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LEGAL DIVISION MS A260
FRANCHISE TAX BOARD
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**NOTICE OF MODIFICATIONS TO TEXT OF PROPOSED REGULATION SECTION 25136-2 IN
TITLE 18 OF THE CALIFORNIA CODE OF REGULATIONS RELATING TO SALES OTHER THAN
SALES OF TANGIBLE PERSONAL PROPERTY AND NOTICE OF PUBLIC HEARING**

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On September 13, 2024, the Franchise Tax Board ("FTB" or "the Board") published a Notice of Proposed Rulemaking in the California Regulatory Notice Register in accordance with section 11346.4 of the Government Code, providing notice to the public of the FTB's intention to amend portions of Title 18 of the California Code of Regulations at section 25136-2 ("Regulation"), relating to sales other than sales of tangible personal property. The Notice of Proposed Rulemaking provided the public with an opportunity to submit written comments on the proposed amendments to the Regulation until 5:00 p.m. on October 31, 2024. The Notice of Proposed Rulemaking also provided the public with an opportunity to request a public hearing if the request was received no later than fifteen (15) days before the close of the written comment period. Requests for a public hearing by interested parties were received by FTB prior to fifteen (15) days before the close of the written comment period. Accordingly, a public hearing date has been scheduled, with further details of the public hearing provided below.

Additionally, FTB staff has reviewed the proposed amended regulation language and determined that modifications are necessary, as identified below. Each substantive and sufficiently related change to the proposed amended Regulation is followed by an explanation. In addition, nonsubstantive changes in subsections (c)(1)(A), (c)(1)(A)2., (c)(1)(B), (c)(1)(F)1., (c)(1)(F)2., (c)(1)(F)4., (c)(1)(F)5., (c)(1)(F)6., (c)(1)(F)7., (c)(1)(F)8., (c)(1)(F)9., (c)(2), (c)(3), (c)(3)(A)2., (d)(1), (d)(1)(A)1.b., (d)(1)(D)1., (d)(1)(D)2., (d)(2)(D)8., (d)(2)(D)9., (f)(1), (f)(4), (g), (h), (i), (i)(1)(A), (i)(2)(C), (j), and (j)(2) were made to correct minor grammatical and formatting errors in order to clarify the language of the Regulation.

Pursuant to the requirements of Government Code section 11346.8(c), and section 44 of Title 1 of the California Code of Regulations, the FTB is hereby providing notice of the modifications made to the proposed Regulation. These new modifications to the proposed amended regulation text are detailed below, and appear in double underline for new additions, and ~~double-strikeout~~ for new deletions. Previously proposed amendments to the Regulation remain in single underline and ~~single-strikeout~~.

MODIFICATIONS TO TEXT OF PROPOSED REGULATION

1. Section 25136-2 Heading:

§ 25136-2. Sales Factor. Sales Other than Sales of Tangible Personal Property in ~~This is~~ State.

FTB staff modified the proposed Regulation's heading to correct a grammatical error which read "in this is State." This modification removes the unnecessary "is" and capitalizes "this" since it is part of the proposed Regulation's title.

2. Section 25136-2(b)(5) Reference to Assignment Rules Updated:

The sixty (60) percent ownership interest sold is subject to assignment under subsections (d)(1)(A)1.a. ~~through f and b.~~

FTB staff modified the reference to "under subsections (d)(1)(A)1.a. and b." for the assignment rules for the complete transfer of property rights in intangible property to reference the proposed Regulation's new assignment rules for this type of sale which are provided under "subsections (d)(1)(A)1.a. through f."

3. Section 25136-2(c)(1)(E) Reference to Paragraph (D) Revised:

(E) Notwithstanding subparagraph (D), for services provided under U.S. government contracts, if the sale cannot be assigned pursuant to the method and substantiation rules under subsection (c)(1)(A), (B), or (C), such as when a contract cannot be disclosed and no information about the service is publicly available, then the benefit of the service is deemed received by the fifty (50) states of the United States.

In order to make all of the proposed Regulation's references to paragraphs and subparagraphs within the proposed Regulation consistent, FTB staff modified the reference from "paragraph (D)" to "subparagraph (D)."

4. Section 25136-2(c)(2) Reference to Subdivision (c)(1) Revised:

(2) Notwithstanding ~~subdivision~~ subsection (c)(1), when gross receipts are from asset management services, but are not subject to Regulation section 25137-14, the benefit of the asset management services is received at the domiciles of the investors in the assets unless the investor is holding title to the assets for a beneficial owner.

In order to make all of the proposed Regulation's references to other parts of the proposed Regulation consistent, FTB staff modified the reference from "subdivision (c)(1)" to "subsection (c)(1)."

