

BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF, )  
 )  
 WORTHINGTON OIL & GAS CORPORATION, )OTA NO. 220410163  
 )  
 APPELLANT. )  
 )  
 )

## TRANSCRIPT OF ELECTRONIC PROCEEDINGS

State of California

Wednesday, December 13, 2023

Reported by:  
ERNALYN M. ALONZO  
HEARING REPORTER

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Transcript of Electronic Proceedings,  
taken in the State of California, commencing  
at 1:50 p.m. and concluding at 2:24 p.m. on  
Wednesday, December 13, 2023, reported by  
Ernalyn M. Alonzo, Hearing Reporter, in and  
for the State of California.

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APPEARANCES:

Panel Lead: ALJ OVSEP AKOPCHIKYAN

Panel Members: ALJ ASAF KLETTER  
ALJ JOSHUA LAMBERT

For the Appellant: LAWRENCE MILES  
SIL REGGIARDO

For the Respondent: STATE OF CALIFORNIA  
FRANCHISE TAX BOARD  
  
KENNETH HAVENS, JR.  
KATIE FRANK

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I N D E X

E X H I B I T S

(Appellant's Exhibits 1-2 were received at page 7.)  
(Department's Exhibits A-G were received at page 6.)

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California; Wednesday, December 13, 2023  
1:50 p.m.

JUDGE AKOPCHIKYAN: We're going on the record in the Appeal of the Worthington Oil & Gas Corporation. The OTA Case No. is 220410163. Today is Wednesday, December 13, 2023, and the time is approximately 1:50 p.m. We're holding this appeal electronically via Webex by the consent of all parties.

This appeal is being heard by a panel of three Administrative Law Judges. My name is Ovsep Akopchikyan and I am the lead judge for purposes of conducting this hearing. Judges Asaf Kletter and Josh Lambert are the other members of this panel. All three Judges are equal decision makers and may ask questions to make sure we have all the information we need to decide this appeal.

Now for introductions, will the parties please identify themselves by stating their name for the record, beginning with Appellant.

MR. MILES: Good afternoon, Judge and members of the Panel. My name is Larry Miles, Lawrence Miles, for Worthington & Gas. My co-Counsel sitting next to me is Sil Reggiardo of Downey Brand.

JUDGE AKOPCHIKYAN: Thank you, Mr. Miles and Mr. Reggiardo.

1           For Franchise Tax Board?

2           MR. HAVENS: Good afternoon. My name is Ken  
3           Havens with the Franchise Tax Board. And my colleague  
4           will introduce herself.

5           MS. FRANK: Hi. I'm Katy Frank, also with the  
6           Franchise Tax Board.

7           JUDGE AKOPCHIKYAN: Thank you Mr. Havens,  
8           Ms. Frank.

9           As discussed at the prehearing conference and as  
10          noted in my prehearing conference minutes and orders, the  
11          issue on appeal is whether gross receipts from Appellant's  
12          sale of Alaska automobile dealerships were properly  
13          excluded from Appellant's California sales factor as  
14          receipts arising from a substantial and occasional sale.

15          With respect to the evidentiary record, FTB  
16          submitted Exhibits A through G during the briefing  
17          process. Appellant did not object to the admissibility of  
18          these exhibits and, therefore, all of FTB's exhibits are  
19          entered into the record.

20          (Department's Exhibits A-G were received in  
21          evidence by the Administrative Law Judge.)

22          JUDGE AKOPCHIKYAN: With respect to Appellant's  
23          exhibits, Appellant submitted two documents during the  
24          briefing process, which I relabeled as Exhibits 1 and 2 in  
25          my prehearing conference minutes and orders. FTB did not

1 object to the admissibility of these exhibits and,  
2 therefore, all of Appellant's exhibits are entered into  
3 the record.

4 (Appellant's Exhibits 1-2 were received  
5 in evidence by the Administrative Law Judge.)

6 JUDGE AKOPCHIKYAN: As agreed, the hearing will  
7 begin with Appellant's presentation for a total of  
8 30 minutes. FTB will then have 20 minutes for its  
9 presentation, and Appellant will have 10 minutes for  
10 rebuttal and final remarks.

11 Are there any questions before we proceed?

12 MR. MILES: Thank you, Judge. Not at this time.

13 JUDGE AKOPCHIKYAN: No questions. Perfect.

14 Okay. Mr. Miles, you may proceed when you're  
15 ready.

16

17 PRESENTATION

18 MR. MILES: Thank you, Your Honor, and thank you  
19 for the opportunity to be heard and members of the Panel.

20 My name is Lawrence Miles, and what I'm going to  
21 do -- what we're going to do here for Appellant is we're  
22 going to divide the work up a little bit. I'm going to  
23 begin by just making a brief introductory overview of the  
24 facts, which I recognize are probably known but just to  
25 refresh the Panel's recollection on the facts.

1 Mr. Reggiardo will talk about the burden of proof issue,  
2 which is in this case. And then I'll come back to want to  
3 speak about the distinction between the two regulations,  
4 which are in controversy here.

5 So just beginning very quickly, the Panel will  
6 recall that this issue deals primarily with the sale of  
7 two Alaskan auto dealerships. That's long way away from  
8 here. They were subsidiary corporations of the California  
9 taxpayer. They operated in Anchorage, Alaska. The  
10 dealerships were sold in the year 2016, and there was an  
11 audit done later on. But the Appellant -- and I'll just  
12 refer to it as WOG. WOG is the taxpayer.

