

BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )  
 )  
PDA ENGINEERING ) No. 94A-0173  
 )

Representing the Parties:

For Appellant: John Murphy

For Respondent: Larry Bobiles, Counsel

Counsel for Board  
of Equalization: Sophia H. Chung,  
Staff Counsel

O P I N I O N

This appeal is made pursuant to section 19045 (formerly section 25666) of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of PDA Engineering against proposed assessments of additional franchise tax in the amounts of \$8,102, \$7,380, and \$17,628 for the income years ended June 30, 1987, June 30, 1988, and June 30, 1989, respectively.

The question presented for decision is whether installment sale payments should be apportioned to California based on the apportionment factors for the year of the sale or the year in which the payments are received.

In January 1983, appellant, a California corporation deriving income solely from California sources, entered into a sales agreement to sell to Southwest Aerospace Company (SAC) several of its government contracts and related assets. Under the terms of the sales agreement, appellant received \$100,000 in cash and a \$3,000,000 installment note from SAC. The installment note required SAC to make semiannual payments equivalent to seven percent of the gross receipts received from the government contracts, with the remaining balance on the note payable in full on August 1, 1991. SAC had the option to extend the final due date of the note by an additional four years.

After 1983, appellant began to do business both within and without California and began to report its income on the basis of a combined report. During the appeal years, appellant reported the installment payments as they were received, including them in its apportionable business income. Appellant apportioned the installment sale payments using the apportionment factors for the year in which the payments were received. Upon review of appellant's tax returns, respondent determined that appellant should have apportioned the installment sale payments using the apportionment factors for the year of the sale. Appellant's California apportionment percentage was 100 percent for the year of the sale, and therefore, respondent apportioned 100 percent of each installment payment to California. Appellant appeals this determination.

In Tenneco West, Inc. v. Franchise Tax Board, 234 Cal.App.3d 1510 (1991), the California Court of Appeal held that installment sale income should be apportioned on the basis of the factors for the year of the sale, regardless of the year in which such income is actually reported. The Court of Appeal reasoned that apportioning the income based upon the factors for the year of the sale more closely reflects the activities which gave rise to the income. In reaching its holding, the Court of Appeal interpreted respondent's Legal Ruling No. 267, issued on September 17, 1964, and Legal Ruling No. 413, issued on January 15, 1979, both of which addressed the apportionment of installment sale payments. The Court of Appeal concluded that Legal Ruling No. 413 provides the general rule for apportioning installment sale payments, that is, the gain or loss from an installment sale should be apportioned on the basis of the factors for the year of the sale regardless of the year in which such gain or loss is actually reported. The Court of Appeal further stated that:

[legal] ruling No. 413 carves out a limited qualified exception for a taxpayer who in the regular course of business makes installment sales as a dealer in tangible personal property under circumstances where the

apportionment factors do not vary significantly from year to year. That exception might apply to a taxpayer engaged in retail sales similar to the taxpayer involved in [legal] ruling No. 267 [in which respondent concluded that payments from installment sales should be apportioned by the apportionment factors for the year in which the payments were reported].

(Tenneco West, Inc. v. Franchise Tax Board, supra, 234 Cal.App.3d at 1537.) This statement by the court clearly indicates that the application of Legal Ruling No. 267 must be limited to the facts as stated in that ruling.

Tenneco West is controlling precedent in this case. We therefore conclude that respondent correctly apportioned the installment sale payments at issue based on the apportionment factors for the year of the sale. Accordingly, the action of the Franchise Tax Board in this matter is hereby sustained.

ORDER

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 19047 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of PDA Engineering against proposed assessments of additional franchise tax in the amounts of \$8,102, \$7,380, and \$17,628 for the income years ended June 30, 1987, June 30, 1988, and June 30, 1989, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 28th day of November, 1995, by the State Board of Equalization, with Board Members Mr. Klehs, Mr. Andal, Mr. Dronenburg, Mr. Sherman and Ms. Connell present.

Johan Klehs \_\_\_\_\_, Chairman

Dean F. Andal \_\_\_\_\_, Member

Ernest J. Dronenburg, Jr. \_\_\_\_\_, Member

Brad Sherman \_\_\_\_\_, Member

Kathleen Connell \_\_\_\_\_, Member