FRANCHISE TAX BOARD

CALIFORNIA CODE OF REGULATIONS TITLE 18,
DIVISION 3, CHAPTER 3.5, SUBCHAPTER 17,
Article 2.5, Section 25136-2
REGARDING MARKET-BASED RULES FOR SALES OTHER THAN
SALES OF TANGIBLE PERSONAL PROPERTY

FINAL TEXT

§ 25136-2. Sales Factor. Sales Other than Sales of Tangible Personal Property in this State.

(a) In General. Sales other than those described under Revenue and Taxation Code Section~~s~~ 25135 and former Section 25136, subdivision (a), as applicable for taxable years beginning on or after January 1, 2011 and before January 1, 2013, are in this state if the taxpayer's market for the sales is in this state.

(b) General Definitions.

(1) "Benefit of a service is received" means the location where the taxpayer's customer has either directly or indirectly received value from delivery of that service.

Examples:

(A) Real Estate Development Corp with its commercial domicile in State A is developing a tract of land in this state. Real Estate Development Corp contracts with Surveying Corp from State B to survey the tract of land in this state. Regardless of where the survey work is conducted, where the plats are drawn, or where the plats are delivered, the recipient of the service, Real Estate Development Corp, received all of the benefit of the service in this state.

(B) Builder Corp with its commercial domicile in State A is building an office complex in this state. Builder Corp contracts with Engineering Corp from State B to oversee construction of the buildings on the site. Engineering Corp performs some of its service in this state at the building site and additional service in State B. Because all of Engineering Corp's services were related to a construction project in this state, the recipient of the services, Builder Corp, received all of the benefit of the service in this state.

(C) General Corp with its commercial domicile in State A contracts with Computer Software Corp from State B to develop and install custom computer software for General Corp. The software will be used by General Corp in a business office in this state and in a business office in State A. The software development occurs in State B. The recipient of the service,

General Corp, received the benefit of the service in both State A and in this state.

(D) Apartment Corp owns 100 apartments in this state and 400 apartments in State A, and contracts with Pest Control Corp for pest control services for all the apartments. The benefit of the service is received in both State A and in this state.

(2) "Cannot be determined" means that the taxpayer's records or the records of the taxpayer's customer which are available to the taxpayer do not indicate the location where the benefit of the service was received or where the intangible property was used.

(3) "Complete transfer of all property rights" means a transfer of all property rights associated with the ownership of intangible property, as distinguished from a licensing of intangible property where the licensor retains some ownership rights in connection with the intangible property licensed to a buyer. A complete transfer does not require that a seller has sold all of its stock in a corporation or all of its interest in a pass-through entity; rather, it merely means that the seller retains no property rights in the stock or other interest that has been sold. For example, a seller who owns one hundred (100) percent of the stock of a corporation and sells sixty (60) percent of its ownership interest in the corporation, retaining no property rights in the stock sold, has engaged in a complete transfer of all property rights with regard to the sixty (60%) percent of the stock that was sold. The sixty (60) percent ownership interest sold is subject to assignment under subsections (d)(1)(A)1.a. and b.

(4) "Intangible property" includes, but is not limited to, patents, copyrights, trademarks, service marks, trade names, licenses, plans, specifications, blueprints, processes, techniques, formulas, designs, layouts, patterns, drawings, manuals, trade secrets, stock, contract rights including broadcasting rights, and other similar intangible assets.

(A) A "marketing intangible" includes, but is not limited to, the license of a copyright, service mark, trademark, or trade name where the value lies predominantly in the marketing of the intangible property in connection with goods, services or other items.

(B) A "non-marketing and manufacturing intangible" includes, but is not limited to, the license of a patent, a copyright, or trade secret to be used in a manufacturing or other non-marketing process, where the value of the intangible property lies predominately in its use in such process.

(C) A "mixed intangible" includes, but is not limited to, the license of a patent, a copyright, service mark, trademark, trade name, or trade secrets where the value lies both in the marketing of goods, services or other items as

described in subparagraph (A) and in the manufacturing process or other non-marketing purpose as described in subparagraph (B).

(5) "Marketable securities" means any security that is actively traded in an established stock or securities market and is regularly quoted by brokers or dealers in making a market. "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. An "established stock or securities market" is defined as (1) a national securities exchange that is registered under Section 78f of the Securities Exchange Act of 1934 (15 U.S.C. Section 78a to 78pp); or (2) a foreign securities exchange or board of trade that satisfies analogous regulatory requirements under the law of the jurisdiction in which it is organized (such as the International Stock Exchange of the United Kingdom and the Republic of Ireland, Limited; the Marche a Terme International de France; the Frankfurt Stock Exchange; and the Tokyo Stock Exchange.)