13 WOG used the general rule and came up with a  
14 formula and applied it, and we thought did it fairly.  
15 Upon audit, the Franchise Tax Board disagreed and applied  
16 25137(c)(1)(A), and it resulted in increasing the sales  
17 tax factor to 31.89 percent. And that sales tax factor  
18 increased the amount of tax that was due to \$210,632. We  
19 paid that, and a claim for refund was filed. So the case  
20 comes to the Panel as a claim for refund. That's the  
21 amount in controversy. That's what we're talking about,  
22 the sale of two Alaskan auto dealerships and primarily  
23 goodwill that was generated from the sale of those  
24 dealerships.

25 So with that quick reminder of the case that's in



1 front of us, let me ask my co-Counsel to begin on our  
2 first point.

3 MR. REGGIARDO: So again, I'm Sil Reggiardo, and  
4 I'm going to focus on really a threshold question, the  
5 burden of proof. And sometimes we'll refer to the  
6 taxpayer as WOG, Worthington Oils & Gas.

7 So WOG filed its tax returns using the default  
8 provisions of Revenue & Taxation Code 25134, and that's  
9 within UDITPA. And we have this escape patch in 25137 of  
10 the Revenue & Taxation Code, and that allows the Franchise  
11 Tax Board to maintain that a default UDITPA provision does  
12 not properly capture California source income, or for the  
13 taxpayer to argue that the State of California is  
14 improperly reaching across its borders to attempt to tax  
15 non-California source income. So that's what we're really  
16 talking about here today.

17 In a critical part of Revenue & Taxation Code  
18 section 25137 is its language regarding the scope to which  
19 it applies. And so I'm going to read some critical  
20 language. It applies if, quote, "The allocation and  
21 apportionment provisions of this act do not fairly  
22 represent the extent of the taxpayer's business activities  
23 in the state." And the words "this act" are critical  
24 because Revenue & Taxation Code section 25120 defines  
25 "this act", those two words, to mean Revenue & Taxation

1 Code sections 25120 through 25139 inclusive.

2 And in Microsoft, it's 39 Cal.4th 750, a 2006  
3 case, the court held that the party invoking Revenue &  
4 Taxation Code section 25137's safety valve has a heavy  
5 burden. It's a burden by clear and convincing evidence to  
6 show that the approximation provided by the standard  
7 formula is not a fair representation in terms of  
8 allocation or apportionment, and that there's the proposed  
9 allocation or alternative is reasonable. That's a  
10 two-part test. It's a heavy burden of proof, clear and  
11 convincing evidence.

12 And so WOG applied the default provisions of  
13 Revenue & Taxation Code section 25134. That is clearly --  
14 that statute is clearly within this act as discussed and  
15 defined in Revenue & Taxation Code 25120 and referred to  
16 in Revenue & Taxation Code 25137. And, therefore, our  
17 position is that the Franchise Tax Board, in attempting to  
18 deviate from that default provision, the one that WOG  
19 applied under Revenue & Taxation Code 25134, is invoking  
20 Revenue & Taxation Code section 25137 and, therefore, has  
21 this heavy Microsoft burden of proof.

22 So the Franchise Tax Board points to a  
23 regulation, Regulation section 25137(c)(1)(A), capital A.  
24 It maintains that it's on point and, therefore, the  
25 taxpayer, WOG, has the burden of proving that its

1       apportionment under Revenue & Taxation Code section 25134  
2       is the appropriate approach.

3               So how does the Franchise Tax Board get there?  
4       Well, it's relying, actually, on Appeal of Fluor, a 1995  
5       Board of Equalization opinion and that was also adopted in  
6       this Panel's decision and Appeal of Amarr. And the  
7       critical language in that opinion says, "Therefore, we  
8       hold that any party wishing to deviate from the methods  
9       prescribed by regulations when found applicable must first  
10      establish by clear and convincing evidence that the  
11      regulation does not fairly represent the extent of the  
12      taxpayer's activities in the state." Sounds very much  
13      like Revenue & Taxation Code section 25137, but it's not.

14             And it cited three cases. Two were U.S. Supreme  
15      Court cases, Moorman and Butler Brothers. The third was  
16      Douglas -- McDonnell Douglas Corporation. And it's  
17      interesting reading Appeal of Fluor. The McDonnell  
18      Douglas case, on which it relied, involved World War II  
19      years where McDonnell Douglas was building airplanes. The  
20      case was actually after 1996 when UDITPA -- 1966 when  
21      UDITPA took effect, but the opinion noted that, although,  
22      UDITPA had passed, it was not a UDITPA case. And the  
23      court looked at the decisions giving the Franchise Tax  
24      Board discretion regarding apportionment factors and  
25      basically held accordingly, held that the Franchise Tax

1 Board had great discretion.

2 Appeal of Fluor appears to have basically looked  
3 at that language and made the same conclusion regarding an  
4 FTB regulation without recognizing that Revenue & Taxation  
5 Code section 25137 has language right on point referring  
6 to the provisions of, quote, "This act," which we have  
7 seen defined in Revenue & Taxation Code 25120. And so our  
8 position is really quite simple. And that is, when this  
9 Panel reads Revenue & Taxation Code 25120, 25134, and  
10 25137, in conjunction with the Microsoft case, it has no  
11 alternative but conclude that the Franchise Tax Board is  
12 invoking Revenue & Taxation Code 25137. Therefore, it has  
13 the Microsoft burden of proof. A regulation is not  
14 evidence. And so the Franchise Tax Board hasn't done a  
15 thing to carry its burden of proof, and the taxpayer  
16 should prevail on that point alone.

