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2023 – OTA – 069P
Precedential

OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **L. SMITH**	OTA Case No. 20036033

OPINION

Representing the Parties:

For Appellant: L. Smith

For Respondent: Matt Cappel, Tax Counsel
Chris Casselman, Tax Counsel IV

For Office of Tax Appeals: William J. Stafford, Tax Counsel III

K. GAST, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, L. Smith (appellant) appeals an action by respondent Franchise Tax Board (FTB) proposing additional tax of $176,936, plus applicable interest, for the 2012 tax year.

Appellant waived the right to an oral hearing; therefore, Office of Tax Appeals (OTA) decides the matter based on the written record.

ISSUE

Whether appellant is liable for tax on a distributive share of gain from the sale of a partnership interest because it constitutes California source income.[1]

[1] Throughout this Opinion, "partnership interest" and "membership interest" are used interchangeably because the limited liability companies at issue are classified as partnerships for federal and California income tax purposes.

FACTUAL FINDINGS[2]

General Factual Background

1. Appellant, an individual, was a California nonresident.
2. Appellant owned an indirect membership interest in a limited liability company (LLC) called SOSV, LLC (Holdco), which was classified as a partnership for federal and California income tax purposes. Holdco was directly owned by three members: Skokie Boulevard Investors, LLC held a 50 percent membership interest; HLS Tyme II Share, LP held a 35 percent membership interest; and the S. Ginsburg 2001 Irrevocable Trust held a 15 percent membership interest.[3]
3. Holdco had its principal office in Illinois, where its sole manager, S. Ginsburg (Ginsburg), an individual, was located. Holdco was a holding company, and on its final 2012 California LLC tax return (Form 568), it reported no tangible (real or personal) property at either the beginning or ending of the year, no payroll or other operating expenses, and no sales.
4. Holdco's sole function was to hold its 50.50 percent (direct) membership interest in an entity called Shell Vacations, LLC (Shell), which was based in Arizona and classified as a partnership for federal and California income tax purposes. The remaining 49.50 percent membership interest in Shell was owned by York Special Opportunities Fund, LP (York), which is unrelated to Holdco or its direct and indirect members.
5. Shell, through its subsidiaries and affiliates, was in the business of acquiring, developing, and selling timeshare/vacation ownership interests and vacation club memberships. Shell conducted business within and without California.

Holdco

6. On its 2012 Form 568, Holdco indicated it began doing business in California in 1997 and its principal business activity was timeshare developer.
7. Holdco's Third Amendment To Operating Agreement (the Holdco Agreement), effective in 2002, indicates Ginsburg was once a direct member of Holdco but he assigned his

[2] Unless otherwise specified, all facts are applicable to the 2012 tax year at issue.

[3] The record does not specify in which of Holdco's direct members appellant held an interest (direct or indirect). However, neither party asserts that affects the outcome of this appeal.

membership interests in Holdco to his trust, the S. Ginsburg 2001 Irrevocable Trust. The Holdco Agreement states Ginsburg was appointed Holdco's sole manager at least as of 2002, and he was authorized to exercise all powers of Holdco. It further states that in 2002, Holdco owned 90 percent of the membership interests in Shell, and Holdco was Shell's manager. The Holdco Agreement is signed by the trustee of the S. Ginsburg 2001 Irrevocable Trust and Ginsburg himself, and both do so in their capacity as general partners, members, and/or managers of Holdco's direct members at the time.

8. At some point in time, Ginsburg held a 50 percent direct membership interest in Shell. As discussed above, Ginsburg assigned his interest in Holdco to the S. Ginsburg 2001 Irrevocable Trust, whose beneficiaries were Ginsburg's children, and HLS Tyme II Share, LP. After 2001, Ginsburg retained no direct interest in Shell, which was apparently directly owned (in large part) by Holdco. Following the 2007 to 2008 global financial crisis, Shell fell into financial hardship and was close to defaulting on its loans. York agreed to buy 49.50 percent of Shell, with the proceeds being used to cover Shell's loan obligations. As a result of the partial sale, Holdco gave up majority control of Shell because Holdco only retained two seats on Shell's seven-member board of managers (Board).

<u>Shell</u>

9. In 2009, Holdco and York entered into an Amended and Restated Limited Liability Company Agreement of Shell (the Shell Agreement), which was formed in 1998.[4] The Shell Agreement is signed by Ginsburg on behalf of Holdco.

10. The Shell Agreement provides "[t]he business and affairs of [Shell] shall be managed by the Board," and "the Board shall have all power and authority to manage, to direct the management, business and affairs of and to make all decisions to be made by or on behalf of [Shell]." It states the Board's approval, consent, or action constitutes approval or action by Shell and is binding on Shell and its members. It further provides that any person dealing with Shell can rely on a certificate or any writing signed by the Board or any officer as a duly authorized action on behalf of Shell.

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[4] Shell's Articles of Organization from 1998 list Holdco as its 20 percent or greater owner. Although unclear, it appears Ginsburg was solely or principally involved in forming both Holdco and Shell.

11. The Shell Agreement authorized the creation of the Board, which had up to seven manager seats. The parties agree six individuals were appointed to the Board: York appointed four (but it had the ability to appoint five); and Holdco appointed the other two, one of whom was Ginsburg.
12. Ginsburg served as CEO of Shell and was one of six members of its Board, of which he was also the chairperson.[5] The record reveals that on behalf of Holdco as its manager, Ginsburg signed a "manager written consent of company resolution of [Shell]," dated in 2010, in which Holdco, as "sole manager" of Shell, appointed a Vice President of Shell.
13. T. Sherles (Sherles), an individual, was President and COO of Shell. Along with Ginsburg, Sherles was appointed by Holdco to be one of six members of Shell's Board.[6] She held an indirect minority interest in Shell through her indirect minority interest in Holdco.
14. D. Glickstein (Glickstein), an individual, was Vice President and General Counsel of Shell. Glickstein was not a member of the Board. Like Sherles, he held an indirect minority interest in Shell through his indirect minority interest in Holdco.
15. Holdco created written resolutions for two loan agreements that Shell (as guarantor) entered into with third-party lenders in 2011 and 2012.[7] Each resolution provides that the members of Holdco "deem it advisable and in the best interests of" Shell that the loan agreement be entered into, and the "terms and provisions" contained in the loan agreement are "authorized and approved."
16. The Shell Agreement provides that Holdco and its affiliates could not engage in any business activities that would compete with Shell's business while Holdco remained a member of Shell.[8]

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[5] The chairperson's principal role was to manage, provide leadership, and be accountable to the Board, and act as a direct liaison between the Board and Shell's management.

