

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:) OTA Case No. 220410163
WORTHINGTON OIL & GAS)
CORPORATION)
_____)

OPINION

Representing the Parties:

For Appellant: Lawrence W. Miles, Jr., Attorney
Sil Reggiardo, Attorney

For Respondent: Kenneth B. Havens Jr., Attorney
Katie Frank, Attorney

For Office of Tax Appeals: William J. Stafford, Attorney

O. AKOPCHIKYAN, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19331, Worthington Oil & Gas Corporation (appellant) appeals Franchise Tax Board’s (FTB’s) deemed denial of appellant’s claim for refund of \$230,632 plus applicable interest for the 2016 tax year.

Office of Tax Appeals (OTA) Administrative Law Judges Josh Lambert, Asaf Kletter, and Ovsep Akopchikyan held an electronic oral hearing for this matter on December 13, 2023. At the conclusion of the hearing, the record was closed and this matter was submitted for decision.

ISSUE

Whether gross receipts from appellant’s sale of its Alaska automobile dealerships were properly excluded from appellant’s California sales factor pursuant to California Code of Regulations, title 18, (Regulation) section 25137(c)(1)(A) as receipts arising from a substantial and occasional sale.

FACTUAL FINDINGS

1. Appellant was the parent company of a unitary business which operated automobile dealerships in California and Alaska during the 2016 tax year.
2. On November 16, 2016, appellant sold to an unrelated third party the assets of its subsidiary corporations, Worthington Ford of Alaska, Inc. and Worthington Imports of Alaska, Inc., for net proceeds of \$53,162,886. The subsidiaries held all the automobile dealerships in Alaska, and their assets were largely comprised of goodwill.
3. On appellant's California Corporation Franchise or Income Tax Return for the 2016 tax year (Form 100), appellant reported the gain on the sale of the Alaska dealerships as business income and used a single-sales factor, which included the gross receipts attributable to the sale of the Alaska dealerships in the denominator but not the numerator, to apportion its total business income.
4. On audit, FTB excluded the gross receipts attributable to the sale of the Alaska dealerships from appellant's California single-sales factor as receipts arising from a substantial and occasional sale under Regulation section 25137(c)(1)(A).
5. On March 20, 2019, FTB issued a Notice of Proposed Assessment, which proposed to assess additional tax of \$210,632, plus applicable interest, for the 2016 tax year.
6. On June 20, 2019, appellant paid the proposed assessment in full and filed a claim for refund.
7. Because FTB failed to issue any notice denying the refund claim within six months, appellant deemed the claim denied and filed this timely appeal.
8. On or about August 14, 2020, appellant submitted a request for alternative apportionment under R&TC section 25137. FTB denied the request in a determination letter dated May 21, 2021.

DISCUSSION

The parties do not dispute that the asset sale generated apportionable business income. For taxable years beginning on or after January 1, 2013, all business income of most apportioning trades or businesses shall be apportioned to this state by multiplying the business income by the sales factor. (See R&TC, § 25128.7.) The sales factor is a fraction, the numerator

of which is the taxpayer's total sales in California during the tax year and the denominator of which is the taxpayer's total sales everywhere during the tax year. (R&TC, § 25134.)

The term "sales" is defined as "all gross receipts of the taxpayer not allocated [as nonbusiness income] under [R&TC] [s]ections 25123 to 25127, inclusive." (R&TC, § 25120(f)(1).) "Gross Receipts" is defined in part as "the gross amounts realized (the sum of money and the fair market value of other property or services received) on the sale or exchange of property . . . in a transaction that produces business income, in which the income, gain, or loss is recognized . . . under the Internal Revenue Code, as applicable for purposes of this part." (R&TC, § 25120(f)(2).)

R&TC section 25137 provides that if the allocation and apportionment provisions of California's version of the Uniform Division of Income for Tax Purposes Act (UDITPA) do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for or FTB may require, in respect to all or any part of the taxpayer's business activity, if reasonable: (a) separate accounting; (b) the exclusion of any one or more of the factors; (c) the inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state; or (d) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

FTB has promulgated special apportionment regulations under R&TC section 25137. OTA precedent provides that, "[i]f a relevant special formula is specifically provided for in the R&TC section 25137 regulations and the conditions and circumstances delineated in such regulations are satisfied, the method of apportionment prescribed in those regulations shall be the standard by which the parties are to compute the taxpayer's apportionment formula." (*Appeal of Amarr Company*, 2022-OTA-041P (*Amarr*), citing *Appeal of Fluor Corp.* (95-SBE-016) 1995 WL 799363 (*Fluor*).) "In other words, once found to be applicable to the particular situation, the R&TC section 25137 regulations will control." (*Ibid.*) "Any party wishing to deviate from the method prescribed by the R&TC section 25137 regulations, when found to be applicable, must establish by clear and convincing evidence that the regulation does not fairly represent the extent of the taxpayer's activities in this state." (*Ibid.*)

