PROPOSED REGULATION SECTION 25137-14
SYMPOSIUM DISCUSSION PAPER

If the allocation and apportionment provisions of the Uniform Division of Income for Tax Purposes Act (UDITPA) do not fairly represent a taxpayer's business activity in California, Revenue and Taxation Code section 25137 authorizes the Franchise Tax Board (FTB) to require the use of another method to effectuate an equitable allocation and apportionment of a taxpayer's income. Pursuant to this authority, FTB has issued a number of regulations prescribing industry-specific methods of apportionment and allocation. There is no regulation prescribing a method of apportionment and allocation for mutual fund service providers.

The need for an alternative apportionment methodology for mutual fund service providers has led to the issuance of regulations and statutory amendments in many of the states that have a significant mutual fund service provider presence. California, while being home to many such companies, has not addressed this issue. This regulation project is intended to provide much needed guidance in this area. In order to encourage industry participation in this project, staff is not proposing draft language at this time. Instead, the symposium should discuss the approaches taken in other states and the elements of those approaches that industry would like to see adopted in California, as well as a discussion of the provisions in other states that are seen by staff or industry as potentially flawed or in need of refinement. In order to focus the discussion, staff is making available language from three states: Maine, Connecticut and Maryland. The approaches in these states are similar, but with variations in some areas. Staff is hopeful that these variations will be the subject of discussion at the symposium, with industry providing input on what is seen as appropriate as well as what areas are problematic. Among the areas that staff hopes to receive input regarding are:

1. The definition of mutual fund service provider. To whom should this regulation apply?
2. The definitions of the various services provided. Are the definitions used in the other states correct?
3. Are there any property or payroll factor issues to be addressed? The other states have left the normal rules in place.
4. For the sales factor, does the ratio language provided work well? Which approach does industry prefer?

There are also areas where there is no guidance to be found in the provisions adopted elsewhere. Of primary concern to staff is the adoption of a methodology to deal with the assignment of receipts to a location where the service provider is not taxable. It is a fundamental concern of UDITPA to avoid nowhere income. Many of the industry-specific regulations adopted by California under section 25137 (25137-3, 25137-4.1 and 25137-4.2, for example) contain a throwback rule to address this concern. Staff would like to discuss with industry how such a rule could work in the context of this regulation.

Also, staff envisions receiving input regarding shares in funds that are held by the service providers themselves. Should these shares be included in the shareholder ratio? How should income from the sale of such shares should be assigned for sales factor purposes?