(6) For a taxpayer that is defined as a securities dealer under Internal Revenue Code Section 475 (c)(1) 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).

(~~5~~7) "Reasonably approximated" means that, considering all sources of information other than the terms of the contract and the taxpayer's books and records kept in the normal course of business, the location of the market for the benefit of the services or the location of the use of the intangible property is determined in a manner that is consistent with the activities of the customer to the extent such information is available to the taxpayer. Reasonable approximation shall be limited to the jurisdictions or geographic areas where the customer or purchaser, at the time of purchase, will receive the benefit of the services or use of the intangible property, to the extent such information is available to the taxpayer. If population is a reasonable approximation, the population used shall be the U.S. population as determined by the most recent U.S. census data. If it can be shown by the taxpayer that the benefit of the service is being substantially received or intangible property is being materially used outside the U.S., then the populations of those other countries where the benefit of the service is being substantially received or the intangible property is being materially used shall be added to the U.S. population. Information that is specific in nature is preferred over information that is general in nature.

(~~6~~8) "Service" means a commodity consisting of activities engaged in by a person for another person for consideration. The term “service” does not include activities performed by a person who is not in a regular trade or business offering its services to the public, and does not include services rendered to another member of the taxpayer’s combined reporting group as defined in Regulation section 25106.5(b)(3).

(~~7~~9) "The use of intangible property in this state" means the location where the intangible property is employed by the taxpayer's customer or licensee. In the case of the complete transfer of all property rights in stock of a corporation or interest in a pass-through entity, the location of the use of the stock of the corporation or interest in the pass-through entity is the location of the use of the underlying assets of the corporation or pass-through entity.

(~~8~~10)"To the extent" means that if the customer of a service receives the benefit of a service or uses the intangible property in more than one state, the gross receipts from the performance of the service or the sale of intangible property are included in the numerator of the sales factor according to the portion of the benefit of the services received and/or the use of the intangible property in this state.

(c) Sales from services are assigned to this state to the extent the customer of the taxpayer receives the benefit of the service in this state.

(1) In the case where an individual is the taxpayer's customer, receipt of the benefit of the service shall be determined as follows:

(A) The location of the benefit of the service shall be presumed to be received in this state if the billing address of the taxpayer’s customer, as determined at the end of the taxable year, is in this state. If the taxpayer uses the customer’s billing address as the method of assigning the sales to this state, the Franchise Tax Board will accept this method of assignment. This presumption may be overcome by the taxpayer by showing, based on a preponderance of the evidence, that either the contract between the taxpayer and the taxpayer's customer, or other books and records of the taxpayer kept in the normal course of business, provide the extent to which the benefit of the service is received at a location (or locations) in this state. If the taxpayer believes it has overcome the presumption and uses an alternative method based on either the contract between the taxpayer and the taxpayer's customer or other books and records of the taxpayer kept in the normal course of business, the Franchise Tax Board may examine the taxpayer’s alternative method to determine if the billing address presumption has been overcome and, if so, whether the taxpayer’s alternate method of assignment reasonably reflects where the benefit of the service was received by the taxpayer’s customers.

(B) If the presumption in (c)(1)(A) is overcome by the taxpayer, and an alternative method cannot be determined by reference to the contract between the taxpayer and its customer or the taxpayer's books and records kept in the normal course of business, then the location where the benefit of the services is received by the customer shall be reasonably approximated.

(C) Examples.

1. Benefit of the Service – Individuals, subsection (c)(1)(A). Phone Corp provides interstate communications and wireless services to individuals in this state and other states for a monthly fee. The vast majority of consumers of mobile services receive the benefit of the services at many locations. As a result, a customer's billing address is not reflective of the location where the benefit of the services is received by the customer. Phone Corp has operating equipment and facilities used to provide communications services ("net plant facilities") located in geographical areas where customers utilize its services, based on market size and demand. Phone Corp's books and records, kept in the normal course of the business, identify the net plant facilities used in providing the communications services to Phone Corp's customers. Because Phone Corp's books and records show where the benefit of the services is actually received, the presumption of billing address is overcome. Receipts from interstate communications and wireless services will be attributable to this state based upon the ratio of California net plant facilities over total net plant facilities used to provide those services using a consistent methodology of valuing the property, for example, net book basis of the assets that is determined from Phone Corp's books and records.

2. Benefit of the Service – Individual, subsection (c)(1)(A). Travel Support Corp located in this state provides travel information services to its customers, who are individuals located throughout the United States, through a call center located in this state. The contract between Travel Support Corp and its customers provides that for a fee per call, the customer can call Travel Support Corp for information regarding hotels, restaurants and other travel related information. Travel Support Corp's books and records maintained in the regular course of business indicate that fifteen (15) percent of its customers have billing addresses in this state. However, Travel Support Corp's books and records indicate that only seven (7) percent of the calls handled by the call center originate from this state. Because Travel Support Corp's books and records show where the benefit of the services is actually received, the billing address presumption is overcome and the books and records of the taxpayer may be used to assign seven (7) percent of the gross receipts from the support services provided by the call center to this state.