5. Section 25136-2(c)(3) Reference to Subdivision (c)(1) Revised:

Notwithstanding ~~subdivision~~ subsection (c)(1), if the taxpayer provides services to more than 250 customers in any single professional service as listed in subsection (b)(9), then gross receipts from such services shall be assigned to the customer's billing address.

In order to make all of the proposed Regulation's references to other parts of the proposed Regulation consistent, FTB staff modified the reference from "subdivision (c)(1)" to "subsection (c)(1)."

6. Section 25136-2(c)(3)(A)1. Reference to Subdivision (c)(1) Revised:

Audit Corp shall assign its receipts from legal services according to the methodology prescribed in ~~subdivision~~subsection (c)(1) of this regulation.

In order to make all of the proposed Regulation's references to other parts of the proposed Regulation consistent, FTB staff modified the reference from "subdivision (c)(1)" to "subsection (c)(1)."

7. Section 25136-2(c)(3)(A)3. Deleted:

~~3. Assignment for large volume services, subsection (c)(3). Preparer Corp provides income tax preparation services to its clients, and has over 250 tax preparation customers. Occasionally, Preparer Corp represents a client in an income tax controversy matter with a state revenue agency, typically stemming from Preparer Corp's tax preparation services. Preparer Corp has less than 250 customers for its income tax controversy services. Preparer Corp shall assign its receipts from tax preparation services to the customer billing address. Preparer Corp shall assign its receipts from tax controversy matters according to the methodology prescribed in subdivision (c)(1) of this regulation.~~

During review of the proposed Regulation text, FTB staff discovered that Example 3 above was not deleted from the text as specifically provided for in the Initial Statement of Reasons. The text is now being modified to show that Example 3 has been deleted from the proposed Regulation.

8. Section 25136-2(d)(1)(A)1.a. Added Language from Current Regulation:

a. ~~In the event that~~ fifty (50) % or more of the amount of the assets of the corporation or pass through entity sold, determined on the date of the sale and using the original cost basis of those assets, consist of real and/or tangible personal property, the sale of the stock or ownership interest will be assigned by averaging the payroll and property factors of the corporation or pass through entity in this state for the most recent twelve (12) month taxable year prior to the time of the sale to the extent indicated by the taxpayer's books and records kept in the normal course of business.

During review of the proposed Regulation text, FTB staff discovered that the "In the event that" language shown above - which now is modified to appear in double underline and double strikeout should have been included in this paragraph and shown as removed in the originally proposed Regulation text. This language is included in the current Regulation text within that paragraph and was inadvertently omitted in the proposed Regulation text.

9. Section 25136-2(d)(1)(A)1.f.iii. Added Word "Tax":

Sales in this state shall be determined using the rules for assigning sales under Revenue and Taxation Code sections 25135 and 25136, inclusive, and the regulations thereunder, as modified by Regulation sections 25137 through 25137-15, without regard to whether the entity was required to report a sales factor on a California franchise tax return.

During review of the proposed Regulation text, FTB staff discovered the text inadvertently omitted the word "tax". FTB staff modified the text to include "tax" as the provision was intended to reference the California franchise tax return.

10. Section 25136-2(e)(2) Deleted (A) Lettering:

~~(A) Example: Social Media Corp purchases ten computers, along with two hours of information technology maintenance service, from Computer Corp pursuant to contract.~~

In order to make all singular examples formatted consistently throughout the proposed Regulation, FTB staff modified the text to remove the letter "(A)" from before the word "Example".

11. Section 25136-2(e)(3) Reference to "This Subparagraph" Revised:

~~(3) For purposes of this subparagraph, the value of gross receipts attributable to tangible personal property includes all of the charges enumerated in Regulation section 25134(a)(1)(A).~~

In order to make all of the proposed Regulation's references to paragraphs and subparagraphs within the proposed Regulation consistent, FTB staff modified the reference from "this subparagraph" to "this paragraph."

12. Section 25136-2(f)(4) Added Missing Language from Current Regulation and Correcting Erroneous Addition in Proposed Regulation Text:

~~(A) Example: Securities Dealer Corp sells marketable securities as a principal for its own account. Securities Dealer Corp's books and records kept in the normal course of business do not or do not readily indicate the commercial domicile of its corporate or business entity customers that purchase the marketable securities from Securities Dealer Corp, or Securities Dealer Corp overcomes the presumption in subsection (e)(3)(A), that purchase the marketable securities. Securities Dealer Corp may reasonably approximate the commercial domicile of its corporate or other business entity customers by assigning those sales to the billing address of the corporate or other business entity customers.~~

During review of the proposed Regulation text, FTB staff noticed that language from the current Regulation showing "(e)(2)(A)" was missing from the proposed Regulation text. FTB inadvertently excluded the "(2)" from the proposed Regulation text. Therefore, FTB staff modified the text by adding the missing "(2)" using double underline, and since this subsection was deleted in the proposed Regulation text, the "(2)" is now represented as deleted by double strikeout.