17 So that is our pure statutory analysis. We  
18 believe that Appeal of Fluor went down at the wrong path,  
19 and any of the authorities following it have similarly  
20 followed the wrong path because it did not evaluate the  
21 relevant statutory language. The FTB's authority or  
22 discretion was taken away. We recognize that the FTB has  
23 authority to issue regulations, statute on point Revenue &  
24 Taxation Code 19503. But that does not put a regulation  
25 at the same level as a UDITPA statute. And, again, Revenue

1       & Taxation Code Section 25137 focuses on, quote, "This  
2       act," which would be the UDITPA statutes.

3               So I will now turn it back to co-Counsel.

4               MR. MILES: Yeah. I would just add to what  
5       Mr. Reggiardo is saying a bit. Because in looking at the  
6       Fluor case, which obviously was written by OTA in a case  
7       involving the Franchise Tax Board, it tried to kind of  
8       create a bright line. And we appreciate the concern it  
9       had on the varying decisions that it identified. And in  
10      some cases it held one way, and in other cases it held  
11      another way. And it -- it tried to create this bright  
12      line by saying if there's a regulation on point, that's  
13      going to have the same impact as the statute.

14              But, unfortunately, we're not persuaded that OTA  
15      has the ability to do that. It can't simply ignore the  
16      laws passed by the state legislature, which governed these  
17      proceedings. It also gives great, great -- more deference  
18      to FTB than really is permitted under the statutory scheme  
19      in our view, because FTB can write any old regulation and  
20      all of a sudden it's now incumbent upon the taxpayer to  
21      try to overcome it. So we do think the burden is -- as  
22      Sil said, the burden is the State's. It has not met that  
23      burden. We applied with the applicable law, which was  
24      25134, as he indicated.

25              If the Panel does not want to cross that bridge,

1 if it wants to leave Fluor intact and leave it for the  
2 legislature to, in effect, take some sort of action, then  
3 really we're very puzzled by why the regulation -- the  
4 proper regulation is not being used, which is the one  
5 that's right beneath 25137(c)(1)(A). It's (c)(1)(C), and  
6 that deals with intangibles. And nowhere, no time, no how  
7 have we ever been given a cognizant -- a cognizable  
8 explanation of why the FTB chooses simply to ignore it.  
9 It points to the Amarr case. And Amarr is largely  
10 irrelevant in our view with the exception of one line in  
11 which the FTB relies upon to say that 25137(c)(1)(C) does  
12 not apply because it didn't -- the court in Amarr said  
13 that it was not applicable by virtue of the Regulation  
14 25136-2(h).

15 Now, we know that that regulation deals with  
16 sales that occur inside the State of California. So  
17 trying to understand what it means is quite a feat, but  
18 it -- we think that entire regulation, the 25136-2, deals  
19 with trying to discern and define what is attributable to  
20 sales within California. Here, there can be no dispute.  
21 That regulation is simply inapplicable. We have here a  
22 clear sale of two Alaskan dealerships that are two states  
23 away, a nation away, 3,000 miles away operating  
24 autonomously that have nothing to do. There can be no  
25 confusion about what connection they have to California.

1       It's near none.

2               So given that, then what is left to kind of look  
3       in puzzlement at well, what does 25137(c)(1)(C) mean when  
4       does it get applied, if it does not get applied in a  
5       situation like this. And so when you do that, that really  
6       takes us back to fundamentally considering it as the  
7       general rule, which is to say the sales factor would be  
8       recalculated, the goodwill and the intangibles would be  
9       put back into the denominator of the sales factor, and the  
10      taxes would be readjusted to what the taxpayer initially  
11      indicated, and our claim for refund would be granted.

12              There is no real understanding that the FTB stops  
13      its analysis in the first paragraph of the regulation. It  
14      just stops at (c)(1)(A), and it doesn't read any further  
15      than that. And that's simply not the case. And if you  
16      try to force it to read further than that, then they point  
17      to Amarr and said, well, Amarr repealed it. Well, Amarr  
18      didn't repeal it. Amarr is not applicable to the facts of  
19      this case. And the regulation upon which Amarr relied is  
20      not applicable to the facts of this case. So we think, as  
21      Sil indicated, you know, there's a burden of proof issue.  
22      But even if you get to the regulation and the  
23      interpretations, the wrong regulation has been applied.

24              So I think that that's really the sum and  
25      substance of the points that we would like to make to the

1 Panel. We would hope that the Panel would grant our claim  
2 for refund. And we're prepared to answer any questions it  
3 may wish to pose to us.

4 JUDGE AKOPCHIKYAN: Thank you, Mr. Miles and  
5 Mr. Reggiardo. Sorry if I mispronounce your last name.

6 I'm going to go ahead and turn it over to my  
7 Panel members to see if they have any questions.

8 Judge Kletter, any questions for Appellant?

9 JUDGE KLETTER: This is Judge Kletter. I do not  
10 have any questions. Thank you.

11 JUDGE AKOPCHIKYAN: Thank you.

12 Judge Lambert, any questions?

13 JUDGE LAMBERT: This is Judge Lambert. I don't  
14 have any questions at this time. Thanks.

15 JUDGE AKOPCHIKYAN: Thank you.

16 I'm also going to -- actually, I'll ask one  
17 question now. Based on the briefing and your presentation  
18 today, it doesn't seem like Appellant disputes that the  
19 sale was, in fact, occasional and substantial --  
20 substantial and occasional. Doesn't --

21 MR. MILES: Well, I don't want to give the  
22 impression that that's at the heart of our argument. But  
23 I will say this, is that I think there's at least a  
24 question. I think there is at least a question as to  
25 whether it was substantial. And the reason I say that is



1     because I don't think there's been any kind of either  
2     statutory interpretation or case authority to interpret  
3     what the regulation means in term of substantial.

