

25136-2 -- Summary of October 18, 2013 Interested Parties Meeting

Issues Summary

- (1) What is the definition of the term "marketable securities" as it appears in California Revenue and Taxation Code (RTC) Section 25136(a)(2)?
- (2) What are the rules for assignment of sales of marketable securities under RTC Section 25136(a)(2)?
- (3) How would a taxpayer reasonably approximate assignment of a sale of a minority interest in a corporation or pass-through entity or a sale of an interest in a startup company if the taxpayer did not have available to it the factor information of the underlying corporation?
- (4) How are fees of asset management activities which are not assignable under CCR Section 25137-14 assigned for purposes of CCR Section 25136-2?
- (5) How are dividends assigned for purposes of CCR Section 25136-2?
- (6) How is interest assigned for purposes of CCR Section 25136-2?
- (7) How is goodwill assigned for purposes of CCR Section 25136-2?

Comments Summary

Issue (1)

Definition of "marketable securities."

Comments on issue (1)

Staff stated that a broker-dealer contacted staff and expressed concern that the general definition of "marketable securities" was too narrow for registered broker-dealer type taxpayers. The stakeholder also expressed concern as to how those securities should be assigned. Staff suggested that the solution would probably be a stand-alone definition for registered broker-dealers in order to clarify what receipts are includable in the sales factor for that particular type taxpayer.

A commentator asked if derivatives would be included and the hearing officer responded that hedging transactions are not included as receipts under California Revenue and Taxation Code (RTC) Section 25120. Then the commentator asked if the definition of "marketable securities" in IRC section 475 had been considered. Staff responded that it had, but that the definition was too broad.

Another commentator asked if there was a definition of "security," and staff responded no.

Another question was whether the definition would include mortgage-backed securities. Staff responded that she would research whether or not those type securities were traded on an exchange.

Issue (2)

What are the rules for assignment of sales of marketable securities under RTC Section 25136(a)(2)?

Comments on Issue (2)

A commentator pointed out that in the situation of hedge funds, those securities are sold through the exchange and the hedge fund managers have no idea who the purchaser is. A discussion about the reasonable approximation method of using population outside the U.S. ensued.

Another commentator asked how to source a transaction not on an exchange. Staff responded that then one would look at the general intangible property sourcing rules.

A commentator asked if there was a policy for treating marketable securities differently than non-marketable securities. Staff responded that the Legislature decided that marketable securities should have its own rule and provided such in the underlying statute, although there was nothing in the legislative history of the underlying statute indicating the Legislature's intent in providing a stand-alone provision for marketable securities. Another commentator suggested that the Legislature was focusing on hedge funds. A commentator queried whether that fact should be delineated in the regulation.

A commentator asked if there were a management company LLC which managed hedge funds in California and Florida, would the Florida company be required to file a return in California. Staff responded yes if there were sales to California customers.

Another commentator mentioned that commercial domicile would be difficult to determine in many situations. The response was that assignment would be based on the next cascading rule, reasonable approximation. A commentator suggested that the problem with using population as a reasonable approximation is that it would be limited to U.S. population.

A commentator asked how scientific the department wanted the regulation to be. The response was that we are looking for market distribution. Staff mentioned a Chief Counsel Ruling (for the "on behalf of" regulation amendment to CCR section 25136-2)

where instead of commercial domicile, the taxpayer was allowed to use billing address. Another commentator wanted specific language that allowed a default to billing address.

A commentator asked if the purpose of the regulation was to capture more of Wall Street? Staff responded that it was not.

Issue (3)

How is the sale of an interest in a company assigned by reasonable approximation where the taxpayer may not have available the factor information of the underlying corporation or pass-through entity, such as where a taxpayer has a minority interest or an interest in a startup company?

Comments on Issue (3)

A commentator asked in connection with startup companies why the double threshold was necessary (\$5 million/5 years). The commentator also inquired as to the reason for the need for the receipts limitation.

Another commentator stated that by having a \$5 million rule, problems are avoided. In connection with the 5 year threshold, however, when does the 5 years commence?

A commentator suggested looking to the business premises/commercial domicile as a first cascading rule. Then the commentator asked how does the \$5 million limitation contribute to the 5 years limitation? Staff responded that if you have a young but large company, it is more likely that the young company will have receipts in different places whereas a small company may not be doing much outside of its commercial domicile. The commentator suggested that \$5 million was not a very high threshold. Another commentator stated that \$5 million was based on particular accounting rules.

Issue (4)

How are fees of asset management activities which are not assignable under CCR Section 25137-14 assigned for purposes of CCR Section 25136-2?

Comments on issue (4)

A commentator mentioned that the draft examples for assignment of asset management fees should be located in the business entities section.

Another commentator questioned how securities lending is treated.

Issue (5)

How are dividends assigned for purposes of CCR Section 25136-2?

Comments on issue (5)

No comments were received.

Issue (6)

How is interest assigned for purposes of CCR Section 25136-2?

Comments on issue (6)

A commentator stated that incorporating the CCR Section 25137-4.2 rules of assignment should be done carefully.

Several commentators mentioned that CCR Section 25137-4.2 is geared toward net gain.

Another commentator questioned whether the throw-back rule would be incorporated.

Issue (7)

How is goodwill assigned for purposes of CCR Section 25136-2?

Comments on issue (7)

A commentator asked what rules for reasonable approximation exist for goodwill. Staff responded that for the sale of stock, reasonable approximation rules would apply.

Another commentator suggested that looking at cost basis of intangible property forces a taxpayer into looking at payroll and property. Otherwise, one would get into a valuation issue.

A third commentator suggested not using cost basis for determining the value of goodwill.

A fourth commentator stated that he was unsure how to come up with the right number for that value.

A fifth commentator suggested that fair market value would be the way to value goodwill.

A sixth commentator mentioned that where the value of the company is should be the appropriate rule.