REQUEST FOR PERMISSION TO PROCEED WITH FORMAL REGULATORY PROCESS TO ADOPT AMENDMENTS TO CALIFORNIA CODE OF REGULATIONS, TITLE 18, SECTION 17951-5, AND TO ADOPT A NEW REGULATION AT CALIFORNIA CODE OF REGULATIONS, TITLE 18, SECTION 17951-8.

Introduction And Background

California Revenue and Taxation Code ("RTC") section 17951 provides that nonresident individuals are only subject to California income tax on "gross income from sources within this state." When nonresident individuals operate a unitary business, trade, or profession as a sole proprietor within and without California, their California source income is determined using California's market-based sourcing rules.

Franchise Tax Board (FTB) staff's proposed regulatory amendments to Title 18 of the California Code of Regulations at Section 17951-5 and proposed new regulation at Section 17951-8, ("Proposed Regulatory Action") would clarify (i) the applicability of California's market-based sourcing rules to nonresident directors' nonemployee compensation from corporations, and (ii) that only employee compensation of nonresident individuals is sourced to California based on whether employee performance occurred in California. FTB staff's Proposed Regulatory Action is consistent with the FTB's sourcing guidance in Chief Counsel Ruling 2019-03 on this same issue, and California's market-based sourcing rules in effect since the passing of Proposition 39 in 2012.

Interested Parties Meetings

FTB staff held its first Interested Parties Meeting ("IPM") on October 8, 2020. At the IPM FTB staff explained the purpose of the Proposed Regulatory Action and took public comment. The public responded positively to the Proposed Regulatory Action.

Request for Permission

FTB staff believes that the Proposed Regulatory Action provides appropriate criteria and guidance for determining "gross income from sources within this state" as provided in RTC section 17951, and now requests the Board's permission to commence the formal regulatory process under the Administrative Procedure Act.