

Income/Franchise:

California FTB Addresses Sourcing Gross Receipts from Sales of Services to Business Entities

Legal Ruling 2022-01, Cal. FTB (3/25/22). The California Franchise Tax Board (FTB) issued a new legal ruling (Legal Ruling 2022-01) addressing the “relevant considerations and proper analysis” for determining the assignment of gross receipts from the sales of services pursuant to California Revenue and Taxation Code section 25136(a)(1), as supplemented by California Code of Regulations, title 18, section 25136-2, under three distinct fact patterns. In doing so, the FTB generally explains that the analysis requires addressing the following four questions and then applying the fact-based answers to California’s “cascading rules,” as applicable:

URL: <https://www.ftb.ca.gov/tax-pros/law/legal-rulings/2022-01.pdf>

1. Who is the customer?
2. What is the service being provided by the taxpayer?
3. What is the benefit of the service received by the customer?
4. Where is the benefit of the service being received?

Regarding the first question, the guidance states that “it is always the value to the taxpayer’s customer that is analyzed and not the value provided to any other party,” and that a “common misconception” in analyzing where gross receipts from the performance of a service should be assigned occurs when a benefit from the taxpayer’s service is received by a third party and then this benefitted third party is wrongly “assumed to be the taxpayer’s customer for purposes of the analysis.” Regarding the third question, the guidance states that “[u]sually, the value of the service is the direct effect of the action or function being performed.” Regarding the fourth question, the guidance explains that when the value of the service is the direct effect of the action or function being performed, “the location of the benefit will be where the direct effect impacts the taxpayer’s customer.” Furthermore, the guidance provides that when a service provided by the taxpayer is directed at the customer’s customer(s), “the benefit received by the customer is likely located at the customer’s customer(s)’ location,” and that “this is most common when the taxpayer’s services directly engage or principally concern the customer’s customer(s).” Specifically, the guidance explains that for subcontracting arrangements by a business entity with a corporate subcontractor, the benefit may be located at the customer’s customer’s location, because the service provided is directed towards persons or things other than the subcontractor’s customer.

The FTB notes that in issuing Legal Ruling 2022-01, it revokes Chief Counsel Rulings 2015-03 and 2017-01, and that to the extent Legal Ruling 2022-01 conflicts with any other prior FTB guidance, Legal Ruling 2022-01 “shall supersede such guidance.”

See forthcoming Multistate Tax Alert for more details on this new ruling, including some related taxpayer considerations, and please contact us with any questions in the meantime.

— Roburt Waldow (Minneapolis)
Principal
Deloitte Tax LLP
rwaldow@deloitte.com

Shirley Wei (Los Angeles)
Senior Manager
Deloitte Tax LLP
shiwei@deloitte.com

Jairaj Guleria (San Jose)
Partner
Deloitte Tax LLP
jguleria@deloitte.com

Kathy Freeman (Sacramento)
Managing Director
Deloitte Tax LLP
katfreeman@deloitte.com

This document contains general information only and Deloitte is not, by means of this document, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This document is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor. Deloitte shall not be responsible for any loss sustained by any person who relies on this document.

About Deloitte

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited (“DTTL”), its global network of member firms, and their related entities (collectively, the “Deloitte organization”). DTTL (also referred to as “Deloitte Global”) and each of its member firms and related entities are legally separate and independent entities, which cannot obligate or bind each other in respect of third parties. DTTL and each DTTL member firm and related entity is liable only for its own acts and omissions, and not those of each other. DTTL does not provide services to clients. Please see www.deloitte.com/about to learn more.