4             Because when it says a right is from an  
5     occasional sale of a fixed asset or other property held or  
6     used in the regular course of business, one has to kind of  
7     infer that other property means intangible assets. And  
8     it's hard to come to that conclusion when there's a  
9     regulation literally five sentences beneath it that  
10    actually specifically addresses intangible assets. So if  
11    the statute of the regulation has specific language  
12    dealing with intangible assets, then I don't think  
13    necessarily we should leap to the conclusion.

14            We clearly know fixed assets are not in  
15    controversy here. It's the amount of money that was paid  
16    for goodwill for these dealerships was a substantial  
17    amount of money and is being taxed by California at an  
18    exorbitant in our view and unconstitutional rate. And so  
19    the issue -- the reason I just don't concede the issue is  
20    because I think there's at least some question as to what  
21    other property means in the context of this regulation.  
22    If you conclude that other property includes intangible  
23    assets, notwithstanding -- notwithstanding (c)(1)(C), if  
24    you include it, then, yes, it is occasional and  
25    substantial. Those thresholds have been met.

1           But if you exclude the goodwill and say we're  
2           going to exclude it in determining whether there's been a  
3           distortion of income, there's less than a 2 percent  
4           distinction between the amount of revenue for 2016 and  
5           prior years. So it's not distortion.

6           And so respectfully, Your Honor, I think it all  
7           comes down to how one takes a look at what is fixed assets  
8           or other property. What is that phrase, "other property,"  
9           mean. I would suggest that you can't necessarily assume  
10          it includes goodwill when goodwill is addressed later in  
11          the regulation. So that's -- again, we think that's an  
12          issue. We don't think you have to kind of get to that  
13          point because we think simply if you look at either the  
14          burden at issue or the subparagraph (c) issue, that really  
15          should control.

16          I hope that was responsive.

17          JUDGE AKOPCHIKYAN: Thank you, Mr. Miles. I  
18          think you ultimately did answer my question in there.

19          I don't have any follow-up questions at this  
20          time. So I'm going to go ahead and turn it over to the  
21          Franchise Tax Board for its presentation.

22          MR. HAVENS: Thank you, Judge.

23

24                               PRESENTATION

25          MR. HAVENS: Good afternoon. I'm Ken Havens,

1       again, from the Franchise Tax Board.

2               If the issues before the Panel this afternoon  
3       seem all too familiar, it's because they are. They've  
4       been heard by the OTA multiple times in the last five  
5       years, and were addressed definitively in the OTA's  
6       precedential decision in the Appeal of Amarr Company.

7               At the core of this dispute are two distinct  
8       inquiries. The first relates to California Code of  
9       Regulations Title 18, which I'll refer to as the CCR  
10      sections 25137 through 25137-14, and ask whether the  
11      provisions of those regulations constitute the standard  
12      UDITPA formula when they are deemed to apply. The second  
13      inquiry relates to California Revenue & Taxation Code or  
14      R&TC section 25137, and asks which party bears the burden  
15      of proof to establish that the UDITPA apportionment  
16      formula does not fairly represent a taxpayer's business  
17      activities before reasonable alternative apportionment  
18      formula is warranted.

19              Worthington argues that analyses are conjoined,  
20      and the Franchise Tax Board bears the burden of  
21      establishing distortion to enforce the throw out provision  
22      of the substantial and occasional sale rule at CCR section  
23      25137 subdivision (c)(1)(A). The Office of Tax Appeals  
24      and its predecessor, the State Board of Equalization, or  
25      SBE, have heard this argument and variations of it many

1 times. In each instance, the SBE and the OTA dismissed  
2 these arguments finding that the regulations in CCR  
3 sections 25137 through 25137-14 constitute the standard  
4 apportionment formula without a need by either party to  
5 establish distortion. Furthermore, should the UDITPA  
6 formula unfairly represent a taxpayer's business  
7 activities, R&TC section 25137 offers a remedy.

8 In the presentation that follows I'll discuss  
9 Worthington's facts and the relevant regulations and  
10 statutes in this appeal and the applications of those  
11 regulations and statutes to Worthington. I'll discuss the  
12 precedence relied upon the OTA in determining the  
13 substantial and occasional sale rule is the standard  
14 formula and cover the origins and current posture of the  
15 evidentiary standard formed by a party seeking deviation  
16 from the UDITPA formula. Finally, I'll address  
17 Worthington's representations relating to its California  
18 business activities and why Worthington has not met the  
19 clear and convincing evidence standard applicable to R&TC  
20 section 25137.

21 First and foremost, Worthington represented in  
22 contemporaneous documentation that it was the parent  
23 company of the unitary combined reporting group operating  
24 automotive dealerships in both California and Alaska  
25 during 2016. In Exhibit B, Worthington's response to the

1 Schedule 2, it indicated that Worthington is in the  
2 business of automotive sales and services. In Exhibit A,  
3 Worthington's R-7 indicates that all entities were part of  
4 a combined unitary group. Worthington's sole goodwill of  
5 Worthington Ford of Alaska and Worthington Imports of  
6 Alaska, the combined reporting group members holding the  
7 Alaska automotive dealerships to an unrelated third party  
8 on November 16th of 2016, sale that approximated or for a  
9 sale price of approximately \$53 million.

