Deloitte.

Deloitte Tax LLP | March 21, 2025

MULTISTATE INDIRECT TAX

San Francisco GRT draft market sourcing rules impact on asset managers

Tax Alert

Overview

As discussed in our Tax Alert dated March 19, 2025, and as provided for under Proposition M, the Tax Collector for the City of San Francisco (the "City") released proposed market sourcing regulations ("Proposed Regulations") on February 28, 2025 addressing how businesses must allocate their receipts to the City for purposes of the City's Gross Receipts Tax ("GRT"). The Proposed Regulations generally align with the California Franchise Tax Board regulations for sourcing sales of services provided by mutual fund service providers and sourcing sales provided by other asset management businesses asset managers.

Before Proposition M, professional and financial service businesses allocated their gross receipts to the City based on payroll only. Effective January 1, 2025, all professional and financial service businesses, including asset management businesses, must use a two-factor apportionment formula with a 25% payroll factor and 75% market factor based on "where the benefit of the service is received."

This Tax Alert discusses the proposed market sourcing rules specific to asset management services and mutual fund service providers.

Asset management industry – Managers of non-regulated investment companies

The Proposed Regulations provide that where gross receipts are from asset management services not subject to the special industry rules applicable to a mutual fund service provider, the benefit of the asset management services is received at the domiciles of the investors in the assets unless the investor is holding title to the assets for a beneficial owner. If the investor is holding title to the assets for a beneficial owner, the benefit is received at the domicile of the beneficial owner of the assets.

The Proposed Regulations define "asset management services" as the "direct or indirect provision of management, distribution, or administration services to funds." These services include, but are not limited to, rendering investment advice to a fund, providing services related to the selling or purchasing of

securities constituting assets of a fund, making determinations as to when sales and purchases of securities are to be made on behalf of the fund, or providing services related to the selling or purchasing of securities constituting assets of a fund.

"Beneficial owner" means any person who made an "independent decision to invest assets," which the Proposed Regulations further define as "a decision to invest assets made by a person who was not required or committed to do so by contract, agreement, or any other arrangement, understanding, or relationship." The Proposed Regulations exclude from the definition of beneficial owner: (i) master funds, feeder funds, or entities that pool investors' assets, (ii) a shareholder of a publicly traded corporation whose board invests the corporation's excess capital into an investment vehicle, or (iii) a participant of a defined benefit plan.

Specific presumptions apply under the Proposed Regulations to determine the domicile of investors and beneficial owners. The domicile of an investor is presumed to be the investor's billing address indicated in the records of the taxpayer. However, the presumption is overcome if the taxpayer has actual knowledge that the investor's principal place of business is different than the investor's billing address. The domicile of a beneficial owner of assets managed by an asset manager shall be presumed to be the beneficial owner's billing address indicated in the records of the entity for whom the asset management services are rendered, or in the records of the asset manager. If the entity for whom the asset management services are rendered, or the asset manager, has actual knowledge that the beneficial owner's primary residence or principal place of business is different than the beneficial owner's billing address, the presumption does not control.

Receipts are assigned to the City in proportion to the average value of interest in the assets held by the asset's investors or beneficial owners domiciled in the City. If the average value of interest is unknown to the taxpayer, reasonable estimates are permitted. Census data and gross domestic product are both considered reasonable approximations under the Proposed Regulations.

Mutual fund service providers – Managers of regulated investment companies

Where gross receipts are from the direct or indirect provision of management, distribution, or administrative services to or on behalf of a regulated investment company ("RIC"), the Proposed Regulations provide that receipts are assigned using a shareholder ratio. The shareholder ratio is calculated by multiplying total receipts for the tax year from each separate RIC for which the mutual fund service provider performs management, distribution, or administration services by a fraction, the numerator of which is the average number of shares owned by the RIC's shareholders domiciled in the City at the beginning and end of the RIC's tax year, and the denominator being the average of the number of shares owned by the RIC's shareholders everywhere at the beginning and end of the RIC's tax year.

"Mutual fund service provider" is defined in the Proposed Regulations as "any unitary business that derives income from the direct or indirect provision of management, distribution, or administration services to or on behalf of a RIC. A RIC is a regulated investment company as defined in Section 851 of the Internal Revenue Code."

If the domicile of a shareholder is unknown because the shareholder of record is a person that holds the shares of the RIC as depositor for the benefit of others, the Proposed Regulations provide for the use of "any reasonable basis," including the use of the zip codes of underlying shareholders, to determine the location for the assignment of these shares. If a reasonable basis cannot be developed to determine the proper location, then all the shares held by the

shareholder are to be disregarded in computing the shareholder ratio. If all the shares of the RIC at issue are disregarded, then the gross receipts from the RIC are to be allocated to the City in proportion to taxpayer's payroll apportionment in accordance with section 956.2 of the Business and Tax Regulations Code.

If a mutual fund service provider has receipts from performing asset management services, in addition to performing services for RICs, receipts from its non-RIC asset management services are assigned to the City if the domicile of the beneficial owner of the assets is in the City.

When asset management services are provided (directly or indirectly) to a pension plan, retirement account or institutional investor, the gross receipts are assigned to the City to the extent the domicile of the beneficiaries of the plan, account, or similar pool of assets held by the institutional investor is in the City. Any reasonable basis may be utilized to determine the domicile of the individual beneficiaries if otherwise unknown. If the domicile of these specific beneficiaries cannot be obtained, and the taxpayer cannot devise a reasonable method to approximate this information, the gross receipts are to be allocated to the City in a proportion to the taxpayer's payroll apportionment in section 956.2 of the Business and Tax Regulations Code.

Economic nexus

Under the City's economic nexus standards, taxpayers with $500,000 or more of in-City receipts are considered to be doing business in the City for purposes of the City's GRT. Any taxpayer with nexus – economic or traditional physical or agency nexus – is required to register with the City and pay a graduated annual registration fee, ranging from $41 to $45,000, based on in-City gross receipts from the preceding year. In addition, Taxpayers are subject to the GRT unless their in-City gross receipts are less than $5,000,000, in which case the small business exemption from the GRT will apply, and they will not be required to file a GRT return.

Based on the City's Proposed Regulations, an asset management business or mutual fund service provider with no office or employees in the City may nevertheless have a City registration requirement and annual fee payment obligation, and, if the small business exemption from the GRT does not apply, a GRT return filing and payment obligation, solely by reason of it having sufficient in-City receipts from the provision of asset management services for the benefit of investors or beneficial owners domiciled in the City or from the provision of management, distribution, or administrative services to or on behalf of RICs with shareholders domiciled in the City. Note that the tax rates for financial services increased under Proposition M from .62% to .868% for 2024 and from 1.5% to 3.36% for 2025.

Considerations

Taxpayers should review the Proposed Regulations to consider its impact on a potential registration and filing requirement effective for tax years beginning on or after January 1, 2025. The Tax Collector scheduled a public hearing on April 8, 2025 to discuss the proposed rules. Taxpayers may submit written comments by this date.

Get in touch

Hal Kessler
Lindsay Crews