[6] In an exhibit attached to the Shell Agreement, Ginsburg and Sherles are listed as Shell's only managers.

[7] The two loan resolutions list various borrower entities but their relationships, if any, with Shell are not provided.

[8] This non-compete provision does not appear to apply to York.

Holdco's Sale of Shell

17. In 2012, Holdco sold its entire 50.50 percent (direct) membership interest in Shell to an unrelated third-party. The sale resulted in a net gain of over $53 million.[9]

Procedural History

18. On its final 2012 Form 568, Holdco recognized the entire net gain on its sale of Shell, but did not source any of it to California.[10] Therefore, as an indirect pass-through member of Holdco, appellant did not pay tax on the gain to this state.

19. On audit, FTB determined Holdco and Shell constituted a unitary business and therefore took the position that Holdco's gain on the sale of its interest in Shell was apportionable business income. Since Holdco had no apportionment factors of its own, FTB further determined Holdco's gain should be apportioned to California using Holdco's share of Shell's apportionment factors, which was the same apportionment percentage Holdco reported on its 2012 Form 568.[11] This resulted in less than half of the gain being apportioned to California.

20. FTB issued a Notice of Proposed Assessment (NPA) to appellant that reflected its determination he owed tax on his share of Holdco's gain from the sale of its interest in Shell that constituted California source income. Appellant protested the NPA, but FTB affirmed it with a Notice of Action. This timely appeal followed.[12]

[9] The entire net gain was attributable to so-called "hot assets" and taxed as ordinary income under Internal Revenue Code (IRC) section 751.

[10] Also on its 2012 Form 568, Holdco reported a distributive share of income of over $9 million from Shell. Because it had no apportionment factors of its own, Holdco reported its share of Shell's apportionment factors. This led to an apportionment percentage (i.e., a three-factor formula comprised of a property factor, a payroll factor, and a double-weighted sales factor) of 41.9766 percent. (See R&TC, § 25128(a).) Holdco then multiplied this percentage by its distributive share of income from Shell to derive its California source income, which it reported to its direct members on California Schedule K-1s.

[11] The parties appear to agree Holdco's gross receipts from the sale of its interest in Shell are excluded from Holdco's sales factor under California Code of Regulations, title 18, (Regulation) section 25137(c)(1)(A), as substantial receipts from an occasional sale.

[12] This appeal was deconsolidated from others involving similar facts and issues.

DISCUSSION

I. Introduction

FTB's proposed assessment of additional tax is presumed correct and the taxpayer bears the burden of proving it to be incorrect. (*Appeal of Stabile*, 2020-OTA-198P.) Unsupported assertions are insufficient to satisfy a taxpayer's burden of proof. (*Appeal of Bindley*, 2019-OTA-179P.) In the absence of credible, competent, and relevant evidence showing error in FTB's determination, the determination must be upheld. (*Ibid*.) The burden of proof requires proof by a preponderance of the evidence. (Cal. Code Regs., tit. 18, § 30219(c).) To meet this evidentiary standard, a party must establish by documentation or other evidence that the circumstances it asserts are more likely than not to be correct. (*Appeal of Belcher*, 2021-OTA-284P.)

Appellant primarily contends Holdco's sale of its interest in Shell was the sale of an intangible asset and the resulting gain should be sourced, for personal income tax purposes, to appellant's out-of-state residence under R&TC section 17952 since the partnership interest did not acquire a business situs in California. Therefore, appellant argues, FTB's use of corporate apportionment rules to source the gain to California was incorrect.

FTB counters that California Code of Regulations, title 18, (Regulation) section 17951-4(d) is the governing sourcing provision. In FTB's view, because Holdco and Shell constitute a unitary business, the gain is properly considered apportionable business income and, under the unitary combination method set forth in Regulation section 25137-1(f), it is apportioned to California at Holdco's level using Holdco's share of Shell's apportionment factors. Consequently, under FTB's position, the apportioned gain retains its character as California source income as it flows up[13] from Holdco to its ultimate taxpaying owners, such as appellant. For reasons discussed below, OTA finds in favor of FTB.[14]

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[13] As used in this Opinion, "flow, flows, or flowed up" means the income and/or apportionment factors that a direct or indirect partner receives via a distributive share from a lower-tier pass-through entity, and is intended to have the same (or similar) meaning as items that "pass-through" from such lower-tier pass-through entity.

[14] Because OTA sustains FTB's unitary position, it declines to address FTB's alternative position the gain generates business income (and is apportioned) at Shell's level under IRC section 751, even in the absence of a unitary relationship. (See also FTB Legal Ruling 2022-02.)

II. Appellant's Share of Holdco's Gain Should Be Sourced Under Regulation Section 17951-4(d)

Under the Personal Income Tax Law (the PITL), California resident individuals are taxed on their entire taxable income regardless of source, while nonresidents, such as appellant, are only taxed on income derived from California sources. (R&TC, §§ 17041(a), (b), & (i)(1), 17951.) Taxable income of nonresidents from sources within and without California "shall be allocated and apportioned under rules and regulations prescribed by [FTB]." (R&TC, § 17954.) Under this legislative grant of rulemaking authority, FTB enacted regulations specifying types of income from sources within this state (Regulation section 17951-2), as well as regulations dealing with how to treat intangible personal property (Regulation section 17952) and nonresident income from a business, trade, or profession (Regulation section 17951-4). (*The 2009 Metropoulos Family Trust, et al. v. Franchise Tax Bd.* (2022) 79 Cal.App.5th 245, 266 (*Metropoulos*).)

Regulation section 17951-4 and R&TC section 17952 provide different nonresident sourcing provisions. Regulation section 17951-4 contains income sourcing provisions applicable to a nonresident's business, trade, or profession. Specifically, Regulation section 17951-4(d) provides rules when "a nonresident [such as appellant] is a partner in a partnership which carries on a unitary business, trade or profession within and without this state."[15] In general, "the total business income of the partnership shall be apportioned at the partnership level [here, Holdco's level] in accordance with the apportionment rules of the Uniform Division of Income for Tax Purposes Act [(the UDITPA)], [R&TC] [s]ections 25120 to 25139 [found in the Corporation Tax Law (the CTL)] . . . and the regulations thereunder."[16] (Cal. Code Regs., tit. 18, § 17951-

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[15] In 2018, which is after the 2012 tax year at issue, Regulation section 17951-4(d) was amended and most of its subsections were renumbered. The parties do not address the applicability of these amendments to the facts or whether such amendments are applied on a retroactive or prospective basis. (See Cal. Code Regs., tit. 18, § 17951-4(j) [most of the renumbering amendments apply to taxable years beginning on or after January 1, 2001, but the substantive change adding new subsection (d)(2) is effective January 1, 2019].) Because the parties do not argue these amendments affect this appeal, the current version of Regulation section 17951-4 will be cited for ease of reference.

