

Upcoming Franchise Tax Board Interested Parties Meeting - California Market Sourcing Rules for Asset Managers

The California Franchise Tax Board (FTB) is holding an Interested Parties Meeting (IPM) on January 20, 2017 to solicit public input on possible proposed amendments to California's market sourcing regulation. Among the topics to be discussed are market-based sourcing rules specifically applicable to asset management service revenue received by managers who are *not* providing services to regulated investment companies (RICs), also commonly referred to as mutual funds, and changes to the rules for sourcing dividend and interest income. Asset managers who may be impacted by these potential changes should consider participating in the IPM by telephone or attending in person. Instructions for attending are contained in the [FTB announcement](#). Note that anyone planning to attend in person is asked to RSVP by January 13, 2017. The FTB's description of the topics to be discussed is also [posted online](#).

Background

Asset Management Fees

The last amendments to California's market sourcing regulations were finalized on September 15, 2016. This [Deloitte Tax External Alert](#) summarizes these regulations. Those amendments did not include two examples regarding the sourcing of asset management revenue that had been included in prior drafts of the regulations but were removed on December 29, 2015. A summary of the two deleted examples can be found in this [Deloitte Tax External Alert](#). The FTB is soliciting public comment on including the examples in possible new amendments to the regulations. Generally, the examples are modeled on California's rules applicable to managers of RIC's and provide for a "look through" approach to sourcing asset management revenue. Under this approach, asset managers source management fee revenue to the residence or commercial domicile of the investors in funds under management. Coupled with California's economic nexus rules, the look through approach may cause out of state asset managers providing services to funds with California investors to be subject to California taxation even though the fund manager does not have physical presence in the state.

Dividends

The regulations finalized last October source dividends treated as business income to California based on the level of the payer's activity in the state. In practice, this approach is difficult to apply because dividend recipients are often unable to obtain information regarding the payer's California activities. The FTB is inviting the public to provide additional input on dividend sourcing for possible changes to the existing regulation, including taking dividends out of the sales factor.

Interest

The existing regulations source interest income on loans to business entities that are not secured by real estate to the commercial domicile of the borrower. The FTB is seeking public comment on how interest income should be sourced.

If you have questions regarding the IPM or other California tax matters, please contact any of the following Deloitte Tax professionals:

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