

TITLE 18. FRANCHISE TAX BOARD

As required by section 11346.4 of the Government Code, this is notice that a public hearing has been scheduled to be held at 1:00 p.m., January 13, 2010, at 9645 Butterfield Way, Town Center Golden State Room A, Sacramento, California, to consider amendment of section 25136 under Title 18 of the California Code of Regulations, pertaining to sales of other than tangible personal property.

An employee of the Franchise Tax Board will conduct the hearing. Interested persons are invited to present comments, written or oral, concerning the proposed regulatory action. It is requested, but not required, that persons who make oral comments at the hearing also submit a written copy of their comments at the hearing.

Government Code section 15702, subdivision (b), provides for consideration by the three-member Franchise Tax Board of any proposed regulatory action if any person makes such a request in writing.

Interested are invited to present comments, written or oral, concerning the proposed regulatory action. It is requested, but not required, that persons who make oral comments at the hearing also submit a written copy of their comments at the hearing.

WRITTEN COMMENT PERIOD

Written comments will be accepted until 5:00 p.m., January 13, 2010. All relevant matters presented will be considered before the proposed regulatory action is taken. Comments should be submitted to the agency officer named below.

AUTHORITY & REFERENCE

Section 19503 of the Revenue and Taxation Code authorizes the Franchise Tax Board to prescribe regulations necessary for the enforcement of Part 10 (commencing with section 17001), Part 10.2 (commencing with section 18401), Part 10.7 (commencing with section 21001) and Part 11 (commencing with section 23001) of the Revenue and Taxation Code. The proposed regulatory action interprets, implements, and makes specific section 25136 of the Revenue and Taxation Code.

INFORMATIVE DIGEST/PLAIN ENGLISH OVERVIEW

Taxpayers who have business activities within and without California are required to determine the amount of income properly attributed to activities in California by use of the Uniform Division of Income for Tax Purposes Act (UDITPA), Section 25120 et seq., Revenue and Taxation Code (RTC). Under UDITPA, business income is assigned to a state through the application of a three-factor apportionment formula that separately compares a business' property, payroll and sales within California to those values everywhere. These percentages are then added together, with the sales factor counted twice (see RTC section 25128), and the resulting sum of these four factors is then divided by four. This percentage is then applied to the business income of the taxpayer to determine the percentage of business income attributable to California.

The three-factor apportionment formula was adopted as a way of reflecting the different elements that provide value to a taxpayer's operation in a given state. The payroll factor reflects the amount of labor utilized by the taxpayer in performing its activities in the state. The property factor reflects the amount of capital utilized by the taxpayer in the state. The sales factor reflects the market for the goods or services of the taxpayer in the state. It has been stated that the purpose of the sales factor is "to give weight to the obtaining of markets," balancing to some extent property and payroll factors that favor production or manufacturing states.

The sales factor component of the UDIPTA apportionment formula has two assignment rules. Sales of tangible property are generally assigned to the location of the customer (the "destination" rule contained in RTC section 25135). Sales of other than tangible property are assigned to the jurisdiction where the income-producing activity related to the sale is performed (RTC section 25136).

RTC section 25136 generally provides that where the income-producing activity is performed both in and outside California, the sale will be assigned to California if the greater costs of performance in connection with the income-producing activity are incurred in California. The assignment of sales derived from (1) the provision of services, (2) the sale or rental, leasing, licensing or other use of real property, (3) the rental, leasing, licensing or other use of tangible personal property, and (4) the sale, licensing or other use of intangible personal property, is subject to the income-producing activity rules of the current Regulation section 25136.

Under subsection (b) of current Regulation section 25136, 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."

California's current Regulation section 25136 was adopted from the Multistate Tax Commission's model regulation for the same rule.

In 2006, the Franchise Tax Board issued Legal Ruling 2006-2, which provides that income-producing activities engaged in by members in a combined report on behalf of a taxpayer are includable as activities directly engaged in by the taxpayer for the income-producing activity/cost of performance analysis.

Later in 2006, the Multistate Tax Commission revised its model regulation for this rule and adopted amendments making assignments based upon activities of both the taxpayer and those performed on behalf of the taxpayer. This change was accomplished through a series of amendments. Two of the amendments strike the word "directly" and the words "does not" from the language in the model regulation. Another of the amendments adds additional language to the model regulation setting forth rules for determining the state where activities performed on behalf of a taxpayer are to be assigned.