[16] As noted above, appellant held an *indirect* pass-through membership interest in Holdco. Appellant does not assert his indirect interest somehow renders Regulation section 17951-4(d) inapplicable. Rather, he asserts R&TC section 17952 is the correct sourcing provision because his indirect distributive share of Holdco's gain was from the sale of an intangible asset. In any event, appellant has not provided any facts beyond who Holdco's direct members were, such as how he held his indirect interest in Holdco for purposes of determining how its income ultimately flowed up to him.

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4(d)(1).) “The source of a partner’s distributive share of items which do not constitute business income shall be determined in accordance with the sourcing rules of [R&TC] [s]ections 17951 through 17955 [which includes R&TC section 17952 found in the PITL] . . . and the regulations thereunder, as if the income producing activity were undertaken by the partner in its individual capacity.” (Cal. Code Regs., tit. 18, § 17951-4(d)(4).) In contrast, R&TC section 17952 provides that nonresident income from intangible personal property is not income from sources within California unless the property has acquired a business situs in this state. (See also Cal. Code Regs., tit. 18, § 17952.)

Appellant argues, citing *Appeal of Holiday Inns, Inc*. (86-SBE-074) 1986 WL 22707, that since Holdco’s partnership interest in Shell is classified as intangible personal property, the gain from Holdco’s sale of that partnership interest, in appellant’s hands, is sourced under R&TC section 17952. He asserts, citing *Appeals of Ames, et al.* (87-SBE-042) 1987 WL 50165, the gain should be sourced to his out-of-state residence because the partnership interest did not acquire a business situs in California. Therefore, appellant concludes, Regulation section 17951-4(d), and its incorporation of the corporate apportionment rules under the UDITPA, have no application here.

However, appellant improperly focuses the analysis on the gain at his level when it was actually generated at Holdco’s level. Indeed, the substance of appellant’s argument was recently rejected by the California Court of Appeal in *Metropoulos*. In that case, the court held that nonresident trust shareholders of a concededly unitary multistate S corporation are properly taxed on their pass-through pro rata shares of income from the sale of goodwill because it is business income sourced to California under the UDITPA. (*Metropoulos*, *supra*, 79 Cal.App.5th 245, 259.) The court therefore rejected the taxpayer’s position, like the one advanced here, that R&TC section 17952 applied to the exclusion of Regulation section 17951-4 (and the UDITPA) with respect to the geographic sourcing of S corporation unitary business income. (*Id.* at p. 274.)

Although the court in *Metropoulos* dealt with unitary S corporations and their nonresident shareholders, OTA finds its reasoning equally applicable to unitary partnerships and their nonresident partners. Critically, the court found Regulation section 17951-4 is accorded the same dignity as a statute such that it does not subordinate to R&TC section 17952. (*Metropoulos*, *supra*, 79 Cal.App.5th 245, 275.) Therefore, like the rules under Regulation section 17951-4(f) for nonresident S corporation shareholders, those under Regulation section

17951-4(d), which are specific to a nonresident partner's distributive share of partnership income and which are incorporated into Regulation section 17951-4(f), likewise do not subordinate to R&TC section 17952. The court also found the conditional conformity language in R&TC section 17087.5—i.e., "except as otherwise provided under" the PITL or the CTL, California conforms to the federal taxation scheme of S corporations and their shareholders—meant the federal S corporation pass-through rules yield to California's UDITPA. (*Id.* at pp. 268-269, 274, 276.) Similarly, R&TC section 17851 provides that for PITL purposes, the federal taxation scheme of partnerships and partners applies in this state "except as otherwise provided," which suggests the federal partnership pass-through rules also yield to California's UDITPA.

The court found further support in the federal S corporation rules in which the character of a shareholder's pro rata share of S corporation income is determined as if the income were realized directly from the source from which realized by the corporation. (*Metropoulos*, *supra*, 79 Cal.App.5th 245, 274, citing Internal Revenue Code (IRC), § 1366(b).) This principle is known as the "conduit rule" and was intended by U.S. Congress to be the same as the partnership rule. (*Id.* at pp. 269-270; see IRC, § 702(b).) In short, the court was clear that "income from [a pass-through entity] is thus characterized at the [pass-through entity] level as either business or nonbusiness income; the business income is apportioned under the [UDITPA], and the nonbusiness income is sourced under [R&TC] sections 17951 through 17953 and 17955." (*Id.* at pp. 274-275.) Accordingly, because the gain in question was generated at Holdco's level, consistent with *Metropoulos*, OTA will employ Regulation section 17951-4(d) to determine how that gain should be sourced.[17]

III. Holdco and Shell are Engaged in a Unitary Business Such That Holdco's Gain is Treated as Business Income and Sourced to California Using Shell's Apportionment Factors

A. Applicable Nonresident Tax Sourcing Principles

As noted above, Regulation section 17951-4(d) applies to source a nonresident partner's distributive share of income from "a partnership which carries on a unitary business, trade or profession within and without" California. Appellant's alternative position is Holdco is not

[17] Although unclear, appellant does not appear to argue Holdco itself does not " carr[y] on a unitary business, trade or profession within and without this state" within the meaning of Regulation section 17951-4(d). In any event, OTA finds below that Holdco is engaged in a unitary business with Shell.

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unitary with Shell and therefore Holdco's share of Shell's apportionment factors cannot be used to apportion Holdco's gain, even if that gain is apportionable business income. FTB similarly focuses the analysis on the unitary issue between Holdco and Shell for purposes of determining whether Holdco's gain is business income and which entity's factors are used to apportion it. OTA will thus analyze the dispositive unitary issue, but before doing that, a proper recitation of the applicable law is in short order to understand the parties' contentions.

