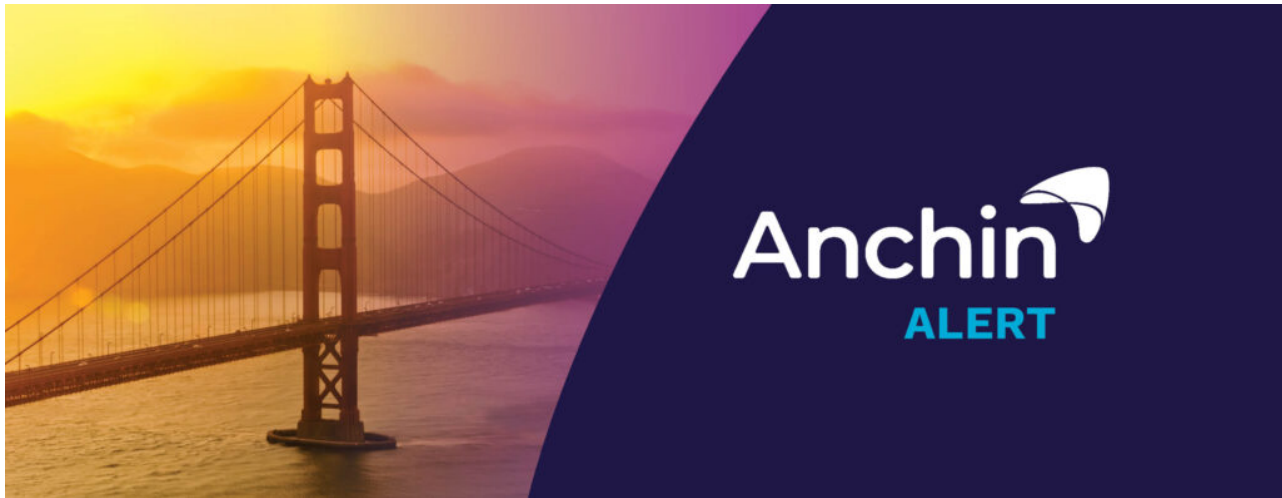


# New California Tax Rules Impact the Financial Services Industry

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The California Franchise Tax Board (FTB) has formally adopted modifications to [California Code of Regulations section 25136-2](#) governing the sourcing of receipts from sales of other than tangible personal property. Changes to the regulation will be effective for all tax years beginning on or after January 1, 2026. For firms, investors, and fund managers in California, understanding the new California tax rules is crucial to avoid compliance issues and capitalize on emerging opportunities.

Recent legislative and regulatory updates not only extend certain taxpayer-favorable provisions but also introduce significant changes to how revenue is sourced for state tax purposes. Together, these developments have meaningful implications for asset managers, securities dealers, and other financial service providers navigating California's complex tax environment.

## Pass-Through Entity Tax (PTET)

In a positive development, California has extended its elective PTET program, which was previously scheduled to expire at the end of 2025. The extension preserves the federal state and local tax (SALT) deduction cap workaround through 2031. Additionally, beginning in 2026, taxpayers who miss or underpay the required June 15 estimated payment will still be allowed to participate in the PTET. However, their

available credit will be reduced by 12.5%.

## **Revenue Sourcing**

After years of discussion, revisions, and public hearings, California has finally updated its market-based sourcing regulations for sales of non-tangible property—such as asset management service fees, securities dealer receipts, and income from intangible property. At their core, the new rules provide that service revenue is sourced to California to the extent the customer receives the benefit of the service within the state. To determine where the benefit is received, the regulations establish a hierarchy of factors to guide taxpayers in identifying the proper sourcing location.

### **1. Asset Management**

- For asset managers, the new regulations specify that the benefit of the service is received at the domicile of the investor or beneficial owner. This domicile is generally presumed to be the investor's billing address unless more accurate information, such as the actual residence or principal business location, is available.
- For state income tax purposes, receipts from asset management services are assigned to California in proportion to the average value of the investors' or beneficial owners' interests in assets. The average value is determined by adding the beginning and ending value of the investors' interests and dividing by two. If the taxpayer does not have sufficient data, it may use a reasonable approximation, for example applying California's share of the U.S. population based on census data.
- In addition, mutual fund service providers must source receipts based on the location of their shareholders. If shareholder information is unavailable, the provider may use a reasonable method to approximate the shareholders' location.

### **2. Securities Dealers**

- Under the new guidance, receipts from dealings in marketable securities are sourced using:
  - The individual customer's address at year-end; or

- The corporate domicile for business customers.
- Importantly, “customers” for this purpose are defined as those holding the most significant economic rights in the securities, excluding intermediaries. As a result, investment funds that lack information about the ultimate security holders may rely on reasonable approximations, such as population ratios, to determine sourcing.

### **3. Intangibles**

- Receipts from the sale of intangible property, such as the sale of stock or business interests, are assigned to California to the extent the property is used in the state, meaning where the customer employs or exploits the intangible.
- When all rights in an intangible are transferred to the customer, sourcing is based on the contract terms or the taxpayer’s books and records showing where the customer will use the property at the time of sale. In the absence of such information, a reasonable approximation may again be used.

## **Considerations for Businesses**

The extension of California’s PTET offers continued planning opportunities for owners of pass-through entities seeking to mitigate the federal SALT deduction cap. Furthermore, the modification to the June 15 estimated payment requirement provides additional flexibility. Taxpayers who are uncertain about their annual income levels or who face cash flow constraints will no longer be completely disqualified from the PTET election due to missed or insufficient estimated payments albeit at a 12.5% reduction in the available PTET credit.

For businesses providing services to customers in California, especially those in the financial services industry, they should review their customer and investor data to reassess their California apportionment. Collecting detailed address information for investors and customers will be critical to properly sourcing receipts.

Companies not currently filing California returns should also evaluate whether the new sourcing methodology could trigger economic nexus and create a California

filing obligation.

These new rules take effect for tax years beginning on or after January 1, 2026, so now is the time to carefully consider the impact and gather the necessary data to ensure tax reporting is done correctly at the start of the new year.

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