



MULTISTATE INCOME/FRANCHISE TAX

## California adopts amended market-based sourcing regulations for sales other than sales of TPP

### Tax Alert

### Overview

On August 27, 2025, the California Office of Administrative Law (“OAL”) approved amendments to California Code of Regulations (“CCR”), tit. 18, § 25136-2, which assigns sales, other than sales of tangible personal property (“TPP”), for purposes of apportioning business income (hereinafter, the “Adopted Regulations”). The approved text was filed with the California Secretary of State and formally announced in the [California Regulatory Register](#). The Adopted Regulations have since been published in the [CCR](#). The amendments become effective on October 1, 2025, and apply to taxable years beginning on or after January 1, 2026. For more background, see our [Tax Alert](#) dated September 24, 2024.

### General rules

In general, California sources receipts from sales other than sales of TPP to the state if the taxpayer’s market for the sales is in California. The Adopted Regulations provide detailed assignment rules for various categories of gross receipts, including sales from services; asset management services not governed by CCR, tit. 18, § 25137-14, which provide specific rules for mutual fund services providers that provide specific services to or on behalf of a regulated investment company; large-volume professional services; and sales of intangible property.

### Sales of services

In general, sales from services are assigned to California “to the extent the customer of the taxpayer receives the benefit of the service in this state.” The Adopted Regulations provide new presumptions and revise existing substantiation rules for determining the location of the benefit of the services. Specifically, the following four presumptions apply:

- The location of the receipt of the benefit of the service shall be presumed to be in California to the extent the service predominantly relates to:
  - Real property located in California.
  - TPP when the TPP is located in California when the service is received. If the TPP is delivered directly or indirectly to the customer after the service is performed, the benefit of the service is received where the property is delivered, regardless of where the service is performed.
  - Intangible property that is used in California.
  - Individuals who are physically present in California at the time the service is delivered.

The Adopted Regulations continue to provide that both the taxpayer and the Franchise Tax Board (“FTB”) may overcome the presumptions by demonstrating, based on a preponderance of the evidence, that the benefit was received at a location outside California. However, the Adopted Regulations now provide that this showing should primarily rely on information contained in the taxpayer’s contracts or books and records maintained in the ordinary course of business, before considering any other sources or evidence.

For any service, the Adopted Regulations require that the presumptions regarding the location of the benefit be applied before substantiating the location of the receipt of the benefit of the service. The Adopted Regulations revise and reorganize existing substantiation rules to provide that, once a presumption has been overcome, the location of the receipt of the benefit should be substantiated in the following order:

- First, by the taxpayer’s contracts or books and records kept in the normal course of business;
- Second, by all other sources of information that may reasonably substantiate the location of the benefit;
- Third, by reasonable approximation;
- Fourth, if none of the above methods establish the location, the benefit is presumed to be received in California if the customer’s billing address as indicated in the taxpayer’s books and records is in California.

The Adopted Regulations provide new and revised illustrative examples to guide taxpayers in applying the sourcing rules.

## New rules for receipts from sales of asset management services

The Adopted Regulations provide a new definitional and sourcing framework for gross receipts from asset management services. These services are broadly defined as the direct or indirect provision of management, distribution, or administrative services to funds. The Adopted Regulations also newly define key terms such as “administrative services,” “distribution services,” “management services,” “fund,” and “beneficial owner.” Notably, a “beneficial owner” is defined as the person who independently decides to invest assets, excluding pooled investment decision-makers and participants in defined benefit plans.

The Adopted Regulations establish specific rules for determining the location of gross receipts from asset management services based on the domicile of the investor in the assets. If the investor holds title on behalf of a beneficial owner, the benefit of the service is deemed received at the domicile of the beneficial owner. Domicile is presumed to be the billing address unless the taxpayer has actual knowledge of a different principal place of business or residence.

Receipts are assigned to California in proportion to the average value of interest in the assets held by California-domiciled investors or beneficial owners. This average is calculated by taking the sum of the beginning and ending values of the interest held during the taxable year and dividing by two. If precise values are unavailable, taxpayers may use a reasonable estimate, though the regulations do not define what constitutes a “reasonable” estimate.

