

MEMO# 22059

December 28, 2007

California Franchise Tax Board Will Consider Whether Sales Factor Should Include Agents' Activities

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TO: ADVISER DISTRIBUTOR TAX ISSUES TASK FORCE No. 23-07
TAX MEMBERS No. 62-07 RE: CALIFORNIA FRANCHISE TAX BOARD WILL CONSIDER
WHETHER SALES FACTOR SHOULD INCLUDE AGENTS' ACTIVITIES

The California Franchise Tax Board ("FTB") is considering amending Regulation 25136 to include agents' activities in the definition of "income producing activity" for purposes of assigning income to its sales factor numerator. The proposed amendment would reflect the Multistate Tax Commission's ("MTC") recent changes to its model regulations.

Regulation 25136 assigns sales of intangible property to the sales factor numerator based on where the income producing activity is performed. Currently, the term "income producing activity" in Regulation 25136 includes only "activity directly engaged in by the taxpayer in the regular course of its trade or business." The term does not include "transactions and activities performed on behalf of the taxpayer, such as those conducted on its behalf by an independent contractor."

In 2006, the California FTB ruled that the sales factor numerator includes subcontractor activities if a contractor and a subcontractor are in the same unitary group. The FTB reasoned that subcontractors in a unitary group are not independent contractors; including such subcontractor activities in the sales factor numerator does not violate Regulation 25136. The FTB ruled that the inclusion of subcontractor activities more accurately assigns

receipts to the place where services are performed for unitary groups.

In August 2007, the MTC approved amendments to its model Regulation IV.17, which is almost identical to California's Regulation 25136. The MTC's revised regulation now assigns sales to the sales factor numerator based on the activities of both the taxpayer and the taxpayer's agents and independent contractors. The revised MTC regulation provides rules for determining whether the activities of independent contractors are assigned to California, assigned to another state or disregarded.

The FTB has scheduled an interested parties meeting on January 9, 2008 to discuss whether and to what extent California should adopt the MTC regulation. The FTB also is soliciting comments regarding any other possible changes to Regulation 25136. Information regarding the interested parties meeting is located at http://www.ftb.ca.gov/law/intParty/ipmtg_010908_130PM.pdf. Go to http://www.ftb.ca.gov/law/intParty/ipmtgTopics_010908_130PM.pdf to read background materials related to the proposed changes.

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