
California – Interested parties meetings for market-based sourcing and apportionment of partnership income

September 27, 2013

In brief

On October 18, 2013, the Franchise Tax Board (FTB) is holding two interested parties meetings (IPMs) -- a second IPM regarding possible amendments to its market-based sourcing regulation and a second IPM concerning amendments to its regulation concerning the apportionment and allocation of partnership income and certain items of income that are unique to the asset management industry.

Affected California taxpayers should review the proposed regulatory amendments to identify significant issues. Taxpayers should also consider attending either meeting to provide input or voice concerns. The FTB requests that businesses intending to attend either meeting should RSVP by October 16, 2013.

In detail – Market-based sourcing meeting

The FTB's October 18, 2013, IPM will include a discussion regarding the treatment of sales of services and intangible property not previously addressed in California Code of Regulations Section (Regulation) 25136-2, which provides a market-based approach for assignment of sales other than sales of tangible personal property to the sales factor. Key proposed amendments to the regulation include the following.

Marketable securities

Revenue and Taxation Code Section 25136 provides that sales of marketable securities are in California if the customer is in California. However, the existing regulation does not address how to determine the location of the customer. The proposed amendment provides that if the customer is an individual, the sale shall be assigned to the customer's billing address. If the customer is a business entity, the sale is assigned to the customer's commercial domicile. The FTB intends to explore possible examples at the IPM.

Asset management fees

Existing Regulation 25137-14 provides shareholder-based sourcing rules for assigning fees from asset management services, but those rules arguably only apply to taxpayers that provide services to a regulated investment company.

Proposed amendments to Regulation 25136-2 add two examples that essentially extend similar sourcing rules to asset management fees that do not fall within Regulation 25137-14. Under the new examples, an asset manager providing services to pension plans, retirement accounts, and

other investment accounts contracts with a third-party to provide such services 'on behalf of' the shareholders, beneficial owners, and investors. The services are assigned to the domicile of the shareholders, beneficial owners, and investors because they are the parties deemed to be receiving the benefit of these services. If the taxpayer cannot reasonably approximate the domicile of those parties, the receipts are thrown out and disregarded in the sales factor.

Sale of a minority interest in a corporation or pass-through entity (including a startup)

Under the existing regulation, receipts from sale of an entity interest are assigned to the location where the entity operates, measured by either its sales factor, or by its average property and payroll.

The proposed amendments provide rules for reasonably approximating factor information in situations where the taxpayer does not have access to the entity's sales, property, or payroll data.

An entity's sales factor may be 'reasonably approximated' by using a ratio of a taxpayer's ownership interest. In other words, if a taxpayer owns 20% of an entity, the entity's sales factor is approximated to be 20%. Accordingly, 20% of the receipts from the sale of the taxpayer's ownership interest in the entity will be assigned to California.

Interest, dividends, and goodwill

The proposed amendments state that gross receipts attributable to interest, dividends and goodwill are sourced in the same manner as sales of an

interest in a corporation or pass-through entity. However, there is no further explanation in the draft regulation to explain how to implement this guidance or how to treat passive items of income.

Additional reading

- [Second Interested Parties Meeting Notice](#)
- [Discussion Draft of Proposed Changes to CCR Section 25136-2](#)
- [FTB's Explanation of Discussion Draft](#)
- [Summary of March 2013 Interested Parties Meeting](#)

In detail –Partnership regulation meeting

FTB's October 18, 2013, IPM will include a discussion concerning amendments to Regulation 25137-1, *Apportionment and Allocation of Partnership Income*, and associated provisions of Regulations 17951-4 and 25137-2 to:

- clarify the treatment of distributive share items from non-unitary partnerships
- address tiered partnerships
- address indirect ownership of business assets
- address intercompany sales between partners and partnerships
- address special allocation of partnership interests
- address variations in taxable years between partners and partnerships
- clarify sales factor treatment of partnership interests

- eliminate duplicate long-term contract provisions
- integrate personal and corporate income tax rules
- clarify the application of safe harbor rules in Regulation 17951-4

Issues raised by the proposed amendments include:

- How to assign factors to a unitary partner whose 'partnership interest' may differ from its share of current income. A related issue may arise when certain items of income are allocated differently than other ordinary items (e.g., carried interest). Does a taxpayer create different allocation percentages for flowing up factors?
- Whether clarification is needed regarding the potential deferral of intercompany income resulting from sales between a partner and a partnership.

Additional reading

- [Second Interested Parties Meeting Notice](#)
- [Discussion Topics for October 18, 2013 meeting](#)

The takeaway

Affected California taxpayers should review the proposed regulatory amendments to identify significant issues should they consider attending either meeting to provide input or voice concerns.

Let's talk

For more information about either IPM, please contact:

State and Local Tax Services

Ligia Machado
Partner, *Sacramento*
+1 (916) 930-8260
ligia.l.machado@us.pwc.com

Jon Sperring
Principal, *Sacramento*
+1 (916) 930-8204
jon.a.sperring@us.pwc.com

Derick Brannan
Managing Director, *Sacramento*
+1 (916) 930-8253
derick.j.brannan@us.pwc.com

Kathy Freeman
Managing Director, *Sacramento*
+1 (916) 930-8408
kathy.freeman@us.pwc.com

State and Local Tax Services - Asset Management

Brian Rebhun
Principal, *New York*
+1 (646) 471-4024
brian.rebhun@us.pwc.com

Sam Melehani
Partner, *Los Angeles*
+1 (213) 356-6900
sam.melehane@us.pwc.com

Eran Liron
Partner, *San Jose*
+1 (408) 817-3937
eran.j.liron@us.pwc.com

Alan Bollinger
Director, *Sacramento*
+1 (916) 930-8203
alan.d.bollinger@us.pwc.com