The Franchise Tax Board proposes to adopt the MTC amendments to its model regulation to include all income-producing activities in the sales assignment process. However, while the Franchise Tax Board proposes to adopt the concept of the amendments to the MTC model regulation, the Franchise Tax Board's proposed

language makes the meaning of the new cascading rules clearer and adds examples to help to explain how the cascading rules work.

DISCLOSURES REGARDING THE PROPOSED REGULATORY ACTION

Mandate on local agencies and school districts: None.

Cost or savings to any state agency: None.

Cost to any local agency or school district which must be reimbursed under Part 7, commencing with Government Code section 17500, of Division 4: None.

Other non-discretionary cost or savings imposed upon local agencies: None.

Cost or savings in federal funding to the state: None.

Significant statewide adverse economic impact directly affecting business including the ability of California businesses to compete with businesses in other states: None.

Potential cost impact on private persons or businesses affected: The Franchise Tax Board is not aware of any cost impacts that a representative private person or business would necessarily incur in reasonable compliance with the proposed action.

Significant effect on the creation or elimination of jobs in the state: None.

Significant effect on the creation of new businesses or elimination of existing businesses within the state: None.

Significant effect on the expansion of businesses currently doing business within the state: None. Corporations have been calculating their sales factor for sales of other than personal property using the cost of performance method; where the greater cost of performance is incurred is where the sale is assigned. The proposed amended Regulation section 25136 would not only simplify the way sales of other than personal property are assigned but would more accurately reflect the sales market for that corporation.

Effect on small business: The regulation is generally utilized by large multinational corporations and not small businesses.

Significant effect on housing costs: None.

CONSIDERATION OF ALTERNATIVES

In accordance with Government Code section 11346.5, subdivision (a)(13), the Board must determine that no alternative considered by it would be more effective in carrying out the purpose for which the action is proposed or would be as effective and less burdensome to affected private persons than the proposed regulatory action.

The proposed regulatory action pertains to corporate taxpayers and therefore does not affect private persons.

AVAILABILITY OF STATEMENT OF REASONS AND TEXT OF PROPOSED REGULATIONS

An initial statement of reasons has been prepared setting forth the facts upon which the proposed regulatory action is based. The statement includes the specific purpose of the proposed regulatory action and the factual basis for determining that the proposed regulatory action is necessary.

The express terms of the proposed text of the regulation, the initial statement of reasons referred to above, and the rulemaking file are prepared and available upon request from the agency contact person named in this notice. When the final statement of reasons is available, it can be obtained by contacting the agency officer named below, or by accessing the Franchise Tax Board's website mentioned below.

CHANGE OR MODIFICATION OF ACTIONS

The proposed regulatory action may be adopted after consideration of any comments received during the comment period.

The regulation may also be adopted with modifications if the changes are nonsubstantive or the resulting regulation is sufficiently related to the text made available to the public so that the public was adequately placed on notice that the regulation as modified could result from that originally proposed. The text of the regulation as modified will be made available to the public at least 15 days prior to the date on which the regulation is adopted. Requests for copies of any modified regulation should be sent to the attention of the agency officer named below.

ADDITIONAL COMMENTS

If you plan on attending or making an oral presentation at the regulation hearing, please contact the agency officer named below.

The hearing room is accessible to persons with physical disabilities. Any person planning to attend the hearing who is in need of a language interpreter or sign language assistance, should contact the officer named below at least two weeks prior to the hearing so that the services of an interpreter may be arranged.

CONTACT

All inquiries concerning this notice or the hearing should be directed to Colleen Berwick at the Franchise Tax Board, Legal Branch, P.O. Box 1720, Rancho Cordova, CA 95741-1720; Telephone (916) 845-3306; Fax (916) 845-3648; E-Mail: Colleen.Berwick@ftb.ca.gov. In addition, all questions on the substance of the proposed regulation can be directed to Melissa Potter; Tel.: (916) 845-7831; E-Mail: Melissa.Potter@ftb.ca.gov. The notice, initial statement of reasons and express terms of the regulation are also available at the Franchise Tax Board's website at www.ftb.ca.gov.