3. Benefit of the Service – Individual, subsection (c)(1)(A). Same facts as Example 2 except the contract between Travel Support Corp and its customers provides for a set monthly fee, regardless of whether the customer actually calls for travel support. The fact that only seven (7) percent of the calls originate from this state does not overcome the presumption that the benefit of the services is received at the billing address. This is because the charges are not based on a per call basis but rather a flat monthly fee.

4. Benefit of the Service – Individual, subsection (c)(1)(B). Satellite Music Corp has a contract with Car Dealer Corp to provide satellite music service to Car Dealer Corp's retail customers who buy Make and Model X car. Car Dealer Corp's customers pre-pay for a two (2) year service plan to receive satellite music at a discounted rate as part of the purchase price of the Make and Model X car. While Satellite Music Corp requires an email address for Car Dealer Corp's customers who receive the benefit of this service, Satellite Music Corp does not have access to information as to the billing address or physical location of Car Dealer Corp's customers. Satellite Music Corp may reasonably approximate the location where Car Dealer Corp's customers receive the benefit of its satellite music service by a ratio of the number of Car Dealer Corp locations that offer the two (2) year service plan with Satellite Music Corp to its customers in this state to the number of Car Dealer Corp locations that offer the two (2) year service plan with Satellite Music Corp to its customers located everywhere.

(2) In the case where a corporation or other business entity is the taxpayer's customer, receipt of the benefit of the service shall be determined as follows:

(A) The location of the benefit of the service shall be presumed to be received in this state to the extent the contract between the taxpayer and the taxpayer's customer or the taxpayer's books and records kept in the normal course of business, notwithstanding the billing address of the taxpayer's customer, indicate the benefit of the service is in this state. This presumption may be overcome by the taxpayer or the Franchise Tax Board by showing, based on a preponderance of the evidence, that the location (or locations) indicated by the contract or the taxpayer’s books and records was not the actual location where the benefit of the service was received.

(B) If neither the contract nor the taxpayer's books and records provide the location where the benefit of the service is received, or the presumption in subparagraph (A) is overcome, then the location (or locations) where the benefit is received shall be reasonably approximated.

(C) If the location where the benefit of the service is received cannot be determined under subparagraph (A) or reasonably approximated under subparagraph (B), then the location where the benefit of the service is

received shall be presumed to be in this state if the location from which the taxpayer's customer placed the order for the service is in this state.

(D) If the location where the benefit of the service is received cannot be determined pursuant to subparagraphs (A), (B), or (C), then the benefit of the service shall be in this state if the taxpayer's customer's billing address is in this state.

(E) Examples.

1. Benefit of the Service – Business Entity, subsection (c)(2)(A). Payroll Services Corp contracts with Customer Corp to provide all payroll services. Customer Corp is commercially domiciled in this state and has employees in a number of other states. The contract between Payroll Services Corp and Customer Corp does not specify where the service will be used by Customer Corp. Payroll Services Corp's books and records indicate the number of employees of Customer Corp in each state where Customer Corp conducts its business. Payroll Services Corp shall assign its receipts from its contract with Customer Corp by determining the ratio of employees of Customer Corp in this state compared to all employees of Customer Corp and assign that percentage of the receipts from Customer Corp to this state.

2. Benefit of the Service – Business Entity, subsection (c)(2)(A). Law Corp located in State C has a Client Corp that has manufacturing plants in this state and State B. Law Corp handles a major litigation matter for Client Corp concerning a manufacturing plant owned by its client in this state. All gross receipts from Law Corp's services related to the litigation are attributable to this state because Law Corp's books and records kept in the normal course of business indicate that the services relate to Client Corp's operations in this state.

3. Benefit of the Service – Business Entity, subsection (c)(2)(A). Audit Corp is located in this state and provides accounting, attest, consulting, and tax services for Client Corp. The contract between Audit Corp and Client Corp provides that Audit Corp is to audit Client Corp for taxable year ended 20XX. Client Corp's books and records kept in the normal course of business, as well as Client Corp's internal controls and assets, are located in States A, B and this state. As a result, Audit Corp's staff will perform the audit activities in States A, B and this state. Audit Corp's business books and records track hours worked by location where its employees performed their service. Audit Corp's receipts are attributable to this state and States A and B according to the taxpayer's books and records which indicate time spent in each state by each staff member.