To reiterate, "the total business income of the partnership shall be apportioned at the partnership level [here, Holdco's level] in accordance with the apportionment rules of the [UDITPA], [R&TC] [s]ections 25120 to 25139 [found in the CTL] . . . and the regulations thereunder." (Cal. Code Regs., tit. 18, § 17951-4(d)(1).) "Under the [UDITPA] (R&TC sections 25120 through 25139)—adopted by California and certain other states and which seeks to establish uniform rules for the attribution of corporate income—a unitary enterprise's 'business income' is apportioned among the tax jurisdictions according to a formula." (*Appeal of Robert Half International Inc. & Subs*., 2019-OTA-330, citing *Microsoft Corp. v. Franchise Tax Bd.* (2006) 39 Cal.4th 750, 755-756; see also R&TC, § 25121; Cal. Code Regs., tit. 18, § 25121(a)(2), (b).) For the tax year at issue, California generally required a taxpayer's business income to "be apportioned to this state by multiplying the business income by a fraction, the numerator of which is the property factor plus the payroll factor plus twice the sales factor, and the denominator of which is four." (R&TC, § 25128(a).) Holdco used this formula, consisting solely of its share of Shell's factors, to apportion its distributive share of income from Shell for the 2012 tax year.[18]

"'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." (R&TC, § 25120(a).) In contrast, "'[n]onbusiness income' means all income other than business income." (R&TC, § 25120(d).) The source of a nonresident partner's distributive share of nonbusiness income is assigned under R&TC sections 17951 through 17955. (Cal. Code Regs., tit. 18, § 17951-4(d)(4).)

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[18] Holdco did not elect to use a single-sales factor apportionment formula. (Former R&TC, § 25128.5.)

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The parties do not specifically address whether Holdco's gain from the sale of its partnership interest in Shell constitutes business or nonbusiness income under R&TC section 25120(a). (See Cal. Code Regs., tit. 18, § 17951-4(d)(1).) Indeed, appellant does not argue Holdco's gain is nonbusiness income under R&TC section 25120(d) and thus properly sourced under R&TC section 17952. (See Cal. Code Regs., tit. 18, § 17951-4(d)(4).) Rather, the parties appear to agree that if the entities are engaged in a unitary business, Holdco's partnership interest in Shell is a unitary asset to Holdco and the gain from its sale should be properly classified as apportionable business income. OTA agrees with the parties on this point.[19]

The unitary business determination has important implications beyond whether income is classified as business or nonbusiness income. The crux of the issue on appeal is which entity's factors are used to apportion Holdco's gain. The resolution of that issue turns on whether the entities are unitary. Regulation section 17951-4(d) itself does not discuss how the apportionment calculation is performed when a partnership (i.e., Holdco) owns an interest in another partnership (i.e., Shell). But the parties appear to agree that Regulation section 25137-1, involving how a corporate partner's distributive share of partnership items are apportioned or allocated under the UDITPA, provides guidance.

Regulation section 25137-1 is one of the regulations found under California's UDITPA that is incorporated by Regulation section 17951-4(d)(1). It provides detailed rules to determine "the portion of [a taxpayer partner's] distributive share (constituting business and nonbusiness income) which has its source in [California] or which is includible in the taxpayer's business income subject to apportionment . . . [when] the taxpayer, or the partnership, or both, have

[19] In *Hoechst Celanese Corp. v. Franchise Tax Bd.* (2001) 25 Cal.4th 508, the California Supreme Court held that R&TC section 25120(a) establishes both a "transactional test" and a "functional test" for determining whether income constitutes business income. (*Id*. at pp. 520-526.) The satisfaction of either test leads to a determination that the income is apportionable business income. (*Id*. at p. 526.) Under the transactional test, the controlling factor for identifying business income is the nature of the income-producing transaction. (*Ibid*.) The functional test, in contrast, focuses on the income-producing property. (*Id*. at p. 527.) In applying the functional test, the critical inquiry is the relationship between the property and the taxpayer's business operations. (*Ibid*.) In general, gain from the sale of a unitary asset generates apportionable business income, at least under the statutory functional test. (See, e.g., *Jim Beam Brands Co. v. Franchise Tax Bd.* (2005) 133 Cal.App.4th 514 [gain on the sale of stock in unitary subsidiary generates business income]; *Appeal of Centennial Equities Corp.* (84-SBE-086) 1984 WL 16165 [gain on the sale of partnership interests in unitary partnerships generates business income]; see also *Mobil Oil Corp. v. Commissioner of Taxes* (1980) 445 U.S. 425, 439 [U.S. Constitutional standard provides that "the linchpin of apportionability in the field of state income taxation is the unitary-business principle"].)

income from sources within and without this state."[20] (Cal. Code Regs., tit. 18, § 25137-1(a).) Under Regulation section 25137-1(a), "[i]f the partnership's activities and the taxpayer's activities constitute a unitary business under established standards, disregarding ownership requirements, the taxpayer's share of the partnership's trade or business shall be combined with the taxpayer's trade or business as constituting a single trade or business." (See also Cal. Code Regs., tit. 18, § 25137-1(f).) If, however, "the activities of the partnership and the taxpayer do not constitute a unitary business under established standards, disregarding ownership requirements, the taxpayer's share of the partnership's trade or business shall be treated as another trade or business of the taxpayer," which means the partnership's apportionment factors do not flow up to its partner and are not combined at the partner level. (Cal. Code Regs., tit. 18, § 25137-1(g).)

Therefore, if Holdco and Shell are engaged in a unitary business, Holdco's share of Shell's apportionment factors will flow up to Holdco and be used to apportion its unitary business income, including its gain from the sale of its interest in Shell. But if they are not unitary, Shell's apportionment factors do not flow up to Holdco, and thus Holdco's gain, even if it is business income, is apportioned only with Holdco's own factors in California, which are zero and leads to no California source income.[21]

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[20] The first step is to determine which portion of the taxpayer's distributive share of partnership items constitutes business or nonbusiness income under R&TC section 25120 and the regulations thereunder. (Cal. Code Regs., tit. 18, § 25137-1(a).) That determination is made at the partnership level. (*Ibid*. ["Income arising from transactions and activity in the regular course of the partnership's trade or business constitutes business income. Thus, a [] partner's distributive share of partnership business income constitutes business income to the [] partner . . ."].) Here, Holdco did not receive the gain at issue as a distributive share from Shell because that gain occurred at Holdco's level, where the business or nonbusiness determination is made.

