

ANNOUNCEMENT OF PROPOSED MODIFICATIONS TO AMENDED MULTISTATE TAX COMMISSION MODEL REGULATION FOR CALIFORNIA REGULATION SECTION 25136

Franchise Tax Board Solicitation of Comments Regulation Section 25136: Sales Factor. Sales Other than Sales of Tangible Personal Property in this State

On January 9, 2007, an interested parties meeting was held to discuss the possibility of adopting and, to what extent, the amended Multistate Tax Commission (MTC) model regulation for California Regulation Section 25136 (section 25136). Public comments received at the interested parties meeting were considered by staff.

On June 5, 2008, the Franchise Tax Board approved staff's recommendation to proceed with the formal regulatory process of adopting the amended MTC model regulation for section 25136, subject to the condition that staff solicit public comment on examples that were then being developed prior to initiating the formal regulatory process under the Administrative Procedure Act. In developing these examples, staff has determined that the proposed MTC language can also be modified for greater clarity. Those changes are shown in Exhibit A attached hereto and an explanation of the changes is set forth below. Pursuant to staff's understanding of the Board's direction, if no comments are received objecting to the proposed changes, or no request for additional Board consideration is made, staff will then initiate the formal regulatory process.

First, the amended MTC model regulation has been modified to make the language easier to understand without changing its meaning. For example, the original amended MTC model regulation read "Such income-producing activity is in this state:" followed by a series of cascading rules that are awkwardly stated and confusing: [(i) now (A)] "...but if the activity occurs in more than one state, the location where the income-producing activity is actually performed shall be deemed to be not reasonably determinable at the time of filing." Staff deleted that last phrase from that subsection and created a new subsection, (B), that reads "If the income-producing activity occurs in more than one state, subsection (d)(3)(A) does not apply" and then goes on to state the first cascading rule that applies if the income-producing activity is performed in more than one state. The amended MTC model regulation in its cascading rules restates the prior subsections in their entirety rather than simply referring to the subsection number. Staff modified all subsections to refer to the subsection(s) and not the language in the subsections. Staff also modified the language so that the cascading rules are stated affirmatively and clearly. For example, the amended MTC model regulation stated in (iii) [now (C)] "if it cannot be determined [then repeats some of the language from subsections (i) and (ii),] when the contract between the taxpayer and the taxpayer's customer indicates it is to be performed in this state..." Staff rewrote that subsection to read "(C) If the location of the income-producing activity cannot be assigned pursuant to subsection (d)(3)(A) or (B), the income-producing activity is in a state to the extent the contract between the taxpayer and the taxpayer's customer or the taxpayer's records indicate it is to be performed in such state..." Staff renamed all subsections so that under (3) Services on Behalf of Taxpayer, there are now 5 subsections, (A) through (E) rather than breaking out the subsections into two groups under (A) and (B) as the amended MTC model regulation did. There are other, minor changes to make the language clearer and simpler. In addition,

throughout the body of the regulation, staff corrected grammatical errors and underscored the headings to improve readability.

Second, staff has included an option for taxpayers when determining the location of the income-producing activity to look to the "taxpayer's records" in addition to their contract with an agent or independent contractor, or their contract with a customer, to make the determination of where the income-producing activity was actually performed. Staff believes that in many business situations the above-referenced contracts may not indicate the location of the income-producing activity but that the broader scope of "taxpayer's records" would provide this information.

Third, staff has developed examples for the MTC model language's cascading rules. It is the purpose of these examples to show how the cascading rules work in a hypothetical situation.

Fourth, language has been included to indicate that the special rules of subsection (d)(2) are applicable to the activities of an agent or independent contractor.

Please submit any comments to the attached language within 15 days to:

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