4. Benefit of the Service – Business Entity, subsection (c)(2)(A). Web Corp provides internet content to its viewers and receives revenue from providing advertising services to other businesses. Web Corp's contracts with other businesses do not indicate the location (or locations) where the benefit of the service is received. The advertisements are shown via the website to Web Corp viewers and the fee collected is determined by reference to the number of times the advertisement is viewed and/or clicked on by viewers of the website. If Web Corp, through its books and records kept in the normal course of business, can determine the location from which the advertisement is viewed and/or clicked on by viewers of the website, then gross receipts from the advertising will be assigned to this state by a ratio of the number of viewings and/or clicks of the advertisement in this state to the total number of viewings and/or clicks on the advertisement.

5. Benefit of the Service – Business Entity, subsection (c)(2)(B). Same facts as Example 4 except Web Corp cannot determine the location from which the advertisement is viewed and/or clicked on through its books and records, so Web Corp shall reasonably approximate the location of the receipt of the benefit by assigning its gross receipts from advertising by a ratio of the number of its viewers in this state to the number of its viewers everywhere.

6. Benefit of the Service – Business Entity, subsection (c)(2)(C). For a flat fee, Painting Corp contracts with Western Corp to paint Western Corp's various sized, shaped and surfaced buildings located in this state and four (4) other states. The contract does not break down the cost of the painting per building or per state. Painting Corp's books and records kept in the normal course of business indicate the location of the buildings that are to be painted but do not provide any method for determining the extent that the benefit of the service is received in this state, i.e. the size, shape, or surface of each building, or the materials used for each building~~s~~ to be painted. In addition, there is no method for reasonably approximating the location(s) where the benefit of the service was received. Since neither the contract nor Painting Corp's books and records indicate how much of the fee is attributable to this state and there is no method of reasonably approximating the location of where the benefit of the service is received, the sale will be assigned to this state if the order for the service was placed from this state.

7. Benefit of the Service – Business Entity, subsection (c)(2)(D). Same facts as Example 6 except the sale cannot be assigned under subsection (c)(2)(C), so that the sale shall be assigned to this state if Western Corp's billing address is in this state.

(d) Sales from intangible property are assigned to this state to the extent the property is used in this state.

(1) In the case of the complete transfer of all property rights (as defined in subsection (b)(3)) in intangible property (as defined in subsection (b)(4)) for a jurisdiction or jurisdictions, the location of the use of the intangible property shall be determined as follows:

(A) The location of the use of the intangible property shall be presumed to be in this state to the extent that the contract between the taxpayer and the purchaser, or the taxpayer's books and records kept in the normal course of business, indicate that the intangible property is used in this state at the time of the sale. This may include books and records providing the extent that the intangible property is used in this state by the taxpayer for the most recent twelve (12) month taxable year prior to the time of the sale of the intangible property. This presumption may be overcome by the taxpayer or the Franchise Tax Board by showing, based on a preponderance of the evidence, that the actual location of the use of the intangible property by the purchaser at the time of purchase is not consistent with the terms of the contract or the taxpayer's books and records.

1. Where the sale of intangible property is the sale of shares of stock in a corporation or the sale of an ownership interest in a pass-through entity, other than sales of marketable securities, <u>or where the gross receipts from intangible property are dividends or goodwill,</u> the following rules apply:

a. In the event that fifty (50) % or more of the amount of the assets of the corporation or pass-through entity sold, determined on the date of the sale and using the original cost basis of those assets, consist of real and/or tangible personal property, the sale of the stock or ownership interest will be assigned by averaging the payroll and property factors of the corporation or pass-through entity in this state for the most recent twelve (12) month taxable year prior to the time of the sale to the extent indicated by the taxpayer's books and records kept in the normal course of business. If, however, the sale occurs more than six (6) months into the current taxable year, then the average of the current taxable year's payroll and property factors shall be used.

b. In the event that more than -fifty (50%) percent of the amount of the assets of the corporation or pass-through entity sold, determined on the date of the sale and using the original costs basis of those assets, consist of intangible property, the sale of the stock or ownership interest will be assigned by using the sales factor of the corporation or pass-through entity in this state for the most recent twelve (12) month taxable year prior to the

time of the sale to the extent indicated by the taxpayer's books and records kept in the normal course of business. If, however, the sale occurs more than six (6) months into the current taxable year, then the current taxable year's sales factor shall be used.

2. Where the gross receipt from intangible property is interest, the interest gross receipt shall be assigned as follows:

   a. Interest from investments, other than loans defined under California Code of Regulations Section 25137-4.2(b)(7), shall be assigned to this state if the investment is managed in this state.

   b. Interest from loans defined under California Code of Regulations Section 25137-4.2(b)(7) which are secured by real property shall be assigned to this state to the extent the real property is located within this state.

   c. Interest from loans defined under California Code of Regulations Section 25137-4.2(b)(7) which are not secured by real property shall be assigned to this state if the borrower is located in this state.