10 Income from the sale of assets of the combined  
11 reporting group members was included in the apportionable  
12 business income of the unitary combined group.  
13 Worthington also included gain or loss from the sale in  
14 the sales factor. The Franchise Tax Board revised the  
15 sales factor to reflect gross receipts, rather than gain  
16 or loss -- it's required under R&TC section 25120 -- and  
17 determined that the proceeds of Worthington's sale,  
18 including goodwill, should be thrown out of the California  
19 sales factor pursuant to the operation of the substantial  
20 and occasional sale rule.

21 Exhibit D, at page 5, provides the breakdown of  
22 the Franchise Tax Board's calculation showing removal of  
23 Worthington's \$53 million of gross receipts related to the  
24 sale, created a 25.5257 percent decrease in the unitary  
25 combined groups sales factor denominator. The exhibit

1       also presents auditor's determination that the sale was  
2       not in the normal course of Worthington's automotive sale  
3       and service business.

4               Respondent issued a Notice of Proposed Assessment  
5       for approximately \$210,000, which Worthington paid.  
6       Worthington then submitted a letter requesting alternative  
7       apportionment pursuant to R&TC section 25137, which  
8       Respondent denied in his determination letter attached at  
9       Exhibit G. As the taxpayer stated here, there are two  
10      primary statutory and regulatory provisions at issue. The  
11      first is the substantial and occasional sale rule,  
12      provided at subdivision (c)(1)(A). This is one of the  
13      three original throw out provisions that was adopted in  
14      1973, and the fourth was added in 2007. This particular  
15      provision was modified in 2001 to incorporate changes that  
16      were made in Legal ruling 1997-1, which included the  
17      intangibles in the substantial and occasional sale  
18      analysis.

19             Moreover, during that modification, the term  
20      substantial and occasional were defined within the  
21      regulation. Specifically, additions included the fact  
22      that occasional sale is of a fixed asset or other property  
23      qualify. And examples, such as the sale of a factory  
24      patent or affiliate stock be included as, if substantial,  
25      these two items being intangible assets, as was provided

1 in 1997-1 and the regulatory history for this particular  
2 regulation. Such sales are substantial if they decrease  
3 the sales factor denominator of the combined reporting  
4 group, in this case, by greater than 5 percent.  
5 Occasional if they are outside of the taxpayer's normal  
6 course and occur infrequently.

7 By contrast, R&TC section 25137 provides relief  
8 valve. It states that if the allocation apportionment  
9 provisions of the act did not fairly represent the extent  
10 of the taxpayer's business activity that the Board may  
11 require, or the taxpayer may request alternative  
12 apportionment. The evidentiary standard that attaches to  
13 this particular inquiry has been around for more than 40  
14 years as evidenced by the precedents that are cited in  
15 Fluor. The SBE standard was restated in Microsoft versus  
16 Franchise Tax Board where the California Supreme Court  
17 provided that it is a release valve to the standard  
18 formula not fairly reflect its activities. And the party  
19 seeking alternative apportionment, whether Board or the  
20 taxpayer must prove unfair representation by clear and  
21 convincing evidence.

22 The relevant precedence provide that the  
23 substantial and occasional sale rule, when satisfied,  
24 becomes the required UDITPA formula. In the Appeal of  
25 Fluor, the Appellant excluded gross receipts from its

1 sales factor, pursuant to the occasional and substantial  
2 sale rule, after selling a significant fraction of real  
3 property. The FTB objected, arguing that unless the  
4 Appellant carried the burden of proof, the inclusion of  
5 gross proceeds -- excuse me -- gross receipts in the sales  
6 factor produced distortive results, the Appellant couldn't  
7 rely on the regulation.

8 The SBE held that when the conditions of a  
9 regulation promulgated under section 25137 are met, those  
10 regulations become the standard apportionment formula  
11 without a need to show distortion by either party. This  
12 was seen again in the Appeal of Amarr where the asset  
13 sale, including the sale of goodwill, was at issue. The  
14 OTA specifically provided that if a relevant special  
15 formula is specifically provided for in R&TC section 25137  
16 regulations and the conditions and circumstances  
17 delineated in such regulations are satisfied, then the  
18 method of apportionment prescribed in those regulations  
19 shall be the standard apportionment by which those parties  
20 are to compute the Appellant's apportionment formula.

21 As we stated, removal of Worthington sale result  
22 in a 25 percent reduction in the sales factor denominator,  
23 thus, exceeding the 5 percent substantial threshold. It  
24 is a sale of intangible property, which is specifically  
25 encompassed in the appropriate regulation. Moreover, it's



1 occasional in that it isn't part of the normal course of  
2 Worthington's automotive sales of service, trade, or  
3 business and occurs infrequently. As the occasional and  
4 substantial elements are met, the application of the  
5 regulatory formula is required.

6 As the regulation is required, Worthington bears  
7 the burden of proof under R&TC section 25137. Amarr and  
8 Fluor provide that Worthington must prove by clear and  
9 convincing evidence that the formula is not  
10 representative. It has not done so. Worthington relies  
11 upon the location of its dealerships in Alaska and  
12 physical distance from California to presume that its  
13 unitary goodwill is somehow distinct. This is  
14 inconsistent with the unitary business principle.  
15 Intangibles of a unitary combined group are subject to  
16 UDITPA apportionment, rather than pre-UDITPA concepts  
17 regarding business situs for business income.

