

STATE OF CALIFORNIA
LEGAL DIVISION MS A260
FRANCHISE TAX BOARD
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**NOTICE OF AMENDMENTS TO TEXT OF PROPOSED REGULATION SECTION 25136-2 IN TITLE
18 OF THE CALIFORNIA CODE OF REGULATIONS RELATING TO MARKET BASED SOURCING
RULES**

On August 7, 2015, the Franchise Tax Board (FTB) published a Notice of Proposed Rulemaking in the California Regulatory Notice Register in accordance with section 11346.4 of the Government Code, providing notice to the public of the Franchise Tax Board's intention to amend portions of Title 18 of the California Code of Regulations (CCR), section 25136-2. On September 22nd, 2015, the FTB held a hearing on the proposed amendments to CCR section 25136-2, with department staff serving as the "hearing officer." The proposed amendments to CCR Section 25136-2 for which the hearing was held are summarized here as follows: two different definitions of marketable securities, assignment rules for marketable securities, examples for asset management fee assignment, assignment rules for dividends and goodwill, assignment rules for interest, miscellaneous clean up fixes, and an effective date of the regulation.

Department staff reviewed the proposed regulation language and considered the comments submitted before and during the hearing. The hearing officer recommended changes to the proposed amended regulations. These changes constitute sufficiently related changes within the meaning of Government Code section 11346.8 and nonsubstantial changes within the meaning of Government Code section 11346.8.. The proposed sufficiently related changes are summarized below by regulation number, and appear in double strikeout as follows:

1. Subsection (d)(1)(a)2 provides the assignment rules for gross receipts from intangible property comprised of interest. However, one commentator pointed out that there is language that is confusing in this provision. This language should be removed from the text, as follows:

~~Where the gross receipts from intangible property are interest, even if the underlying transaction is excluded from gross receipts in the sales factor under the provisions of Revenue and Taxation Code Section 25120, the interest gross receipts shall be assigned as follows:~~

2. In the proposed regulation language accompanying the August 7, 2015 publication of the Notice of Proposed Rulemaking in the California Regulatory Notice Register, there are three places in which language appears which was proposed to be added during the informal regulatory process, but which was subsequently rejected during the Interested Parties Meeting process. This language erroneously appeared in the proposed regulation language accompanying the August 7, 2015 publication in ~~strikeout~~, and should be removed from the text as indicated below:

Subsection (b) (6): For a taxpayer that is defined as a securities dealer under Internal Revenue Code Section 475 (c)(1) ~~that purchases and sells intangible assets of the type defined in Internal Revenue Code Sections 475(c) or (e), such as a registered broker-dealer,~~ or a commodities dealer that has made an election under Internal Revenue Code Section 475(e), “marketable securities” means any security that is defined in Internal Revenue Code Sections 475(c)(2) or 475(e)(2)(B), (C), or (D), and any contract to which Internal Revenue Code Section 1256(a) applies, which has not been excepted under Internal Revenue Code Section 475(b). Receipts from marketable securities under this subsection include any interest and dividends associated with such marketable securities. "Marketable securities" do not include those types of securities that are traded in transactions specifically excluded from gross receipts under Revenue and Taxation Code Section 25120(f)(2)(L).

Subsection (c)(2)(E)6. Benefit of the Service – Business entity, subsection (c)(2)(A): Asset Management Corp, which is not subject to California Code of Regulations section 25137-14 because the taxpayer is not providing services to at least one Regulated Investment Company, provides administration, distribution and management services for pension plans, retirement accounts, or other investment accounts, by contracting with third party entities to provide these services on behalf of shareholders, beneficial owners, or investors of the pension plans, retirement accounts or other investment accounts. Since the benefit of the services is received by the shareholders, beneficial owners, or investors, the sale of these services shall be assigned to the location of the shareholders, beneficial owners, or investors. ~~If Asset Management Corp, through its books and records kept in the normal course of business, can determine the domicile of the shareholders, beneficial owners, or investors, then the gross receipts shall be assigned to this state by the ratio of shareholders, beneficial owners, or investors in this state over the shareholders, beneficial owners, or investors everywhere.~~

Subsection (d)(2)(D)7. Intangible Property - Mixed Intangible, subsection (d)(2)(C)1: Axel Corp enters into a two-year license agreement with Biker Corp in which Biker Corp is granted the right to produce motor scooters using patented technology owned by Axel Corp, and also to sell such scooters by

marketing the fact that the scooters were manufactured using the special technology. The scooters are manufactured outside this state, but ~~the taxpayer~~ Biker Corp is granted the right to sell the scooters in a geographic area in which this state's population constitutes 25% of the total population in the geographic area during the period in question. The license agreement specifies separate fees to be paid for the right to produce the motor scooters and for the right to sell the scooters by marketing the fact that the scooters were manufactured using the special technology. The licensing agreement constitutes both the license of a marketing intangible and the license of a non-marketing intangible. Assuming that the separately stated fees are reasonable, the Franchise Tax Board will: (1) attribute no part of the licensing fee paid for the non-marketing intangible to this state, and (2) attribute 25% of the licensing fee paid for the marketing intangible to this state.

These nonsubstantial and sufficiently related changes are being made available to the public for the 15-day period required by Government Code section 11346.8(c) and section 44 of Title 1 of the California Code of Regulations.

A copy of the proposed amendments is being sent to all individuals who requested notification of such changes, as well as those who attended the hearing and those who commented orally or in writing, and will be available to other persons upon request.

All written comments concerning this notice must be submitted to FTB no later than 5:00 p.m. on November 20, 2015, and should be directed to:

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All written comments received by November 20, 2015, which pertain to the indicated changes will be reviewed and responded to by FTB's staff as part of the compilation of the rulemaking file. Please limit your comments to the proposed modifications to the text.