BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
NEW YORK FOOTBALL GIANTS, INC.)

Appearances:

For Appellant: John F. O'Dea
Attorney at Law

For Respondent: Kendall Kinyon
Counsel

OPINION

This appeal is made pursuant to section 26077 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claim of the New York Football Giants, Inc., for refund of franchise tax in the amount of $1,117.41 for the income and taxable year 1968.

We are called upon to interpret various provisions of the Uniform Division of Income for Tax Purposes Act, Revenue and Taxation Code sections 25120 through 25139.

The New York Football Giants, Inc., appellant herein, is a corporation organized under the laws of New York and having its commercial domicile in that state. It operates a professional football team in the National Football League (NFL). Each year appellant's team plays some exhibition games and half its regular season games at its home stadium in New York. The team also plays occasionally in California, and during the appeal year it had one game in this state.

On its California corporate income tax return[1/] for the year in question, appellant apportioned its income between California and other states by using the formula set out in Revenue and Taxation Code section 25128. That section, which is part of the Uniform Division of Income for Tax Purposes Act (hereinafter referred to as "the Uniform Act" or "the Act"), provides:

> All business income shall be apportioned to this state by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three.

Respondent audited the return and made certain adjustments, described below, to appellant's business income, sales factor, and payroll factor. Appellant contends that each of these adjustments was improper.

Business Income

Prior to 1966 appellant had an exclusive franchise to operate an NFL team in New York. In that year, however, the NFL merged with another league and a second team was granted an NFL franchise in the same

1/ For convenience, respondent apparently allows professional football teams to file corporate income tax returns, rather than franchise tax returns, provided they compute their tax liability under the Franchise tax provisions of chapter 2 of the Bank and Corporation Tax Law.

area. Under the terms of the merger the teams from the other league agreed to pay an indemnity in yearly installments to compensate appellant for the loss of its exclusive territorial rights. Appellant received a $275,462 payment under this agreement during the year in question, and the Internal Revenue Service apparently treated the payment as a capital gain for federal income tax purposes. The issue presented in this portion of the appeal is whether that payment should be apportioned among California and other states by formula, as respondent contends, or whether it should be allocated entirely to New York.

Revenue and Taxation Code section 25128 requires all business income to be apportioned by formula. The term "business income" is defined in subdivision (a) of section 25120 as follows:

> "Business income" means income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.

Capital aains, however, to the extent they do not constitute business income, are not subject to formula apportionment but rather are specifically allocated under the provisions of Revenue and Taxation Code section 25125. In particular, subdivision (c) of that section provides:

> Capital gains and losses from sales of intangible personal property are allocable to this state if the taxpayer's commercial domicile is in this state.

Appellant contends that the payment in question is not business'income and that, since it is a capital gain, it must therefore be allocated to the state of appellant's commercial domicile under section 25125. In support of this

position, appellant contends that the term "business income" includes only income from transactions which occur in the regular course of the taxpayer's trade or -business. We considered this issue in the Appeal of Borden, -Inc., decided this day, and decided it adversely to appellant. For the reasons expressed in that opinion, we conclude that the term "business income" includes income from -tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations, even though the income may arise from an occasional sale or other extraordinary transaction.

In this case, appellant's business is the operation of an NFL franchise. The exclusive nature of the franchise was -an important aspect of the business, and was acquired or developed and maintained .as part of appellant's normal business operations. It undeniably enhanced the value of the franchise -and contributed materially to the production of business income. For these reasons we conclude' that the acquisition, management, and disposition of the exclusive territorial right were integral parts of appellant's regular -business operations, and that the income from its disposition therefore constitutes business income.. (Cal. 'Admin. Code, tit. 18, reg. 25120, subd. (c) (2) (art. 2); Appeal of Velsicol Chemical Corp., Cal. St. Bd. of Equal., Oct. 5, 1965; Appeal of Borden, Inc., supra.)

Sales Factor

Appellant receives a part of its income each year from the sale of tickets to its home games. Under the NFL's constitution and by-laws, appellant is obligated to pay either :a portion of such gate receipts or a flat fee to the visiting team at each home game. 'In its apportionment formula for the year in question,, appellant included its entire home game gate receipts in the denominator -of the sales factor. Respondent determined., however, that the portion of the gate receipts paid to visiting teams should be excluded from the sales factor, and adjusted appellant's return accordingly.

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Revenue and Taxation Code section 25134 defines "sales factor" as a fraction whose numerator is the taxpayer's total sales in California during the income year, and whose denominator is the taxpayer's total sales everywhere during that year. For purposes of the sales factor, the term "sales" means "all gross receipts of the taxpayer," with certain exceptions not relevant here. (Rev. & Tax. Code, § 25120, subd. (e).) Respondent appears to concede that appellant's entire home game gate receipts are part of its "gross receipts," as that term is commonly understood (see Artnell Co. v. Commissioner, 400 F.2d 981, 986 (7th Cir. 1968)), and thus properly includible in the denominator of its sales factor under a-literal reading of section 25134. Respondent argues, however, that it has the discretion to require taxpayers to compute their sales factors in a manner other than that set out in the statute, and that it properly exercised that discretion in this case.

In support of its position respondent relies on a prior decision of this board involving the same taxpayer, the Appeals of New York Football Giants, Inc., et al., decided August 27, 1962. In that case we approved an adjustment to appellant's sales factor identical to the one at issue here on the ground that the adjustment was reasonable. The basis for our decision was the then well settled rule that respondent has broad discretion in defining the factors to be used in apportionment formulas (El Dorado Oil Works v. McColgan, 34 Cal. 2d 731 [215 P.2d 4] (1950), appeal dismissed, 340 U.S. 801 [95 L. Ed. 589] (1950)), and that the burden is on the taxpayer to show wherein respondent's formula is arbitrary and unreasonable. (RKO Teleradio Pictures, Inc. v. Franchise Tax Board, 246 Cal. App. 2d 812, 819 [55 Cal. Rptr. 299] (1966).)