18 As the Microsoft court noted, it's the flow of  
19 value created by the unitary trade or business that  
20 animates the unitary business principle. And as Amarr  
21 noted, when citing to Borden, the value that's created  
22 over the life of the unitary relationship accretes as  
23 goodwill. Gain on a combined reporting group's  
24 disposition of a group member is interwoven with the  
25 taxpayer's business constitutes business income. That's

1       been upheld multiple times, first in Times Mirror Company  
2       versus Franchise Tax Board and again in Jim Beam Brands.

3               This concept was recently applied to a former OTA  
4       case of Metropoulos and JP Morgan Company of Delaware  
5       versus Franchise Tax Board where the Appellate Court held  
6       that goodwill in an asset sale is explicitly included in  
7       apportionable business income if it constitutes an  
8       integral part of the taxpayer's unitary business.  
9       Worthington's claims that its dealerships in Alaska and  
10      his connections are so distinct as to undermine the  
11      application of the unitary business principle in this  
12      respect is unsupportable. Worthington also asserts in its  
13      reply brief that it meets the burden under 25137 as to the  
14      application -- excuse me -- let me rephrase.

15             Worthington also asserts in its reply brief that  
16      it meets the evidentiary requirement under R&TC section  
17      25137 as the substantial and occasional sale rule yields  
18      at 31.89 percent sales factor in the year at issue, as  
19      opposed to previous year averages of approximately 27.92  
20      percent. The fact is that apportionment provides a  
21      constitutionally sufficient estimate of business income  
22      attributable to California, according to the Supreme Court  
23      of California in Microsoft. As referenced in Exhibit G,  
24      in the rejection of Worthington's 25137 request, the  
25      Appeal of Merrill, Lynch, Pierce, Fenner, and Smith,

1 furthers establishes that a difference between outcomes of  
2 various formulas is not de facto proof of distortion.

3 In conclusion, Amarr and Fluor provide the  
4 relevant guidance for the inquiries driving this case.  
5 Should Worthington seek to deviate from the standard  
6 UDITPA formula, which includes special regulations at CCR  
7 section 25137 and following, it bears the burden of proof.  
8 Worthington has not proven by clear and convincing  
9 evidence that the standard formula unfairly represents  
10 California business activities. And thus, its request for  
11 refund is without merit.

12 I'd be happy to accept any questions the Panel  
13 may have at this time.

14 JUDGE AKOPCHIKYAN: Thank you, Mr. Havens.

15 I'm going to go ahead and turn it over to my  
16 Panel members to see if they have any questions.

17 Judge Kletter, any questions for the Franchise  
18 Tax Board?

19 JUDGE KLETTER: This is Judge Kletter. I do not  
20 have any questions at this time. Thank you.

21 JUDGE AKOPCHIKYAN: Josh Lambert, any questions?  
22 I mean, Judge Lambert. I apologize.

23 JUDGE LAMBERT: This is Judge Lambert. No  
24 questions at this time. Thanks.

25 JUDGE AKOPCHIKYAN: Thank you.

1           Mr. Havens, you made a point to say that the sale  
2           of the dealership generated business income. I didn't  
3           think that was an issue on appeal, whether it generated  
4           business or non-business income. Do you think that it is?

5           MR. HAVENS: No, Judge. It is not particularly  
6           disputed here. The point that it was business income was  
7           merely to emphasize the application of the UDITPA standard  
8           factor to those receipts.

9           JUDGE AKOPCHIKYAN: Okay. Thank you. That's all  
10          I had.

11          Okay. Turning it over to Mr. Miles and  
12          Mr. Reggiardo for their rebuttal.

13          You have some time left over from your opening,  
14          so you could maybe take about 15 minutes, if you want.

15

16                                   CLOSING STATEMENT

17          MR. MILES: Thank you.

18          The first think I want to say is I almost  
19          interrupted Counsel because -- I don't know. We have our  
20          volume turned up as loud as it will go, and we can hardly  
21          hear the participants. So I don't know if there's  
22          anything on your end with your monitor, people, staff, if  
23          there's any way to turn up volume or not or speak closer.  
24          But I thought I would make that comment because we're --  
25          if you see us peering in, it's because we're trying to

1       hear what's being said.

2               With respect to the merits of a reply, as hard as  
3       I was listening, I again did not hear Counsel deal with  
4       the regulation that's clearly on point, how it's not on  
5       point. And merely by ignoring it doesn't really deal with  
6       the issue, the 27137 Regulation (1)(a)(C) [sic], where the  
7       income producing activity and respect to business income  
8       from intangible personal property can readily be  
9       identified. There's no question this wasn't a buy-sell  
10      agreement. It was spelled out. There's no dispute. The  
11      amounts were indicated in the buy-sell agreement. It's  
12      easily and readily identifiable.

13             This regulation is clearly on point. So if you  
14      go to the regulations, at least the Franchise Tax Board  
15      should be tasked with using the right regulation. So I  
16      don't think that's been responded to at all, and we don't  
17      think that it was repealed. It's still on the books, and  
18      we don't think that the regulation under 25136 [sic] has  
19      anything to do with this fact pattern. It's not been  
20      addressed by the Franchise Tax Board. I hope the Panel  
21      will at least address it, if not, rule in our favor on  
22      that point.

23             And as to the burden, issue, we simply have a  
24      disagreement. We respectfully understand why the Office  
25      of Tax Appeals would want to try to create some bright

1 line in this territory. But as we indicated, the statute,  
2 the law, the governing legislation tells us what we have  
3 to do, which is to include the goodwill and the intangible  
4 assets in the denominator in this instance. So we've just  
5 simply not heard anything that persuades us to the  
6 contrary.