[21] In 2018, which is after the 2012 tax year at issue, Regulation section 25137-1 was amended at the same time as Regulation section 17951-4, as discussed above. One amendment added a new sentence to Regulation section 25137-1(a), which provides that the principles in that regulation also apply when a taxpayer has an interest in a partnership (e.g., Holdco) that itself owns an interest, directly or indirectly, in one or more other partnerships (e.g., Shell). The parties do not address the applicability of this amendment to the facts or whether it is applied on a retroactive or prospective basis. (See Cal. Code Regs., tit. 18, § 25137-1(j) [the amendments are applicable only as of the effective date of the amendments, which is January 1, 2019].) Appellant does not argue this amendment affects this appeal, or in the amendment's absence, why Regulation section 25137-1 could not be interpreted to apply to a tiered partnership structure, such as here. (See *Appeal of Saga Corp*. (82-SBE-102) 1982 WL 11779 [applying FTB's subsequently amended corporate apportionment regulation under California's UDITPA that dealt with partners and partnerships to earlier tax years also involving the UDITPA].)

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B. Holdco and Shell are Engaged in a Unitary Business

1. Applicable Law

"[A] taxpayer [] contesting [FTB's] determination of unity . . . must prove by a preponderance of the evidence that, in the aggregate, the unitary connections relied on by [FTB] are so lacking in substance as to compel the conclusion that a single integrated economic enterprise did not exist." (*Appeal of Saga Corp*. (82-SBE-102) 1982 WL 11779.) In the partnership context, the existence of a unitary business is analyzed "under established standards, disregarding ownership requirements." (Cal. Code Regs., tit. 18, § 25137-1(a), (f), (g).) "The term 'unitary business' has been well-established by judicial precedent by creating criteria for determining whether business activities conducted within and without the state were sufficiently interrelated or dependent upon or contributory to one another to be considered a single, or unitary, business." (*Appeal of Bindley*, *supra*.)

The California Supreme Court has set forth two alternative tests for determining whether a business is "unitary." The Court held that the existence of a unitary business may be established by applying what is known as the "three unities test." (*Butler Bros. v. McColgan* (1941) 17 Cal.2d 664, 678, affd. (1942) 315 U.S. 501.) Under this test, a unitary business is "definitely established" when there is (1) unity of ownership, (2) unity of operation as evidenced by central purchasing, advertising, accounting and management divisions, and (3) unity of use in the centralized executive force and general system of operation. (*Ibid*.) "All three unities must be found to exist." (*Dental Ins. Consultants, Inc. v. Franchise Tax Bd.* (1991) 1 Cal.App.4th 343, 348 (*Dental Ins.*).) Later, the Court developed an alternative test—known as the "dependency or contribution test"—and held that a business was unitary if the operation of the portion of the business done within the state is dependent upon or contributes to the operation of the business without the state. (*Edison California Stores, Inc. v. McColgan* (1947) 30 Cal.2d 472, 481.) If either the three unities test or the dependency or contribution test is satisfied, the businesses are unitary. (*A.M. Castle & Co. v. Franchise Tax Bd.* (1995) 36 Cal.App.4th 1794, 1805 (*A.M. Castle*); see also *Dental Ins.*, *supra*, 1 Cal.App.4th 343, 348 ["These tests are not

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mutually exclusive, and application of either to a particular set of facts should result in the same conclusion"].)[22]

2. There Is No Special Unitary Test for Holding Companies

As a threshold matter, FTB believes well-settled unitary law requires special consideration in the context of pass-through holding companies, such as Holdco. Although FTB considers the most recent and relevant authority to be *Appeals of PBS Building Systems, Inc. et al*. (94-SBE-008) 1994 WL 719050 (*PBS Building*), a precedential decision issued by the Board of Equalization (BOE), OTA's predecessor, FTB finds this area of law complex for purposes of how to reconcile existing case law as applied to corporations and how that law should be applied to pass-through entities. FTB notes it has been nearly 30 years since a holding company case has been issued, with no existing cases specifically covering pass-through holding companies. On appeal, FTB therefore proposes a "workable rule" to aid in the unitary analysis for pass-through holding companies. In its view, that rule should consider two critical factors: "control"; and "operational management," a term that FTB describes as central executive officers and not a board of directors. It argues "[o]ther factors, such as intercompany financing or non-compete arrangements, while [they] may be used to support a unity finding, are not as significant as control and operational management."[23]

However, in *PBS Building*, the BOE "explicitly dispel[led] the notion that a separate unitary test exists in the holding company context." It further concluded "there is no such separate standard or higher burden of proof which holding companies must meet in order to be held unitary with operating subsidiaries." Simply stated, and contrary to FTB's position in that case, the BOE found no rule stating pure holding companies are (or are not) per se nonunitary.

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[22] FTB's regulation also sets forth criteria to evaluate the unitary nature of an enterprise. (See Cal. Code Regs., tit. 18, § 25120(b)(1)-(3) [listing three factors—same type of business, steps in a vertical process, and strong centralized management—the presence of any of which creates a "strong presumption" that the taxpayer is engaged in a single trade or business].) In addition, the U.S. Supreme Court declared that unity depends on whether "contributions to income result[] from functional integration, centralization of management, and economies of scale." (*Mobil Oil Corp. v. Commissioner of Taxes* (1980) 445 U.S. 425, 438.) To be an unrelated business activity, the separate business entity must constitute a "discrete business enterprise" of the taxpayer. (*Exxon Corp. v. Wisconsin Dept. of Revenue* (1980) 447 U.S. 207, 223-224.)

[23] But see Legal Ruling 2021-01 [where FTB does not suggest that "control" and "operational management" are more significant factors and instead states that "other, non-traditional factors [including intercompany financing and covenants not to compete] are more heavily weighted in determining unity" in the context of pass-through holding companies].

Although *PBS Building* dealt with the unitary combination of corporations, OTA discerns no reason why the rationale of that decision cannot be applied to pass-through holding companies, especially since the California courts have for many decades steadfastly adhered to well-settled unitary tax law. (See, e.g., *Mole-Richardson v. Franchise Tax Bd.* (1990) 220 Cal.App.3d 889, 899 [rejecting FTB's position that a different unitary standard applies to corporations engaged in diverse businesses]; *A.M. Castle*, *supra*, 36 Cal.App.4th 1794, 1806, citing *Container Corp. v. Franchise Tax Bd.* (1983) 463 U.S. 159, 178 & fn. 17 [courts may apply any judicially-created test to determine unity as long as there is "a flow of value" between the segments of a unitary business].) In addition, the plain language of Regulation section 25137-1(a) instructs that "established [unitary] standards" should be used in the partnership apportionment context. Accordingly, OTA declines to adopt FTB's "workable rule" for pass-through holding companies.