Additionally, FTB inadvertently added the phrase "~~that purchase the marketable securities~~", appearing in single strikeout, to the proposed Regulation text. However, this phrase should not have been included in the proposed Regulation text because this language is not in the current Regulation. Therefore, the phrase "~~that purchase the marketable securities~~" is now removed as modified.

13. Section 25136-2(i)(2)(C) Reference to Paragraph (A) Revised:

~~(C)-(A) Notwithstanding subparagraph (A),~~ Once a taxpayer has used a reasonable approximation method to determine the location of the market for the receipt of the benefit of the services or the location of the use of the intangible property, or the location of the customer for sales from marketable securities, then the taxpayer must continue to use that method in subsequent taxable years.

In order to make all of the proposed Regulation's references to paragraphs and subparagraphs within the proposed Regulation consistent, FTB staff modified the reference from "paragraph (A)" to "subparagraph (A)."

14. Section 25136-2(j)(2) Added Reference to Subsection (f)(4) Which is Referenced in Current Regulation at its Former Numbering as Subsection (e)(3):

(2) The amendments contained in this regulation which includes subsection (a) "In General" clarification of statutory reference, subsection (b)(~~75~~) definition of "Marketable securities," subsection (b)(~~86~~) definition of "marketable securities" for securities dealers, ~~subsections (c)(2)(E)6 and 7 "Examples" of assignment of asset management fees,~~ subsection (d)(1)(A)1~~2~~, assignment of "dividends or goodwill," subsection (d)(1)(A)2~~3~~, assignment of an "interest," and subsections (f)(~~e~~)(1), (2), ~~and (3), and (4)~~ assignment of "sales of marketable securities" are applicable for taxable years beginning on or after January 1, 2015.

During review of the proposed Regulation text, FTB staff noticed that the proposed Regulation's reference to subsections "(f)(1), (2), and (3)" was inadvertently missing a reference to subsection (f)(4), when it was intended to be included since all of these subsections govern assignment of "sales of marketable securities." Subsection (f)(4) in the proposed Regulation was renumbered and updated from the current Regulation's subsection (e)(3). Therefore, FTB staff modified the text to add subsection (f)(4) as one of the subsections governing assignment of sales of marketable securities under this applicability date provision.

15. Section 25136-2(j)(3) Changed Applicability Date:

(3) The amendments to this regulation filed with the Secretary of State on [insert date here] are applicable to taxable years beginning on or after January 1, ~~2024~~2025.

Given the number of comments received by interested persons during the written comment period, upon review of the proposed Regulation text FTB staff modified the date so the amendments to the Regulation will be applicable to tax years beginning on or after January 1, 2025.

PUBLIC HEARING

Pursuant to the requirements of Government Code Section 11346.8(a) a public hearing is scheduled to be held at 10:00 a.m. on January 30, 2025, at 9645 Butterfield Way, Town Center, Gerald H. Goldberg Auditorium, Sacramento, California.

An employee of the FTB will conduct the hearing to allow for comments on the proposed amendments to the Regulation as detailed in the Notice of Proposed Rulemaking and this Notice of Modifications to Text of Proposed Regulation Section 25136-2 in Title 18 of the California Code of Regulations Relating to Sales Other Than Sales of Tangible Personal Property. Interested persons are invited to present comments, written or oral, concerning the proposed regulatory action and may participate in person at the address provided above or by telephone. 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.

To participate telephonically:

- Dial 844-767-5651 and use access code: 8835965 when prompted.
- Once you join, the moderator will request your name.
- After each discussion topic, the facilitator will invite the public to provide oral comments.
 - At the moderator's prompt, if you would like to comment, push 1 then 0 to speak on your phone.
 - You will be placed in a queue and will be prompted when it is your turn to speak.
- When you begin public comment, state your name and who you represent (if applicable).
- When you are done, you may continue to stay on the line or leave the meeting.

WRITTEN COMMENT PERIOD

Any interested person, or their authorized representative, may submit written comments relevant to the proposed regulatory action to the FTB either at the public hearing or within the written comment period. The written comment period closes at **5:00 p.m. on February 5, 2025**. The FTB will consider only comments received at the FTB offices by that time. The FTB encourages submission of written comments in electronic form, rather than in paper form. Comments may be submitted by email to FTBRegulations@ftb.ca.gov.

Comments in paper form may be submitted to:

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