

NOTE: This paper is intended only for purposes of facilitating discussion at the Interested Parties Meeting scheduled for November 8, 2023.

DISCUSSION TOPIC PAPER

The purpose of the Interested Parties Meeting ("IPM") is to discuss whether defining the term "beneficial owner" within California Code of Regulations, title 18, section 25137-14, *Mutual Fund Service Providers and Asset Manager Service Providers*, ("Regulation 25137-14") is necessary.

Regulation 25137-14 was promulgated in 2007 in order to provide a special apportionment formula to taxpayers who provide services to mutual funds. Prior to the promulgation of Regulation 25137-14, mutual fund service providers ("MFSPs") successfully petitioned the Franchise Tax Board for an alternative apportionment methodology, pursuant to California Revenue and Taxation Code ("R&TC") section 25137. The MFSPs contended that the normal apportionment factor rules for the sales factor did not reflect the market for their services, but simply assigned most of their receipts to their home state based on the activities of their employees. As a result, Regulation 25137-14 was promulgated to provide all taxpayers in the mutual fund industry with the same shareholder apportionment methodology approved by the Board through the R&TC section 25137 petition process.

Regulation 25137-14 defines MFSP as "any unitary business that derives income from the direct or indirect provision of management, distribution, or administration services to or on behalf of a regulated investment company ["RIC]." It also defines MFSPs' provision of the same services to non-RICs as "asset management services." (Cal. Code Regs., tit. 18, § 25137-14, subd. (a)(7).)

Pursuant to the regulation, receipts from MFSPs' management, administrative, and distribution services to or on behalf of a RIC are sourced by reference to each RIC's shareholders' domicile. (Cal. Code Regs., tit. 18, § 25137-14, subd. (b)(1)(A) and (A)1.) When a shareholder's domicile is unknown, Regulation 25137-14 uses a reasonable basis "to determine the proper location for the assignment of these shares." (*Ibid.*) If a reasonable basis cannot be developed, then "all of the shares held by the shareholder of record shall be disregarded in computing the shareholder ratio for the fund in issue." (*Ibid.*)

Regulation 25137-14 also sources receipts from MFSPs' "asset management services" to California to the extent the domicile of the assets' beneficial owner is in California. (Cal. Code Regs., tit. 18, § 25137-14, subd. (b)(1)(B).) In pertinent parts, it states:

1. In the case of asset management services directly or indirectly provided to a pension plan, retirement account or institutional investor, such as private banks, national and international private investors, international traders or insurance companies, receipts shall be assigned to this State to the extent the domicile of the beneficiaries of the plan, beneficiaries of the account or beneficiaries of the similar pool of assets held by the institutional investor, is in California. If the individual domiciles of the beneficiaries are not available, a mutual fund service provider may utilize any reasonable basis in

order to determine the domiciles of the individual beneficiaries, including information based on zip codes or other statistical data.

2. In the event the domicile of the beneficiaries is not or cannot be obtained, and the taxpayer cannot devise a reasonable method to approximate this information, the receipts shall be disregarded for purposes of the sales factor.

(Cal. Code Regs., tit. 18, § 25137-14, subd. (b)(1)(B)1. and 2.)

The Franchise Tax Board now requests the public's input whether defining the term "beneficial owner" within Regulation 25137-14" is necessary.