposes of the MIC.
3. The SBE also concluded that certain facilities were special purpose buildings and foundations and thus qualified property.
4. The SBE held that the heating, ventilating and air conditioning systems installed in clean rooms was not qualified property.

**F. *Lienau*, Case Nos. 156798, 156810, 156814 and 156808 (SBE, July 9, 2003)**

1. In another taxpayer victory, the SBE held in a summary decision that the gain realized by a California S corporation, passed through to its shareholders, on the receipt of insurance proceeds for equipment losses and deferred under IRC § 1033 was chargeable to the capital account and thus constituted qualified costs for purposes of the MIC.

**G. *LSI Logic, Inc. and Cypress Semiconductor Corporation*, Case Nos. 142330 and 173287 (SBE, August 7, 2003)**

1. In a controversial summary decision, the SBE voted 2-1 to grant refund claims under RTC § 6902.2. Under that statute, a taxpayer may claim a sales tax refund in lieu of the MIC. The in-lieu credit cannot be claimed any earlier than the MIC could have been claimed and the amount of the in-lieu credit cannot be in excess of the amount of the MIC that could have been claimed by the taxpayer.
2. In these cases, the taxpayers used research and development credits to eliminate their franchise tax liability. They did not claim MIC credits, although they would have been entitled to do so. The taxpayers thus claimed the in-lieu credit under RTC § 6902.2 in the amount of the MIC they otherwise could have claimed.

3. The SBE rejected its staff's arguments that the Legislature did not intend to allow taxpayers to claim both the R&D credit and the MIC in-lieu refund because such could essentially make the MIC a refundable credit.

4. On September 29, 2003, Senate Bill No. 1064 was signed into law overturning on a prospective basis the *LSI* and *Cypress* decisions. SB 1064 permits any taxpayer that had filed a MIC in-lieu claim under RTC § 6902.2 on or before the date of the *LSI* and *Cypress* decisions (August 7, 2003) to obtain that refund.

**H. MIC Repealed**

1. The MIC was repealed by its own terms and ceased to be operative as of January 1, 2004.
2. Various bills were introduced to revive the MIC but none passed.
3. MIC credits for years prior to 2004 and which have not yet been used, may be carried forward until fully utilized.

**V. Business v. Nonbusiness Income**

**A. *Jim Beam Brands Co. v. FTB*, San Francisco Superior Court No. CGC-02-408203 (June 28, 2004).**

1. Trial court concluded that the gain from the sale of a unitary subsidiary was business income under the functional test.
2. The court declined to follow the cessation of line of business or partial liquidation exception theories.
3. Case pending in the Court of Appeal.

**VI. Water's Edge Election**

**A. *Amdahl Corporation v. FTB*, 120 Cal. App. 4<sup>th</sup> 459 (2004)**

1. California Court of Appeal concluded that for purposes of calculating the Subpart F inclusion ratio under the water's edge combined report, dividends from lower-tier controlled foreign corporations should be excluded and not taken into account under RTC § 25106. In addition, the Court concluded that California has adopted the previously taxed income provisions of IRC § 959.

2. The Court also concluded that refunds of UK Advance Corporation Tax payments are dividends under California law and thus subject to elimination under RTC § 25106.
  3. In the only portion of the opinion in which the Court agreed with the FTB, the Court concluded that California's water's edge method of reporting does not facially discriminate against foreign commerce. The court distinguished the *Kraft v. Iowa* decision on the basis of the "footnote 23" argument which has been accepted by some other states.
  4. FTB has filed a petition for review with the California Supreme Court.
- B. *Yamaha Motor Corporation, Case No. 89002467500* (SBE, November 28, 2001)**
1. Taxpayer made intercompany sales of inventory during a year in which it filed on a worldwide basis and eliminated the gains. Taxpayer then elected water's edge the next year. The inventory was sold to third parties outside of the group. On a petition for rehearing by the FTB, the SBE reversed its earlier decision. In a summary decision, the SBE concluded that the gains should be included in income at the taxpayer's apportionment percentage for the worldwide year which was lower than the taxpayer's apportionment percentage in the year of sale to the third parties. The SBE also concluded that the income should be prorated over a five-year period, beginning with the first water's edge year, consistent with FTB Notice 89-601.
- C. *Alps Electric (USA), Inc. and Canon U.S.A., Inc., Case Nos. 55001 and 55446* (SBE, January 13, 2003)**
1. In a summary decision by the new Board which is at odds with *Yamaha*, the SBE concluded that the taxpayer was required to use the elimination and carryover basis approach with respect to inventory sold in intercompany transactions in years prior to the making of a water's edge election. The later sale of the inventory to third parties occurred after the water's edge election. The gain was included in income at the taxpayer's apportionment percentage for the water's edge year. No proration of the gain was allowed.
- D. *Mitsubishi Electric America, Inc., Case No. 207902* (SBE, February 18, 2004)**
1. The SBE concluded that domestic subsidiaries of a Japanese parent should have used the elimination and basis transfer or carryover basis, method of accounting for inventory items they had acquired by intercompany purchases from their parent and its foreign affiliates in pre-water's edge years, in determining their basis in inventory.
- E. *Pacific Telesis Group, Inc. v. FTB, SFSC No. 319008* (2003)**
1. While not a water's edge election case, the case involved deferral/elimination issues similar to those raised in *Yamaha* and *Alps*.
  2. California trial court concluded that a parent corporation of a unitary group was not entitled to a refund of corporation franchise taxes paid by one of its subsidiaries on gains realized by a sister subsidiary on equipment sales.
  3. Case is pending in the Court of Appeal.
- F. *Baxter Healthcare Corporation, Case No. 150881* (SBE, August 1, 2002)**
1. In a summary decision, the SBE concluded that Treasury Regulation 1.954-2(b)(1) excluded from Subpart F income for California water's edge purposes, the dividend paid by one foreign subsidiary to another foreign subsidiary.
  2. The SBE agreed with the taxpayer that IRC § 959(b) was incorporated into California law through the operation of Treasury Regulation 1.954-2(b)(1).
- G. FTB Notice 2004-2 (May 3, 2004)**
1. On May 3, 2004, FTB issued a notice regarding the implementation of new water's edge election statute.
- VII. Mark-To-Market**
- A. *The McGraw-Hill Companies, Inc. v. FTB, San Francisco Superior Court No. CGC 03424737***
1. Case involves the issue whether for 1993 and 1994 the taxpayer should be permitted, for California purposes, to use the mark-to-market method of accounting for accounts receivable