3. Majority Ownership and Control are Not Required to Establish Unity

Similar to the three unities test, the contribution or dependency test implicitly contains an ownership requirement. (*Appeal of Willamette Industries, Inc*. (87-SBE-053) 1987 WL 50176.) In the affiliated corporation context, unity of ownership requires more than 50 percent of the voting power of a corporation's stock be owned, directly or indirectly, by another corporation. (R&TC, § 25105.) But in the partnership context, the unitary determination is applied "disregarding ownership requirements." (Cal. Code Regs., tit. 18, § 25137-1(a), (f), (g).) "[U]nlike a corporate shareholder, only the partner's ownership interest in the partnership's income and apportionment factors may be combined, and that combination is proper even though that ownership interest is less than a majority interest." (*Appeal of Willamette Industries, Inc*., *supra*.)

Critically, Regulation section 25137-1's instruction that unity is to be determined without regard to ownership requirements also means "unitary combination does not require that a partner have control of the partnership that is combined." (*Appeal of Willamette Industries, Inc*., *supra*; see also *Appeal of Albertson's, Inc*. (82-SBE-211) 1982 WL 11960 ["lack of control over the partnership business, by itself, does not preclude unitary treatment of a partner and its share of the partnership business"].) This disposes of appellant's contention that Holdco and Shell

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were nonunitary because York, through its majority representation on Shell's Board, had a controlling membership interest in Shell.[24]

4. Application of Unitary Law to Holdco's and Shell's Facts

The analysis here focuses on the dependency or contribution test because FTB bases its proposed assessment on that test and does not argue on appeal that any other established unitary test is applicable. As a practical matter, however, OTA is mindful "the dependency or contribution test overlaps with the three unities test 'in many areas and many of the same facts and factors are used in reaching a determination under either test.'" (*A.M. Castle*, *supra*, 36 Cal.App.4th 1794, 1807, citing *Appeal of A.M. Castle & Co.* (1989) 245 Kan. 739.) As further support, FTB relies heavily on *PBS Building*, the most recent California decision (administrative or judicial) in the holding company context, which OTA agrees serves as useful guidance to aid in the unitary analysis here.[25]

In *PBS Building*, the BOE held that a holding company corporation and its operating subsidiary were entitled to file a unitary combined report because there was evidence of a complete overlap of officers and directors, intercompany financing, and a covenant not to compete. In rejecting the argument that holding companies are incapable of providing or receiving a flow of value from an operating company, the BOE noted "[c]onsiderable unity of operation may exist, for example, by virtue of intercompany financing, including loans, loan guarantees, debt refinancing and debt reduction, and by virtue of large tax loss carryforwards owned by the holding company which are utilized by the operating subsidiary." (*PBS Building*, *supra*.) It observed some of the most significant unitary factors, such as intercompany product flow, often will not exist when there is no horizontal or vertical integration. (*Ibid*.) In the BOE's view, factors that might be considered relatively insignificant in those situations take on added importance because they are the only factors to consider. (*Ibid*.)

[24] Although control is not a prerequisite to a finding of unity, that does not mean control is irrelevant to (or not a factor in) the partnership analysis. York, of course, had the *potential* to control the decisions of Shell through its control of Shell's Board, but it is the *actual* control of a subsidiary that is relevant to a unitary business relationship. (*ASARCO Inc. v. Idaho State Tax Com.* (1982) 458 U.S. 307, 321-322.) Appellant has not established York exercised such control over Shell.

[25] The procedural posture of *PBS Building* was unique because during post-hearing briefing, FTB conceded the entities in question were unitary. Nonetheless, the BOE issued a precedential decision, which can be cited before OTA because OTA has not removed the decision's precedential status. (Cal. Code Regs., tit. 18, § 30504.)

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The BOE went on to observe that a holding company may provide its operating company significant advantages, such as insulation from liability. (*PBS Building*, *supra*.) "[F]lows of value or contribution and dependency may take the form of shared tax benefits [], intercompany financing (loans, loan guarantees and debt retirement), or improved credit worthiness (bond security, more favorable insurance rating or interest rates on borrowed capital)." (*Ibid*.) The BOE also observed that when a group of corporations conduct only one business, it is expected that the requisite contribution or dependency would exist between the holding and operating companies. (*Ibid*.)

a. Integration of Executive Forces

"Integration of top executive forces is an influential factor in determining unity; for the partnership 'to have the assistance and direction of high executive authority of [a partner] . . . is an invaluable resource.'" (*Appeal of Albertson's, Inc*., *supra*, quoting *Chase Brass and Copper Co. v. Franchise Tax Bd.* (1970) 10 Cal.App.3d 496, 504.) In *PBS Building*, one unitary indicator was "a complete overlap of officers and directors" between the holding company and its operating subsidiary. (But see *Appeal of Insul-8 Corp.* (92-SBE-007) 1992 WL 92342 [the existence of that fact, standing alone, generally does not support a unitary finding].) Although there was not a complete overlap of officers and boards of managers between Holdco and Shell, there was still an integration of executive forces. Ginsburg held the most important and influential positions in the two entities—i.e., he was the sole manager of Holdco as well as the CEO of Shell. He thus was responsible for managing the day-to-day operations of both companies. Ginsburg was also a member and chairperson of Shell's Board. Thus, management overlap between Holdco and Shell was significant.

Appellant disagrees, asserting Ginsburg's role with Holdco (as manager) was separate and distinct from his roles with Shell (as CEO and chairperson of the Board). He further asserts Ginsburg was not authorized to make any decisions on behalf of Holdco. However, there is evidence to indicate Ginsburg did indeed act on behalf of Holdco when dealing with Shell. For example, on behalf of Holdco as its manager, he signed the Shell Agreement. And on at least one occasion, on behalf of Holdco as its manager, he signed a "manager written consent of company resolution of" Shell in which Holdco, as "sole manager" of Shell, appointed a Vice

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President of Shell. Ginsburg thus made important business decisions for both companies, which operated, and dealt with each other, in significant part through him.[26]

Indeed, the limited factual record suggests Ginsburg may have been the main architect of Holdco and Shell, he was solely or principally involved in forming both companies in the late 1990s, and for a period of time, he directly owned controlling interests in both. While Ginsburg eventually assigned his interests in Holdco to his trust (and possibly HLS Tyme II Share, LP) at some point prior to the 2012 tax year at issue, his trust still retained a direct ownership interest in Holdco (and indirect ownership interest in Shell) and he remained actively involved in both companies. This did not change when York purchased a direct membership interest in Shell around 2009. Following the 2007 to 2008 global financial crisis, Shell fell into financial hardship and was close to defaulting on its loans. York agreed to step in and buy a 49.50 percent direct interest in Shell. The sale proceeds were used to cover Shell's debt to keep it afloat. Although Holdco gave up control of Shell by losing a large share of Board seats to York, the facts do not show York relieved Holdco and Ginsburg of their historical responsibilities to Shell. (See *ASARCO Inc. v. Idaho State Tax Com.* (1982) 458 U.S. 307, 321-322 [actual, not potential, control of a subsidiary is what is relevant in the unitary analysis.) Rather, with his expertise in, and historical knowledge of, Shell's business, Ginsburg still played an important role in Shell's reliance on Holdco for management services.[27] (Cf. *Noell Industries, Inc. v. Idaho State Tax Com.* (2020) 167 Idaho 367 [nonunitary relationship found between holding company and its operating subsidiary because subsidiary's high-level executive, who was also the founder of the holding company, did not manage the day-to-day operations of the subsidiary].)