The Adopted Regulations provide two new examples to assist with determining the average value of the interest in the assets.

## New rules for the assignment of large-volume professional services

The Adopted Regulations provide a new definition for professional services to include management services, tax services, payroll and accounting services, audit and attest services, legal services, business advisory consulting services, technology consulting services, services related to brokering securities that generate commission income, investment advisory services other than asset management services as defined in the Adopted Regulations, and services related to the underwriting of debt or equity securities.

A new sourcing rule applies to “large volume professional services,” defined as any single professional service provided to more than 250 customers during the taxable year. Under the rule, receipts from large-volume professional services are assigned based on the customer’s billing address. However, if more than 5% of the receipts from the sale of a specific service are derived from a single customer, then receipts from that customer do not fall under this rule.

The Adopted Regulations provide two new examples to assist with assigning large volume professional services.

## Other amendments

### Sales from intangible property

The rules for assignment of sales from intangible property remained largely unchanged, providing that sales of intangible property are assigned to California to the extent the property is used in California.

However, for transactions involving a complete transfer of intangible rights, including patents, copyrights, stock, and other similar intangible assets, where the sale of intangible property includes the sale of corporate shares, ownership interests in pass-through entities, or receipts derived from dividends or goodwill, the Adopted Regulations provide minor revisions that depend on the composition of the underlying assets:

- If more than 50% of the assets of the dividend payor or of the corporation or pass-through entity sold or business entity in connection with goodwill, as determined on the date of the sale and using the original cost-basis of those assets, are real or tangible property, gross receipts are assigned by using the average of California payroll and property factors of the entity sold for the most recent taxable year prior to the time of sale.
- If more than 50% of the assets of the dividend payor or of the corporation or pass-through entity sold or business entity in connection with goodwill, as determined on the date of the sale and using the original cost-basis of those assets, are intangible property, gross receipts are assigned using the sales factor of the entity sold for the most recent taxable year prior to the time of sale.
- New special rules apply for situations where the taxpayer does not have access to information to determine the asset mix or the relevant apportionment factors (payroll, property, or sales).

## Sales of both a service and tangible or intangible property

The Adopted Regulations establish new rules for sourcing receipts from transactions involving a combination of services and the sale or license of tangible or intangible property. In these instances, if the value of each portion of the receipt is readily ascertainable, then each portion must be separately assigned. If the value of each portion is not readily ascertainable, then the principal purpose for entering the contract will determine how to assign the revenue.

## Other

The Adopted Regulations include further clarifications and minor updates to the following existing sourcing rules.

- Sales derived from marketable securities. The rules remain largely unchanged, but “customer” is defined as the person, without regard to intermediaries, who gains the greatest possession of economic rights in the marketable securities.
- License, lease, rental or other use of intangible property. The rules remain largely unchanged, but a new example has been added to address upfront payment for licensing rights.
- Special rules regarding reasonable approximation. The Adopted Regulations made minor revisions to the special rules governing the method of reasonable approximation for determining the location where the benefit is received, the location of use of intangible property, and the customer’s location for sales of marketable securities. Specifically, the Adopted Regulations introduce the following new requirement, while continuing to require that the method of reasonable approximation be reasonably related to the income of the taxpayer:
  - The taxpayer’s reasonable approximation method shall be used unless the FTB shows, by a preponderance of the evidence, that the method is not reasonable. If the FTB shows that the taxpayer’s method is not reasonable, the FTB must reasonably approximate the location of the receipt of the benefit of the services, the location of the use of the intangible, or the location of the customer for sales from marketable securities.

Please reach out to one of our California specialists listed below with any questions regarding the impact of the Approved Regulations.

## Get in touch

[Ben Elliott](#)

[Kathy Freeman](#)

[Jairaj Guleria](#)

[Valerie Dickerson](#)

[Christopher Campbell](#)

[Roburt Waldow](#)

[Tien Do](#) (Passthrough)

[Farah Raja](#) (Passthrough)

[Suzanne Henley](#) (Passthrough)

[Darren Sweetwood](#) (Passthrough)

[Olivia Chatani](#) (Passthrough)



30 Rockefeller Plaza  
New York, NY 10112-0015  
United States

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