

DISCUSSION TOPICS

Franchise Tax Board Interested Parties Meeting
Section 25136: Sales Factor. Sales Other than Sales of Tangible Personal Property
in this State
January 9, 2008

1. Overview of Regulation section 25136.

California Code of Regulations, title 18, section 25136 (Regulation section 25136), is based upon, and is virtually identical to, Multistate Tax Commission (MTC) Regulation IV.17 prior to the most recent amendments. Regulation section 25136 generally provides that sales of other than tangible property are assigned to the numerator of the sales factor based upon where the income producing activity is performed. Under subsection (b) of the current regulation, income producing activity only includes "activity directly engaged in by the taxpayer in the regular course of its trade or business" and "does not include transactions and activities performed on behalf of a taxpayer, such as those conducted on its behalf by an independent contractor."

The Franchise Tax Board issued Legal Ruling 2006-02 on May 3, 2006. This Legal Ruling held that:

Due to the effects of combined reporting when the contractor and the subcontractor are in a unitary relationship and are members of the same combined reporting group, the activities of the subcontractor in performance of the contract will be considered income producing activities *directly* engaged in by the contractor for purposes of the sales factor in order to more accurately assign the receipt to the place where the services were performed.

A copy of this Legal Ruling is attached hereto as [Attachment A](#).

At the Annual Meeting of the MTC held on August 2, 2007, the MTC approved amendments to the Commission's Regulation IV.17. The amendments adopted by the MTC reverse the general rule found in Regulation section 25136, subsection (b), and make assignments based upon activities of both the taxpayer and those performed on behalf of the taxpayer. This change is accomplished through a series of amendments. Two of the amendments strike the word "directly" and the words "does not" from the language quoted above. Another of the amendments adds additional language, subsection (4)(C), to the model regulation setting forth rules for determining the state where activities performed on behalf of a taxpayer are to be assigned.

A copy of the amendments adopted by the MTC, with deletions in strikeout and additions in underscore, are attached hereto as [Attachment B](#). A copy of the Report of the Hearing Officer Regarding Proposed Amendments to MTC Regulation IV.17 is attached as [Attachment C](#).

2. Discussion.

The department anticipates having an open discussion to address whether and to what extent the MTC model regulation should be adopted in California.

In addition, the department is soliciting comments from interested parties on any other possible changes to the existing regulation either for purpose of clarification or possible substantive revision.

3. Possible Draft of Regulation.

Attached as [Attachment D](#) is a draft, with deletions shown in strikeout and additions in underscore, of how the amended regulation would look if the recent amendments to the MTC model regulation were fully adopted. A few other minor non-substantive changes to the existing regulation are also noted in strikeout and underscore.