In short, it appears Holdco, through its sole manager Ginsburg, devoted all of its activity, however small, to Shell. In fact, on its 2012 Form 568, it reported its principal business activity as timeshare developer, which is the same business Shell operated. And aside from its gain on the sale of its interest in Shell, Holdco's business income in 2012 consisted almost entirely of its

[26] Several other facts are worth noting. Sherles served as Shell's president and COO, was a member of Shell's Board, and held an indirect minority interest in Holdco and therefore in Shell. Glickstein was the Vice President and General Counsel of Shell and also held an indirect minority interest in Holdco and therefore in Shell. While OTA does not rely on these facts to support a unitary finding, OTA notes appellant has not proven his assertion that as with Ginsburg, Sherles and Glickstein were not acting on behalf of Holdco when they performed their duties for Shell. (*Appeal of Bindley*, *supra* [unsupported assertions are insufficient to satisfy a taxpayer's burden of proof].)

[27] It is unclear why Holdco was formed to hold direct membership interests in Shell, as opposed to Holdco's direct and/or indirect members holding direct interests in Shell themselves.

distributive share of income from Shell. "[I]n the typical case where a group of corporations conduct only one unitary business, it would be expected that the requisite contribution or dependency would exist between the 'ultimate parent' holding company and its operating subsidiary or subsidiaries." (*PBS Building*, *supra*; see also *Blue Bell Creameries, LP v. Roberts* (Tenn. 2011) 333 S.W.3d 59, 71 [holding company corporation and its operating partnership were unitary because they both derived their income from "a single underlying activity"].) Ginsburg, as the day-to-day operator of both Holdco and Shell, was thus the unitary bond that held and kept those two entities together.[28]

b. Substantial Intercompany Financing

Substantial intercompany financing is an indicator of unity. (*PBS Building*, *supra*; *A.M. Castle*, *supra*, 36 Cal.App.4th 1794, 1806, 1809.) In *PBS Building*, the operating company advanced over $11 million to its parent holding company without interest or security, the holding company guaranteed third-party loans to the operating company, public debt issued by the holding company were secured by the assets of its operating company, and the operating company expended substantial sums of money on behalf of its parent holding company for the latter's public debt offering.

The record contains no evidence of intercompany financing between Holdco and Shell. However, Holdco created written resolutions for two loan agreements that Shell (as guarantor) entered into with third-party lenders in 2011 and 2012. Each resolution provides that the members of Holdco "deem it advisable and in the best interests of" Shell that the loan agreement be entered into, and the "terms and provisions" contained in the loan agreement are "authorized and approved."

Appellant asserts that Holdco did not "represent" Shell when it sought to enter into those two respective loan agreements with third-party lenders but, rather, only reviewed the terms of the two loan agreements and recommended to Shell that entering into such agreements would be in Shell's best interests. But even if Holdco did not represent Shell in front of the third-party

[28] It further appears Holdco was more akin to a general, rather than a limited, partner in Shell, which tends to show it was unitary with Shell. (See *Appeals of Gasco Gasoline, Inc., et al.* (88-SBE-017) 1988 WL 152325 [corporate limited partner was not engaged in a unitary business with various limited partnerships due to lack of functional integration]; see also *Swart Enterprises, Inc. v. Franchise Tax Bd.* (2017) 7 Cal.App.5th 497 [analogizing limited versus general partner interests for purposes of determining whether a corporate member of an in-state LLC classified as a partnership had franchise tax nexus in California].)

lenders, that fact alone does not establish Holdco and Shell were discrete (nonunitary) business enterprises. The record still shows Shell looked to Holdco for approval on financial matters, and appellant has not shown this was "the type of occasional oversight—with respect to capital structure, major debt, and dividends—that any parent gives to an investment in a subsidiary" to render them nonunitary. (*F.W. Woolworth Co. v. Taxation & Revenue Dept.* (1982) 458 U.S. 354, 369.) Appellant also has not shown what York's role was, if any, in relation to the third-party lenders or how Shell secured financing, if any, to fund its operations.

c. Non-Compete Provision

A covenant not to compete can reflect unitary ties. (*PBS Building*, *supra*.) In *PBS Building*, the evidence established the holding company entered into a covenant not to compete with a third-party to protect its operating company from competition from its former owner, which the BOE characterized as a substantial benefit to the operating company at the expense of its parent holding company.

The Shell Agreement contained a non-compete provision in which Holdco agreed not to participate in any business activities that would be in competition with Shell while Holdco remained a member of Shell. This may have provided important business advantages (e.g., flows of value) to Shell because, while it was a member, Holdco (and its manager, Ginsburg, who was intimately familiar with Shell's business) could not compete with, and take market share away from, Shell. Appellant has not explained why a non-compete provision was needed if Holdco were truly a passive investor or why such provision apparently did not apply to York.

d. Conclusion

Considering the evidence as a whole, appellant has not carried his burden of showing by a preponderance of the evidence that Holdco and Shell were nonunitary businesses in 2012.[29] Holdco and Shell were thus unitary, and as a result, Holdco's gain on the sale of its membership

[29] As further support, OTA notes that on its 2012 Form 568, Holdco used the unitary combination method in Regulation section 25137-1(f) to apportion its distributive share of income of over $9 million from Shell. Conceptually, appellant does not explain why the unitary method is proper to apportion its distributive share of income, yet it is improper to use that method to apportion its gain from the sale of its interest in Shell.

interest in Shell constitutes business income that is properly apportioned using Holdco's share of Shell's apportionment factors.[30]

C. Regulation Section 17951-4(d)(5) and (d)(6) Do Not Apply

Appellant also argues that when a partner holds a less than 20 percent interest in a partnership, the business activity of the partnership is deemed to be not unitary with the business activity of the partner. Regulation section 17951-4(d)(5) provides that, unless a partner owns, directly or indirectly, a 20 percent or more capital or profits interest in a partnership, "the business activity of a partnership will not ordinarily be considered part of a unitary business with another business activity of one or more of its partners." To properly reflect the income or loss of the partnership or its partners, FTB has the discretion to treat the business activity of a partnership and a business activity of one or more of its partners as part of a single unitary business, but only after conducting a comparable uncontrolled price examination under R&TC section 23801(d)(1). (Cal. Code Regs., tit. 18, § 17951-4(d)(5).)