7 Let me just ask Mr. Reggiardo if he want to add  
8 anything.

9 MR. REGGIARDO: The only thing I would add is on  
10 the burden of proof. I just think it needs to be very  
11 clear. We don't have a burden of proving anything  
12 regarding a regulation. So, again, our position is that a  
13 clear reading of the statute's plain language, not the  
14 least bit ambiguous, Revenue & Taxation Code section 25120  
15 and 25137 refer to this act. They don't refer to  
16 regulation supporting this act. We applied a UDITPA  
17 default provision of Revenue & Taxation Code section  
18 25134.

19 The Franchise Tax Board wants to deviate from  
20 that provision and, therefore, it bears the burden of  
21 proof. And we can understand how the Franchise Tax Board  
22 would like the law to read differently than it does, but  
23 this Panel can't pick up pen in hand and make the law read  
24 differently than it does. The legislature deals with  
25 policy decisions. If the FTB wants to lobby the

1 legislature for changes to make the law read the way the  
2 FTB wants it to read, then it should do so.

3 So the law reads the way it is, and it does, and  
4 it's clear and it's plain. And we believe this Panel has  
5 an obligation to simply read the statutes in Microsoft and  
6 apply it accordingly.

7 MR. MILES: I would just conclude. And then if  
8 there are any questions, again, we're happy to answer  
9 them.

10 But even if when you look at 25137, the entire  
11 premise behind the statute starts out, "If the allocation  
12 and appointment provisions of this act, referring to the  
13 default 25134, do not fairly represent the extent of the  
14 taxpayer's business activity in this state." Do not  
15 fairly represent the taxpayer's activity in this state.  
16 Well, there's nothing about the default provision in this  
17 instance that does not fairly represent all of the money  
18 and income that was made by the single dealership, and the  
19 State of California was taxed to the full hilt.

20 So the preliminary requirement of distorting the  
21 income being reduced by activity in the State of  
22 California is not implicated in the fact pattern that we  
23 have here. So 25137 really shouldn't even come into play  
24 because the preliminary requirement is not satisfied. Do  
25 not fairly represent the extent of the taxpayer's business

1 activity in this state. What the FTB -- Franchise Tax  
2 Board is just simply tried to do is they've tried to  
3 manipulate the facts, manipulate the regulation so as to  
4 tax goodwill generated in the State of Alaska.

5 And that's what the United States Supreme Court  
6 has been concerned about in its decisions. That at the,  
7 obviously, at the heart of the whole UDITPA statutory  
8 scheme where we're trying to create constitutional limits  
9 so that states can tax across state lines. But in this  
10 instance under these facts, we believe the State has  
11 simply gone too far.

12 And so with that, we're prepared to submit it.

13 MR. REGGIARDO: I'd like to add one thing. This  
14 is very similar to criminal trial where the defendant  
15 doesn't have to prove anything. And in our view, we  
16 followed the UDITPA default in the Revenue & Taxation Code  
17 section 25134. The Franchise Tax Board maintains that  
18 that does not fairly represent our activity here. It has  
19 the burden of proving otherwise under Microsoft, and it  
20 has to provide evidence. It's got to be -- it's a very  
21 high standard of evidence. It cannot simply point to a  
22 regulation.

23 And we are asking this Panel to recognize that  
24 Appeal of Fluor got it wrong, and Amarr following it got  
25 it wrong. I know that's a heavy ask, but that's what



1 we're asking. It's a matter of reading the statute and  
2 reading Microsoft.

3 And I think that's all I have.

4 JUDGE AKOPCHIKYAN: So to clarify, you're asking  
5 us to overturn our opinion in Appeal of Amarr and not --  
6 you're not distinguishing the Appeal of Amarr?

7 MR. MILES: Well, let me respond to that because  
8 I think that -- I don't think that's necessary. What's  
9 necessary is if the Panel wants to stay with the  
10 precedents that it has written, then I think we can look  
11 simply to the misapplication of the wrong regulation. If  
12 we're going to give deference to regulations, then let's  
13 apply the applicable regulation. And I think the decision  
14 can be decided on that basis alone.

15 Do we disagree with Amarr and Fluor to the extent  
16 that it gives FTB great deference in the writing of  
17 regulations? Yes. We think that it actually is not  
18 consistent with the statutory scheme. But I don't think  
19 that overturning those decisions is necessary to rule in  
20 the taxpayer's favor. Simply applying the right  
21 regulation, I think, would achieve the same result.

22 JUDGE AKOPCHIKYAN: So the regulation, you're  
23 referring to (c) (1) (C) over (c) (1) (A)?

24 MR. MILES: Yes, sir.

25 JUDGE AKOPCHIKYAN: Okay. I think I understand

1       your position.

2               And then with respect to Mr. Havens' sound, we  
3       did check with our stenographer when he was presenting  
4       because we also thought the sound was coming a little on  
5       the softer side, but we were able to transcribe everything  
6       accurately and heard everything he said. So the  
7       transcript will reflect his testimony.

8               MR. MILES: Thank you judge.

9               JUDGE AKOPCHIKYAN: Okay. I'm going to go ahead  
10       and turn it over to my Panel members to see if they have  
11       any final questions.

12              Judge Kletter, any final questions?

13              JUDGE KLETTER: This is Judge Kletter. I do not  
14       have any questions. Thank you.

15              JUDGE AKOPCHIKYAN: Judge Lambert, any questions?

16              JUDGE LAMBERT: This is Judge Lambert. Yeah, I  
17       had a question just for Appellant's arguments in terms of  
18       the regulations versus the statutes as discussed in, like,  
19       Fluor. And I think in the briefing it said Fluor would  
20       give the regulations equal dignity with the statutes, even  
21       though the regulations are subordinate to statutes.