(B) If the extent of the use of the intangible property in this state cannot be determined under subparagraph (A) or the presumption under subparagraph (A) is overcome, the location where the intangible property is used shall be reasonably approximated.

(C) If the extent of the use of the intangible property in this state cannot be determined pursuant to subparagraphs (A) or (B), then the gross receipts shall be assigned to this state if the billing address of the purchaser is in this state.

(D) Examples.

1. Intangible Property – Complete Transfer, Sale of Stock in a Corporation or Ownership Interest in a Pass-through Entity, subsection (d)(1)(A)1.a. Parent Corp sells all of the of stock of Subsidiary Corp. At the time of sale, the predominant value (over 50%) of Subsidiary Corp's assets consists of tangible personal property and Subsidiary Corp had locations in this state and three (3) other states. Taxpayer’s books and records indicate Subsidiary Corp had payroll and property in this state of 15% and 25%, respectively, in its twelve (12) month taxable year preceding the sale. In assigning the receipt from the sale of Subsidiary Corp. Taxpayer may average the property and payroll percentages and assign 20% of the receipt from the sale to this state.

2. Intangible Property – Complete Transfer, Sale of Stock in a Corporation or Ownership Interest in a Pass-through Entity, subsection (d)(1)(A)1.b. Parent Corp sells an interest in Target Entity. At the time of the sale, the predominant value (over 50%) of Target Entity's assets consists of intangible property. Target Entity's books and records indicate that 30% of Target Entity's sales were assigned to California during the most recent full tax period preceding the sale. Parent Corp may assign 30% of the receipt from the sale of the interest in Target Entity to this state.

3. Intangible Property – Complete Transfer, subsection (d)(1)(B). R&D Corp sells a patent to Manu Corp that will be used by Manu Corp to manufacture products for sale in the United States. The contract between R&D Corp and Manu Corp indicates that Manu Corp will have the exclusive rights to the patent for exploitation in the United States. At the time of the purchase, R&D Corp knows that Manu Corp has three factories that will use the patented process in manufacturing, one of which is located in this state. In the absence of specific information as to the amount of manufacturing Manu Corp does at each of the three locations, R&D Corp may reasonably approximate the location of the use by assigning the receipts from the sale equally among the three states where Manu Corp has manufacturing plants, assigning 33% of the sale to this state.

4. Intangible Property – Complete Transfer, subsection (d)(1)(C). Same facts as Example 3, except R&D Corp has no information regarding Manu Corp's activities. R&D Corp shall assign the receipt to the billing address of Manu Corp.

(2) In the case of the licensing, leasing, rental or other use of intangible property as defined in subsection (b)(4), not including sales of intangible property provided for in paragraph (1), the location of the use of the intangible property in this state shall be determined as follows:

(A) Marketing Intangible.

1. Where a license is granted for the right to use intangible property in connection with the sale, lease, license, or other marketing of goods, services, or other items, the royalties or other licensing fees paid by the licensee for such right(s) are attributable to this state to the extent that the fees are attributable to the sale or other provision of goods, services, or other items purchased or otherwise acquired by the ultimate customers in this state. The contract between the taxpayer and the licensee of the intangible property or the taxpayer's books and records kept in the normal course of business shall be presumed to provide a method for determination of the ultimate customers in this state for the purchase of goods, services, or other items in connection

with the use of the intangible property. This presumption may be overcome by the taxpayer or the Franchise Tax Board by showing, based on a preponderance of the evidence, that the ultimate customers in this state are not determinable under the contract or the taxpayer's books and records.

2. If the location of the use of the intangible property is not determinable under subparagraph 1 or the presumption under subparagraph 1 is overcome, the location of the use of the intangible property shall be reasonably approximated. To determine the customer's or licensee's use of marketing intangibles in this state, factors that may be considered include the number of licensed sites in each state, the volume of property manufactured, produced or sold pursuant to the arrangement at locations in this state, or other data that reflects the relative usage of the intangible property in this state.

3. Where the license of a marketing intangible property is for the right to use the intangible property in connection with sales or other transfers at wholesale rather than directly to retail customers, the taxpayer may be unable to develop information regarding the location of the ultimate use of the intangible property. If this is the case, then the taxpayer may attribute the receipt to this state based solely upon the percentage of this state's population as compared with the total population of the geographic area in which the licensee uses the intangible property to market its goods, services or other items. The population used shall be the U.S. population, unless it can be shown by the taxpayer that the intangible property is being used materially in other parts of the world. If the taxpayer can show that the intangible property is being used materially in other parts of the world, then only the populations of those other countries where the intangible is being materially used shall be added to the U.S. population.

