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August 7, 2017

California Franchise Tax Board
c/o: John Su

Via E-Mail

RE: Proposed Changes to California Code of Regulations, title 18, sections 25137-10 and 25137-4.2—Comments in Opposition to Use of Net

Dear Mr. Su:

On behalf of the Council On State Taxation (COST), I am writing in response to the Franchise Tax Board's (FTB) "Supplemental Request for Comments," regarding the above referenced regulation sections. This request comes after the FTB previously issued a discussion memo in which it proposed four options for the sourcing of broker-dealer receipts and after two interested parties' meetings were held. With this request, the FTB has now stated that it "believes the most reasonable and legally supportable solution is to include in the sales factor the broker-dealer principal transaction receipts at net." The FTB has also indicated it may still consider including broker-dealer principal transaction receipts at gross as well. COST respectfully submits these comments in opposition to the FTB's conclusion that net receipts should be used and urges the FTB to use maintain the current practice of using gross receipts as the presumptive starting point.

COST is a nonprofit trade association consisting of approximately 600 multistate corporations engaged in interstate and international business. COST's objective is to preserve and promote equitable and nondiscriminatory state and local taxation of multijurisdictional business entities.

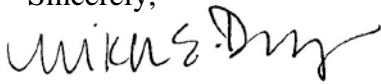
COST disagrees with the FTB's suggested use of the net approach as the presumptive starting point for sourcing broker-dealer receipts and with the FTB's statement that that approach is the "most reasonable and legally supportable solution." Cal. Tax & Rev. Cd section 25120(f)(1), which provides the general definition of sales for purposes of sourcing receipts, explicitly provides that "[s]ales' means gross receipts. . . ." In addition, the use of gross receipts has been upheld by the California Board of Equalization previously. *See Appeal of Merrill Lynch, Pierce, Fenner and Smith Inc.* (89-SBE-017). Finally, the states are generally split as to whether net or gross receipts should be used to source broker-dealer receipts.

Although the use of net may be appropriate in certain situations, COST urges the FTB to not use that as the presumptive starting point. The use of net as the presumptive starting

point is simply inequitable for broker-dealer transaction receipts since these receipts are earned by such taxpayers in the ordinary course of their businesses and the longstanding general rule for the sourcing of sales is to use gross receipts. Thus, COST urges the FTB to maintain the current practice of using gross receipts as the presumptive starting point and to allow for an alternative method to be used where distortion is proven. This may be a more cumbersome process, which is why the FTB would likely want to move away from it; however, a one-size-fits-all approach simply does not be possible with respect to the sourcing of these types of receipts.

Based on the foregoing, COST respectfully urges the FTB to use gross as opposed to net receipts as the presumptive starting point for purposes of sourcing broker-dealer transaction receipts in any proposed draft regulation.

Sincerely,

A handwritten signature in black ink, appearing to read "Nikki Dobay". The signature is fluid and cursive, with the first name "Nikki" being more prominent than the last name "Dobay".

Nikki Dobay

cc: COST Board of Directors
Douglas L. Lindholm, COST President & Executive Director