After our decision in the Giants case, however, California adopted the Uniform Act. One of the Act's provisions, Revenue and Taxation Code section 25137, describes and limits the circumstances under which discretionary adjustments may be made to the Act's allocation and apportionment provisions. Section 25137 states:

> If the allocation and apportionment provis-ions of this act do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may- petition. for or the Franchise Tax Board.may require, in respect to all or any part of the taxpayer's business activity, if reasonable:
>
> (a) Separate accounting;
>
> (b) The exclusion of any one or more of the factors:
>
> (c) The inclusion of one or more additional factors. which will fairly represent the taxpayer's business activity in this state; or
>
> (d) The- employment of any other method". to effectuate an equitable allocation and. apportionment of the taxpayer's income.

This section authorizes exceptional allocation and apportionmentmethods. only where the methods- specified in the Uniform Act do not fairly represent the extent of the taxpayer's in-state business activity. (Kennecott Copper Corp., et al., v. State Tax Commission, 27 Utah 2d 119 [493 P.2d 632](1972), appeal dismissed, 409 U.S. 973 [34 L.Ed. 2d 237](1972); Donald M. Drake Co. v. Department of' Revenue,, 23'6. Or. 26 [500 P.2d 1041](1972); Amoco Production Co. v. Armold, 213 Kan. 636 [518 P.2d 453](1974).)

Because of the adoption of the Uniform Act, our decision in the prior Giants case is no longer- controlling. The stated purpose of the Uhiform Act is "to make uniform the law of those states which enact it." (Rev. & Tax. Code, § 25'138.) Taxpayers subject to the Act are required to allocate and apportion their income in. accordance with its provisions. (Rev. & Tax. Code, § 25121.) Discretionary adjustments to-the statutory allocation and apportionment procedures: are now authorized. only under exceptional circumstances, that is, only where those procedures do not fairly represent the extent of the-taxpayer's business activity in this state.. (Amoco Production Co. v. Armold, supra; Keesling and Warren, California's Uniform Division of Income. for Tax Purposes Act, 15 U.C.L.A. L. Rev-. 156, 171 (1967).) In order to insure that the Act is applied as

uniformly as possible, we hold that the party who seeks to deviate from the statutory formula, whether the taxpayer or the taxing agency, will bear the burden of proving that such exceptional circumstances are present. (Donald M. Drake Co. v. Department of Revenue, supra, 263 Or. at 32 [500 P.2d at 1044] (1972).)

As pointed out above, appellant computed its sales factor for the appeal year precisely as required by Revenue and Taxation Code section 25134. There is nothing in the record in this case to suggest that computing the sales factor in this manner did not fairly represent the extent of appellant's business activity in California. We therefore conclude that respondent erred in making the adjustment in question to appellant's sales factor. (Donald M. Drake Co. v. Department of Revenue, supra.)

Payroll Factor

The final issue concerns the computation of appellant's payroll factor. That factor is defined in Revenue and Taxation Code section 25132 as a fraction whose numerator is the total compensation paid by the taxpayer in California during the income year, and whose denominator is the total compensation which the taxpayer paid everywhere during that year. Under Revenue and Taxation Code section 25133, compensation is deemed to have been paid in this state if:

> (a) The individual's service is performed entirely within the state; or
>
> (b) The individual's service is performed both within and without the state, but the service performed without the state is incidental to the individual's service within the state; or
>
> (c) Some of the service is performed in the state and (1) the base of operations or, if there is no base of operations, the place from which the service is

> directed or controlled is in the state, or (2) the base of operations or the place from which the service is directed or controlled is -not in any state in which some part of the service is performed, but the individual's residence is 'in this state.

Appellant contends that the compensation it paid to its employees should be attributed entirely to New York, and that the numerator of its p-ayroll factor should therefore be zero.. Respondent argues that since appellant's team played one game in this state during the appeal year, -a portion of the compensation paid by appellant should be attributed to California based on the number of working days its employees spent in this State. We agree with respondent.

Under a 'literal reading of section 25133, appellant concededly paid no compensation in this state during the appeal year. As we explained above, however, Revenue and Taxation Code section 2513'7 allows reasonable adjustments to the allocation and -apportionment provisions of the Uniform Act if those provisions do not fairly reflect the extent of the taxpayer's business activity in this state. Computing appellant's payroll factor in the manner prescribed in the Uniform Act would assign its entire payroll to New York. This would clearly not reflect the fact that appellant's team plays a number of games outside New York, including occasional. games in California. Respondent's approach, on the other hand, is 'based on the reasonable premise that compensation should be partially attributed to each state where the taxpayer's employees have rendered services. It is also consistent with -the method used to apportion the 'income of individual football players. (See Appeal of Dennis F. and Nancy Partee, Cal. St. Bd. of Equal., Oct. '6, 1976.1 We accordingly find no error in the adjustment to appellant's payroll factor. (Rev. & Tax. Code, § 25137.)

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O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 26077 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claim of the New York Football Giants, Inc., for refund of franchise tax in the amount of $1,117.41 for the income and taxable year 1968, be modified in accordance with the views expressed in this opinion. In all other respects the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this 3d day of February, 1977, by the State Board of Equalization.

_____, Chairman

_____, Member

_____, Member

_____, Member

_____, Member

ATTEST: _____, Executive Secretary