and customer paper where it was required to do so under IRC § 475. The applicability of FTB Legal Ruling 95-6 is in issue.

2. Cross motions for summary judgment have been filed. Hearing scheduled for November 5, 2004.

## VIII. Legislation

### A. Assembly Bill No. 263

1. See I. B. 4. above.

### B. Senate Bill No. 1100

1. New amnesty provisions enacted for corporation income and franchise taxes, personal income taxes and sales and use taxes.
  - a. Amnesty period February 1, 2005 and March 31, 2005 during a time frame ending no later than June 30, 2005.
  - b. Applies to taxes that were due in tax reporting periods beginning before January 1, 2003.
  - c. Only penalties are waived.
2. "Yacht loophole"
  - a. Establishes a rebuttable presumption that any vehicle, vessel or aircraft brought into California within 12 months of purchase was intended to be used in California and is subject to use tax.
  - b. Under prior law, the time period was 90 days.
  - c. Provision is effective October 7, 2004 and sunsets on July 1, 2006.

### C. Assembly Bill No. 1297

1. Vetoed by Governor Schwarzenegger.
2. Would have nullified insurance policies to indemnify investors against taxes, penalties and other charges related to abusive tax shelters.

### D. Proposed Legislation

1. On April 27, 2004, Treasurer Phil Angelides' called for repeal of "unjustified corporate loopholes."
  - a. Restrict S Corporation use.
  - b. Eliminate various agricultural sales tax exemptions.

- c. Eliminate ability to have different IRC § 338 election treatment under California law.
- d. Angelides also calling for annual review of credits, deductions, etc., in budget process.
- e. Finally, Angelides would require FTB study of water's edge election and require FTB to report on whether law should be changed.

## IX. Miscellaneous

### A. "Total Recall"

1. On October 7, 2003, California Governor Gray Davis (D) was recalled ("terminated") and replaced by Arnold Schwarzenegger (R). The impact on California tax policies still remains to be seen.
2. The Director of the Department of Finance which is a governor appointed position changed. This in turn altered the make-up of the 3-member FTB.
  - a. Carole Migden, who is the Chairwoman of the SBE and thus also on the FTB, is running for State Senator. If elected in November, this will open up slots on both the FTB and SBE.

### B. *Franchise Tax Board v. Gilbert P. Hyatt*, 538 U.S. 488 (2003)

1. The U. S. Supreme Court affirmed a Nevada Supreme Court decision that Nevada courts had properly exercised jurisdiction over intentional tort claims brought against the FTB, for alleged abuses occurring during a personal income tax (residency) audit, by a former California resident, who was a Nevada resident at the time of the audit.

### C. *Geneva Towers Limited Partnership v. City and County of San Francisco*, 29 Cal. 4th 769 (2003)

1. In a case with potentially far reaching ramifications, the California Supreme Court reversed the Court of Appeal and concluded that where a taxing authority fails to act on a claim for refund within six months, the claimant may deem the claim denied and file a suit for refund at any time prior to the mailing of a notice of action on the claim.
2. The Court of Appeal had held that there was a four-year statute of limitations to file the action

which began to run six months after the claim was filed.

**D. FTB Notice 2004-3**

1. Discussion draft of new proposed Regulation 25106.5-11.
2. Proposed Regulation deals with key corporation elections and combined reports.

**E. FTB Notice 2004-5**

1. On August 6, 2004, the FTB announced that accuracy related penalties may be asserted

against taxpayers that file California franchise tax original returns inconsistent with the standard allocation and apportionment provisions of RTC §§ 25120-25136 and has not obtained prior approval from the FTB.

- a. Applicable to returns with a due date, determined without extensions, after October 14, 2004.
- b. For returns with a due date before October 15, 2004, a statement attached to the return that adequately discloses that the taxpayer's return is inconsistent with the standard allocation and apportionment rules, or that the taxpayer has relied on RTC § 25137 will be considered adequate disclosure.