22              And then I think there's cite to -- by FTB about  
23       Metropoulos Family Trust versus FTB that said regulations  
24       that are quasi-legislative have the same -- or accorded  
25       the same dignity as statutes. It cites to -- the court

1       cited to Western States Petroleum which says that when  
2       there's a regulation that is created because it warrants a  
3       special rule is quasi-legislative and having the dignity  
4       of statutes. So under the occasional sale regulation, I  
5       mean, it calls these regulations the rules. It calls them  
6       special rules, and it doesn't seem like they are  
7       interpreting the statutes.

8               So if these are special rules wouldn't.  
9       According to Metropoulos Family Trust, would they have the  
10      same dignity as statutes and be quasi-legislative?

11             MR. REGGIARDO: I can take part of it.

12             Well, I think that the regulations were issued  
13      under the authority of Revenue & Taxation Code  
14      Section 19503 as anything that's necessary for the  
15      enforcement of them. I don't see how they are  
16      quasi-legislative. And even if they were, the language of  
17      Revenue & Taxation Code section 25137 referring to, quote,  
18      "This act," is very limited. It's referring to those  
19      statutes to find in Revenue & Taxation Code section 25120,  
20      and it doesn't refer to anything else. So if the  
21      legislature wanted to give equal dignity to the  
22      regulation, it could certainly do so. But it has not done  
23      so.

24             JUDGE LAMBERT: Thanks. Just to follow up,  
25      you're talking about 19503. I believe in Western States

1       Petroleum there's a concurrence that said that 19503 is  
2       not enough to make it quasi-legislative. And I believe  
3       the majority was ruling that that was incorrect. I don't  
4       know if you're familiar with that case to that extent.

5               MR. REGGIARDO: I'm not, to be honest with you.  
6       But I also looked at the language of Revenue & Taxation  
7       Code section 25137, and it refers to this act. It doesn't  
8       refer to this act and any other statutes. It doesn't  
9       refer to this act and any regulation supporting this act.  
10      It doesn't refer to this act and any regulations  
11      supporting this act that may be given legislative effect.  
12      It's very specific. It refers to this act. And the  
13      statutory -- it's right there in Microsoft how you apply  
14      statutes. If the statute is plain on its face, you apply  
15      it. You stop. You stop right there. You read the  
16      language and apply it. And that's what we're asking this  
17      Panel to do.

18             JUDGE LAMBERT: Okay. Thank you.

19             MR. MILES: I would just add, you know, it's a  
20      question of how far can the Franchise Tax Board go in  
21      writing its regulation. Let's assume that hypothetically  
22      it wrote a regulation that was completely contrary to  
23      25134, the general rule, which at a certain level the  
24      Regulation 25137 when it compels a different result, then  
25      the general rule in 25134 it really is, in effect, writing

1 an antithetical rule.

2 But let's just say it was even more plain than  
3 that. How far does the -- how much deference is given for  
4 them to begin writing regulations that are at odds with  
5 the statutory scheme? This is not an interpretive matter  
6 because as Mr. Reggiardo said, 25134 is pretty plain on  
7 its face. So the FTB has kind of wondered off and written  
8 a regulation to help -- frankly, to help collect more  
9 taxes for the State of California. And it's applying it  
10 in this instance by ignoring other regulations which  
11 really should be applied in this particular instance.

12 So, I mean, I think it's an interesting issue,  
13 and I think that someday the Courts of Appeal may want to  
14 opine, or the legislature may want to start getting into  
15 the weeds on the statutes and regulations that are here.  
16 But I think that to have a decision where state agencies  
17 say forget what the law says, forget what 25134 and 25137,  
18 the statute themselves, say. If FTB writes a regulation,  
19 we're going to put the onus on the taxpayer to overcome  
20 that regulation by clear and convincing evidence.

21 We just don't think that that's what the  
22 legislature would intend or agree with. And as I said  
23 again, and I just repeat it because I don't want to get  
24 lost in the discussion, while we think that these are  
25 important issues, we think the case really is much more

1 easily decided by simply applying the right regulation, if  
2 we're going to go in that direction.

3 Thank you, Your Honor.

4 JUDGE LAMBERT: This is Judge Lambert. Thanks.  
5 I appreciate the answers. I don't have any questions  
6 further.

7 JUDGE AKOPCHIKYAN: All right. Thank you  
8 everybody. Does either party have any questions for us  
9 before we conclude?

10 MR. HAVENS: No, Judge.

11 JUDGE AKOPCHIKYAN: Thank you.

12 All right. So I guess we're ready to conclude  
13 this hearing. This case is submitted on December 13th,  
14 2023, and the record is now closed.

15 I want to thank the parties for their  
16 presentation today. The Panel will meet and decide this  
17 appeal based on the arguments and evidence presented to  
18 the Office of Tax Appeals. And we will issue our written  
19 decision within 100 days from today.

20 This concludes the last hearing for today, and we  
21 will reconvene tomorrow morning at 9:30 a.m. Thank you.

22 (Proceedings adjourned at 2:24 p.m.)

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I, Ernalyne M. Alonzo, Hearing Reporter in and for  
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That the foregoing transcript of proceedings was  
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I further certify that I am in no way interested  
in the outcome of said action.

I have hereunto subscribed my name this 28th day  
of December, 2023.

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ERNALYN M. ALONZO  
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