(B) Non-marketing and manufacturing intangibles.

1. Where a license is granted for the right to use intangible property other than in connection with the sale, lease, license, or other marketing of goods, services, or other items, the licensing fees paid by the licensee for such right(s) are attributable to this state to the extent that the use for which the fees are paid takes place in this state. The terms of the contract between the taxpayer and the licensee of the intangible property or the taxpayer's books and records kept in the normal course of business shall be presumed to provide a method for determination of the extent of the use of the intangible property in this state. This presumption may be overcome by the taxpayer or the Franchise Tax Board by showing, based on a preponderance of the evidence, that the extent of the use for which the fees are paid are not determinable under the contract or the taxpayer's books and records.

2. If the location of the use of the intangible property cannot be determined under subparagraph 1 or the presumption in subparagraph 1 is overcome, then the location of the use of the intangible property shall be reasonably approximated.

3. If the location of the use of the intangible property for which the fees are paid cannot be determined under subparagraphs 1 or 2, it shall be presumed that the use of the intangible property takes place in this state if the licensee's billing address is in this state.

(C) Mixed intangibles.

1. Where a license of intangible property includes both a license of a marketing intangible and a license of a non-marketing or manufacturing intangible, and the fees to be paid in each instance are separately stated in the licensing contract, the Franchise Tax Board will accept such separate statement for purposes of this section if it is reasonable. If the Franchise Tax Board determines that the separate statement is not reasonable, then the Franchise Tax Board may assign the fees using a reasonable method that accurately reflects the licensing of a marketing intangible and the licensing of a non-marketing or manufacturing intangible.

2. Where the fees to be paid in each instance are not separately stated in the contract, it shall be presumed that the licensing fees are paid entirely for the license of a marketing intangible except to the extent that the taxpayer or the Franchise Tax Board can reasonably establish otherwise. This presumption may be overcome, by a preponderance of the evidence, by the taxpayer or the Franchise Tax Board, that the licensing fees are paid for both the licensing of a marketing intangible and the licensing of a non-marketing or manufacturing intangible, and the extent to which the fees represent the marketing intangible and the non-marketing or manufacturing intangible.

(D) Examples.

1. Intangible Property – Marketing Intangible, subsection (d)(2)(A)1. Crayon Corp and Dealer Corp enter into a license agreement whereby Dealer Corp as licensee is permitted to use trademarks that are owned by Crayon Corp in connection with Dealer Corp's sale of certain products to retail customers. Under the contract, Dealer Corp is required to pay Crayon Corp a licensing fee that is a fixed percentage of the total volume of monthly sales made by Dealer Corp of products using the Crayon Corp trademarks. Under the agreement, Dealer Corp is permitted to sell the products at multiple store locations, including store locations that are both within and without this state. The

licensing fees that are paid by Dealer Corp are broken out on a per-store basis. The licensing fees paid to Crayon Corp by Dealer Corp represent fees from the licensing of a marketing intangible and the fees that are derived from the individual sales at stores in this state constitute sales in this state.

2. Intangible Property – Marketing Intangible, subsection (d)(2)(A)2. Moniker Corp enters into a license agreement with Sports Corp where Sports Corp is granted the right to use trademarks owned by Moniker Corp to brand sports equipment that is to be manufactured by Sports Corp or an unrelated entity, and to sell the manufactured product to unrelated companies that make retail sales in a specified geographic region. Although the trademarks in question will be affixed to the tangible property to be manufactured, the license agreement confers a license of a marketing intangible. Neither the contract between the taxpayer and the licensee nor the taxpayer's books and records provide a method for determination of this state's customers of equipment manufactured with Moniker Corp's trademarks. The component of the licensing fee that constitutes sales of Moniker Corp in this state is reasonably approximated by multiplying the amount of the fee by the percentage of this state's population over the total population in the specified geographic region in which the retail sales are made.

3. Intangible Property - Marketing Intangible, Wholesale, subsection (d)(2)(A)3. Cartoon Corp enters into a license agreement with Wholesale Corp where Wholesale Corp is granted the right to use Cartoon Corp's cartoon characters in the design and manufacture of tee shirts and sweatshirts which will be sold to various retailers who will in turn sell them to members of the public. Cartoon Corp is unable to develop information regarding the location of the ultimate customer of the products designed and manufactured in connection with Cartoon Corp's cartoon characters. Cartoon Corp shall assign the licensing fee by multiplying the fee by the percentage of this state's population over the total population in the geographic area in which Cartoon Corp markets its goods, services or other items.

