

## MAJOR REGULATIONS STANDARDIZED REGULATORY IMPACT ASSESSMENT SUMMARY

DF-131 (NEW 11/13)

### STANDARDIZED REGULATORY IMPACT ASSESSMENT SUMMARY

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<p>1. Statement of the need for the proposed major regulation.</p> <p>The purpose of amending California Code of Regulations (Regulation), Title 18, section 25136-2 is to seek to improve compliance with and administrability of Regulation 25136-2 by providing specific sourcing rules for certain industries and through simplifying amendments to the Regulation. This is done by clarifying the sourcing rules for sales other than sales of tangible personal property. The clarifications primarily impact sourcing for sales of professional services, as defined. Furthermore, the amendments also add simplifying rules used to identify whether the benefit of a service is received in California as well as rules for asset management services to be sourced to the domicile of the investor, or the domicile of the beneficial owner of the assets should the investor be holding the title. It also defines the term “customer” for purposes of assigning sales derived from marketable securities.</p>		
<p>2. The categories of individuals and business enterprises who will be impacted by the proposed major regulation and the amount of the economic impact on each such category.</p> <p>Any taxpayer who does business both within and without California would be an apportioning business and could be subject to the changes proposed to this regulation. Because the proposed amendments primarily affect the the calculation of the sales factor for professional services, as defined, the FTB staff expects the amendments to primarily impact large corporations. But, some small businesses with services sourced within and without California could be affected as well.</p> <p>It is not known whether then net impact from these adjustments would produce an increase or a decrease in state revenues. As a result, the estimated economic impact range of this regulation would fall between a loss of up to \$110 million and a gain of up to \$108 million in the first full year of implementation.</p>		
<p>3. Description of all costs and all benefits due to the proposed regulatory change (calculated on an annual basis from estimated date of filing with the Secretary of State through 12 months after the estimated date the proposed major regulation will be fully implemented as estimated by the agency).</p> <p>It is unclear if there would be any material changes in costs for the FTB or the taxpayer. The FTB expects the costs changes associated with audits, protests, and hearings held by the Office of Tax Appeals to be nominally less. Because this regulation is currently in effect and the proposed amendments are intended to provide clarity on how to assign sales other than sales of tangible personal property, the FTB expects many taxpayers to make minor changes to their sales tracking processes. However, there may be some taxpayers who incur more than minor expenses to implement the changes in sourcing rules proposed in this Regulation, but it is expected to be insignificant and the cost is unknown.</p>		
<p>4. Description of the 12-month period in which the agency estimates the economic impact of the proposed major regulation will exceed \$50 million.</p> <p>The FTB estimates that the first 12-month period in which the economic impact could exceed \$50 million is fiscal year 2024-2025 and could be a gain of up to \$116 million or a loss of \$117 million.</p>		

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### 5. Description of the agency's baseline:

The baseline assumption is that, absent the proposed regulation, taxpayers and tax practitioners would continue to have difficulty applying the cascading rules associated with the current regulation.

### 6. For each alternative that the agency considered (including those provided by the public or another governmental agency), please describe:

- a. All costs and all benefits of the alternative
- b. The reason for rejecting alternative

No alternative regulations were proposed during the six stakeholder meetings held over the prior five years. Therefore, the FTB analyzed two alternatives. The first was to maintain Regulation 25136-2 as written today and second was to nest the additional professional services rules within the current Regulation 25136-2.

Benefit: There is no benefit to the state from either alternative. The first provides no additional guidance and the second could complicate an already complex set of rules and could lead to further confusion.

Cost: There would be no clear material change in administrative costs for either of the proposed alternatives. The FTB expects the costs associated with audits, protests, and hearings held by the Office of Tax Appeals to continue to be the same as they are today.

Conclusion: Both alternatives were rejected because they did not improve the taxpayer's ability to comply with the law nor did they improve the FTB's ability to administer the law. This is because the first would not provide any additional clarity how to assign sales from services and sales from intangible property. The second because it would not improve the taxpayer's ability to comply with the law does it improve the FTB's ability to administer the law.

### 7. A description of the methods by which the agency sought public input. (Please include documentation of that public outreach).

The FTB held its first Interested Parties Meeting (IPM) on January 20, 2017. The public was asked to provide input and comments on the proposed amendments to the regulation. Staff explained the purpose of the proposed regulation changes and the public responded positively to receiving additional guidance by way of amendments to the regulation. Numerous topics were discussed, including whether the regulation should address asset management services, government services contracts, reasonable approximation as a sourcing methodology, as well as a discussion of proper sourcing methodology for several other service industries. The FTB held its second IPM on June 16, 2017, and then later its third on May 18, 2018. Additional meetings were held on July 19, 2019, July 21, 2020, and the last was held on June 4, 2021. At each of these meetings, staff presented new draft language and accepted public comments. Summaries of each IPM are available on FTB's public website.

### 8. A description of the economic impact method and approach (including the underlying assumptions the agency used and the rationale and basis for those assumptions).

This economic impact analysis is based on changes over a 12-month period and depends on the timing of payments made by apportioning taxpayers who have sales other than sales of tangible personal property. Because of the complexities associated with the current regulation, the methodology the taxpayer currently uses to determine the source of sales other than sales of tangible personal property cannot be determined from the information reported. As a result, the proposed amendments could cause the taxpayer's apportionment factor to increase, decrease, or remain unchanged. Although the exact change is unknown the FTB's experts believe that the apportionment factor would increase or decrease by no more than 20 percent. It is assumed that because estimated payments are often made four times a year, April, June, September, and January, that the first payment affected would be the April payment. To arrive at the final economic impact the direct revenue impact was grown beyond the first year of implementation and regional multipliers were applied to the results.

Agency Signature

Justyn Howard

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