Appellant argues that since FTB has not conducted a comparable uncontrolled price examination, it cannot deem appellant himself, who is an indirect investor in Holdco and Shell, unitary with any of those entities and no portion of Shell's factors should be used to apportion Holdco's gain. Appellant's argument is misplaced. First, the record does not establish what percentage interest appellant ultimately held in Holdco or Shell to determine whether the 20 percent threshold is met. Second, and critically, even if appellant held less than a 20 percent interest, FTB is not seeking to combine and apportion business activities at appellant's level with those of either Holdco or Shell. Rather, FTB seeks to combine only those two entities under Regulation sections 17951-4(d)(1) and 25137-1(f).

Regulation section 17951-4(d)(6) also provides that if a partner owns a 20 percent or more interest, "and *the business activity* of the partnership is unitary with another *business activity* of the partner . . ., the income of the unitary activity shall be combined at the partner level and apportioned to this state under the [UDITPA] . . ., and the regulations thereunder." (Italics added.) "In determining the amount of business income apportioned to this state, the partner shall combine the business income from unitary sole proprietorships and its distributive

[30] To the extent OTA has not specifically addressed authorities discussed in the parties' briefing, OTA has considered them and finds them to be irrelevant or distinguishable for reasons expressed in this Opinion.

or pro rata shares of business income from 20 percent or more interests in unitary partnerships and S corporations." (Cal. Code Regs., tit. 18, § 17951-4(d)(6).)

Relying on Regulation section 17951-4(d)(6), appellant next argues that since Holdco conducts no "business activity" of its own, it cannot be unitary with Shell and no portion of Shell's apportionment factors can flow up and be combined at Holdco's level, even if Holdco owns more than 20 percent of Shell. Again, appellant's argument is misplaced.

The focus of Regulation section 17951-4(d)(5) and (6) is on whether a *nonresident individual's* own business activities can or cannot be combined with the business activities of a partnership in which that individual also owns an interest (i.e., a situation in which the individual owns two businesses that do not directly own each other, or "brother-sister" entities). Regulation section 17951-4(d) is prefaced with "[i]f a *nonresident* is a partner." Although the regulation does not define "nonresident," it is defined in the PITL as "every individual other than a resident," and "individual" is further defined as "a natural person." (R&TC, §§ 17015, 17005.)[31] Regulation section 17951-4(d)(5) and (d)(6) list a "sole proprietorship" and shares of business income from an "S corporation" as possible combinable business activities and such businesses are generally only owned by individuals (and not other business entities).[32] (See *Providence Washington Ins. Co. v. Valley Forge Ins. Co.* (1996) 42 Cal.App.4th 1194, 1199 [A sole proprietorship is not a legal entity itself but instead refers to a natural person who directly owns the business]; IRC, § 1361(b).) Additionally, Regulation section 17951-4(d)(6) provides only one example, and it involves combining an individual's sole proprietorship with the individual's greater-than-20-percent interest in a unitary partnership (i.e., combining brother-sister business

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[31] But see *Steuer v. Franchise Tax Bd.* (2020) 51 Cal.App.5th 417 [noting trusts compute taxable income in the same manner as individuals].)

[32] Indeed, FTB's Initial Statement of Reasons for the rules in subsections (d)(5) and (d)(6), which were added as subsections (d)(4) and (d)(5) to Regulation 17951-4 in 2001, provides the following rationale: "The purpose is also to provide direct authority for requiring *nonresident individuals* to combine interests in separate businesses which make up a single unitary business, and guidance as to the methodology to be used. It will also provide an ownership interest threshold below which *individuals* whose interests are part of a unitary business will not normally be required to combine. [¶] It further needs to provide direct authority for combining unitary interests of *nonresident individuals* and to allow those with a small ownership interest in pass through entities to avoid the burden of examining whether a unitary business exists." (Italics added.) This document is available at: https://web.archive.org/web/20010612153848/http://www.ftb.ca.gov/LEGAL/regs/17951_4_6_statofreason.pdf.

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activities). Accordingly, Regulation section 17951-4(d)(5) and (d)(6) do not prevent Holdco from being unitary with Shell.[33]

HOLDING[34]

Appellant is liable for tax on a distributive share of gain from the sale of a partnership interest because it constitutes California source income.

DISPOSITION

FTB's proposed assessment is sustained in full.

DocuSigned by:
Kenneth Gast
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Kenneth Gast
Administrative Law Judge

We concur:

DocuSigned by:
Sheriene Anne Ridenour
67F043D83EF547C...
Sheriene Anne Ridenour
Administrative Law Judge

DocuSigned by:
Josh Lambert
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Josh Lambert
Administrative Law Judge

Dated Issued: 12/7/2022

[33] Lastly, appellant argues that even if Holdco and Shell are unitary, the apportionment should be calculated based on partial period combined reporting under Regulation section 25106.5-9. According to appellant, Shell's apportionment factors would only flow up to Holdco for the period prior to the sale of its partnership interest in Shell, resulting in the gain being apportioned with only Holdco's post-sale California factors, which are zero. However, Regulation section 25106.5-9, generally applicable to C corporations required to file a unitary combined report, is not found under California's UDITPA (which includes R&TC sections 25120 through 25139) and there is no authority indicating its provisions could impact the facts here.

[34] Appellant requests attorney fees and costs—presumably under R&TC section 21013, which applies to appeals before OTA—because, in his view, FTB took a position that is "unreasonable" or "not substantially justified." (R&TC, § 21013(a)(1)(B); Cal. Code Regs., tit. 18, § 30702; *Appeal of Jacqueline Mairghread Patterson Trust*, 2021-OTA-187P.) However, OTA will not entertain such a request at this time because the appeal is not yet final and appellant's appeal must also ultimately be granted. (Cal. Code Regs., tit. 18, § 30702 [an appellant whose appeal was not granted does not have an eligible claim].)