4. Intangible Property – Non-marketing and Manufacturing Intangible, subsection (d)(2)(B)1. Formula Corp and Appliance Corp enter into a license agreement whereby Appliance Corp is permitted to use a patent owned by Formula Corp to manufacture and sell appliances at stores owned by Appliance Corp within a certain geographic region. The license agreement specifies that Appliance Corp is to pay Formula Corp a royalty equal to a fixed percentage of the gross receipts from the products sold. The contract does not specify any other fees. The appliances are manufactured and sold in this state and several other states. Given these facts, it is presumed that the

licensing fees are paid for the license of a manufacturing intangible. Since Formula Corp can demonstrate the percentage of manufacturing by Appliance Corp that takes place in this state using the patent, that percentage of the total licensing fee paid to Formula Corp under the contract will constitute Formula Corp's sales in this state.

5. Intangible Property – Non-marketing and Manufacturing Intangible, subsection (d)(2)(B)2. Mechanical Corp enters into a license agreement with Spa Corp where Spa Corp is granted the right to use the patents owned by Mechanical Corp to manufacture mechanically operated spa covers for spas that Spa Corp manufactures. Neither the terms of the contract nor the taxpayer's books and records indicate the extent of the use of the patent in this state. However, there is public information that Spa Corp has three manufacturing locations in this state and an additional six manufacturing locations in various other states. Mechanical Corp may reasonably approximate the location of the use of the intangible property and assign 33% of the licensing fees to this state.

6. Intangible Property - Non-marketing and Manufacturing Intangible, subsection (d)(2)(B)3. Same facts as Example 5 except that Spa Corp is a small, privately held manufacturing corporation that has no publicly available information as to its manufacturing locations, Mechanical Corp shall assign all of the licensing fees to this state if Spa Corp's billing address is in this state.

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.

8. Intangible Property – Mixed Intangible, subsection (d)(2)(C)2. Same facts as Example 7, except that the licensing agreement requires an upfront licensing fee to be paid by Biker Corp to Axel Corp but does not specify which percentage of the fee is derived from Biker Corp's right to use Axel Corp's patented technology. Unless either the taxpayer or the Franchise Tax Board reasonably establishes otherwise, it is presumed that the licensing fees are paid entirely for the license of a marketing intangible. In such cases, it will be presumed that 25% of the licensing fee constitutes sales in this state.

(e) For purposes of Revenue and Taxation Code Section 25136, subdivision (a)(2), sales of marketable securities shall be assigned to the location of the customer as follows:

(1) Where the customer is an individual, the sale shall be assigned to this state if the customer's billing address is in this state.

(2) Where the customer is a corporation or other business entity, the sale shall be assigned to this state if the customer's commercial domicile is in this state. The commercial domicile of the corporation or business entity shall be presumed to be in this state as determined at the end of the taxable year in the taxpayer's books and records kept in the normal course of business. If the taxpayer uses the commercial domicile of the corporation or business entity as provided by the taxpayer's books and records kept in the normal course of business as the method of assigning sales to this state, the Franchise Tax Board will accept this method of assignment. This presumption may be overcome by the taxpayer by showing, based on a preponderance of the evidence, that other credible documentation provides that the commercial domicile of the corporation or business entity is in a state other than this state as provided by the taxpayer's books and records kept in the normal course of business. If the taxpayer believes it has overcome the presumption and assigns the sale to a state other than this state based on other credible documentation, the Franchise Tax Board may examine the taxpayer's alternative method to determine if the commercial domicile presumption has been overcome and, if so, whether the taxpayer's alternate method of assignment reasonably reflects the location of the commercial domicile of the corporation or business entity.

(3) If the customer's billing address cannot be determined under subsection (1) or the customer's commercial domicile cannot be determined under subsection (2), then the location of the customer shall be reasonably approximated.

(A). Example. Securities Dealer Corp's books and records kept in the normal course of business do not or do not readily indicate the commercial domicile of its corporate or business entity customers, or Securities Dealer Corp overcomes the presumption in subsection (e)(2)(A). Securities Dealer Corp may reasonably approximate the commercial domicile of its corporate or other business entity customers by assigning those sales to the billing address of the corporate or other business entity customers.

(~~e~~f) Sales from the sale, lease, rental, or licensing of real property are in this state if and to the extent the real property is located in this state.

(~~f~~g) Sales from the rental, lease, or licensing of tangible personal property are in this state if and to the extent the tangible personal property is located in this state.

Example. Railroad Corp is the owner of ten railroad cars. During the year, the total days each railroad car was present in this state was 50 days. The receipts attributable to the use of each of the railroad cars in this state are a separate item of income and shall be determined as follows:

$$\frac{(10 \times 50 =)\ 500 \times \text{Total Receipts}}{(365 \times 10 =)\ 3650} = \text{Receipts Attributable to This State}$$

(~~g~~h) Special Rules.

(1) In assigning sales to the sales factor numerator pursuant to Revenue and Taxation Code section 25136(b), the Franchise Tax Board shall consider the effort and expense required to obtain the necessary information, as well as the resources of the taxpayer seeking to obtain this information, and may accept a reasonable approximation when appropriate, such as when the necessary data of a smaller business cannot be reasonably developed from financial records maintained in the regular course of business.

(A) Example. Misc Corp, a corporation located in this state, provides limited bookkeeping services to clients both within and outside this state. Some clients have several operations among various states. For the past ten (10) years, Misc Corp's only records for the sales of these services have consisted of invoices with the billing address for the client. Misc Corp's records have been consistently maintained in this manner. If the Franchise Tax Board determines that Misc Corp cannot determine, pursuant to financial records maintained in the regular course of its business, the location where the benefit of the services it performs are received under the rules in this regulation, then Misc Corp's sales of services will be assigned to this state using the billing address information maintained by the taxpayer. Misc Corp will not be required to alter its recordkeeping method for purposes of this regulation.

(2) The following special rules shall apply in determining the method of reasonable approximation of the location for the receipt of the benefit of the services or the location of the use of the intangible property:

(A) Once a taxpayer has used a reasonable approximation method to determine the location of the market for the receipt of the benefit of the services or the location of the use of the intangible property, then the taxpayer must continue to use that method in subsequent taxable years. A change to a

different method of reasonable approximation may not be made without the permission of the Franchise Tax Board. Where the Franchise Tax Board has examined the reasonable approximation method and accepted it in writing, the Franchise Tax Board will continue to accept that method, absent any change of material fact such that the method no longer reasonably reflects the market for the receipt of the benefit of the services or the location of the use of the intangible property.

(B) The method of reasonable approximation shall reasonably relate to the income of the taxpayer. For example, if the taxpayer includes in its reasonable approximation methodology countries which are identified in its contracts or its books and records maintained in the normal course of business but for which no sales are made during the taxable years at issue, then the reasonable approximation methodology being used by the taxpayer does not reasonably relate to the income of the taxpayer.

(3) The sales factor provisions set forth in Regulation sections 25137 through 25137-14 are hereby incorporated by reference, with the following modifications for taxable years beginning on and after January 1, 2011:

(A) All references to Revenue and Taxation Code section 25136 and Regulation section 25136 shall refer to Revenue and Taxation Code section 25136, subdivision (b), and Regulation section 25136-2 as they are operative beginning on and after January 1, 2011.

(B) Regulation section 25137(c)1(C) [Special Rules. Sales Factor] shall not be applicable.

(C) The provisions in Regulation section 25137-3 [Franchisors] that relate to the taxpayer being, or not being, taxable in a state shall not be applicable.

(D) The provisions in Regulation section 25137-4.2 [Banks and Financials] that relate to income-producing activity and costs of performance, and throwback, shall not be applicable.

(E) The provisions in Regulation section 25137-12 [Print Media] that relate to a taxpayer not being taxable in another state and the sale's inclusion in the sales factor numerator if the property had been shipped from this state, shall not be applicable.

(F) The provisions in Regulation section 25137-14 [Mutual Fund Service Providers and Asset Management Service Providers] that relate to the taxpayer not being taxable in a state, and assign the receipts to the location of the income-producing activity that gave rise to the receipts, shall not be applicable.

(i) Effective date.

(1) This regulation applies to assignment of sales other than sales of tangible personal property for taxable years beginning on or after January 1, 2011, but only if the taxpayer has made a single sales factor apportionment election, and is applicable for all taxpayers for taxable years beginning on or after January 1, 2013.

(2) The amendments contained in this regulation which includes subsection (a) "In General" clarification of statutory reference, subsection (b)(5) definition of "Marketable securities," subsection (b)(6) definition of "marketable securities" for securities dealers , subsections (c)(2)(E)6 and 7 "Examples" of assignment of asset management fees, subsection (d)(1)(A)1 assignment of "dividends or goodwill," subsection (d)(1)(A)2 assignment of an "interest," and subsections (e)(1), (2) and (3), assignment of "sales of marketable securities" are applicable for taxable years beginning on or after January 1, 2015.

(3) Notwithstanding paragraphs (1) and (2), any taxpayer may elect to have the amendments apply retroactively to taxable years beginning on or after January 1, 2012, but only if those taxable years are open to adjustment under applicable statutes of limitation.

NOTE: Authority cited: Section 19503, Revenue and Taxation Code.
Reference: Section 25136, Revenue and Taxation Code.