As part of its special apportionment regulations, FTB has promulgated Regulation section 25137(c)(1)(A), which provides:

Where substantial amounts of gross receipts arise from an occasional sale of a fixed asset or other property held or used in the regular course of the taxpayer's trade or business, such gross receipts shall be excluded from the sales factor. For example, gross receipts from the sale of a factory, patent, or affiliate's stock will be excluded if substantial. For purposes of this subsection, sales of assets to the same purchaser in a single year will be aggregated to determine if the combined gross receipts are substantial.

"A sale is substantial if its exclusion results in a five percent or greater decrease in the sales factor denominator of the taxpayer or, if the taxpayer is part of a combined reporting group, a five percent or greater decrease in the sales factor denominator of the group as a whole." (Cal. Code Regs., tit. 18, § 25137(c)(1)(A)(1).) In addition, "a sale is occasional if the transaction is outside of the taxpayer's normal course of business and occurs infrequently." (Cal. Code Regs., tit. 18, § 25137(c)(1)(A)(2).) If the elements of the regulation are met, receipts from the substantial and occasional sale shall be excluded from the numerator and the denominator of the taxpayer's sales factor. (Cal. Code Regs., tit. 18, §§ 25137(c)(1)(A), 25134(a)(2), (b).)

Here, FTB determined that the sale of appellant's Alaska dealerships was a substantial and occasional sale under Regulation section 25137(c)(1)(A). FTB therefore excluded appellant's receipts attributable to the sale of the Alaska dealerships from the sales factor. Appellant concedes that the asset sale was a substantial and occasional sale for purposes of Regulation section 25137(c)(1)(A).¹ However, appellant asserts, for various reasons, that FTB cannot apply Regulation section 25137(c)(1)(A) in this appeal.

First, appellant asks OTA to overturn *Fluor* and *Amarr*'s holding that Regulation section 25137(c)(1)(A) is part of the standard apportionment formula under California law. Appellant contends that the substantial and occasional sale rule is not part of the standard apportionment formula of California's UDITPA and, therefore, FTB is required to invoke R&TC section 25137 and establish by clear and convincing evidence that the standard apportionment formula (without the substantial and occasional sale rule) is distortive.

¹ At the hearing, appellant conditioned its concession on OTA finding that the substantial and occasional sale rule in Regulation section 25137(c)(1)(A) applies to the sale of intangibles, as appellant's sale was largely attributable to goodwill. However, in its briefing, appellant seemingly also concedes that Regulation section 25137(c)(1)(A) applies to intangibles by arguing that "if an isolated and substantial sale of intangible property in this state occurs (such that R&TC § 25136 applies), Regulation § 25137(c)(1)(A) applies." In any event, OTA observed in *Amarr* that Regulation section 25137(c)(1)(A) was amended in 2001 to apply to intangibles.

Appellant has not persuaded this panel that OTA should overturn *Fluor* and *Amarr*. *Fluor*'s holding on this issue is a longstanding California law and this panel does not believe *Fluor* and *Amarr* are clearly wrong such that OTA should depart from stare decisis. (Cal. Code Regs., tit. 18, § 30504.)

Second, appellant's alternative position is that if OTA does not overturn *Fluor* and *Amarr*, OTA should direct FTB to apply Regulation section 25137(c)(1)(C) rather than Regulation section 25137(c)(1)(A). Regulation section 25137(c)(1)(C) provides in part as follows:

Where the income producing activity in respect to business income from intangible personal property can be readily identified, such income is included in the denominator of the sales factor and, if the income producing activity occurs in this state, in the numerator of the sales factor as well.

Amarr squarely addresses appellant's alternative position; it concludes that Regulation section 25137(c)(1)(C) does not apply to tax years beginning on or after January 1, 2013.² This appeal is for the 2016 tax year and, therefore, Regulation section 25137(c)(1)(C) does not apply.³

Third, appellant contends that if Regulation section 25137(c)(1)(A)'s substantial and occasional sale rule applies because it is part of the standard apportionment formula, appellant has nevertheless properly invoked R&TC section 25137 and established that the substantial and occasional sale rule does not fairly represent the extent of appellant's business activities in California. Specifically, appellant contends that its burden has been satisfied because the tax at hand is unconstitutional⁴ and excessive, as shown by the fact that appellant's California sales factor for the 2016 tax year is approximately 15 percent higher than in any other tax year. Appellant, however, has not provided evidence showing that (1) the approximation provided by the standard formula is not a fair representation of its business activities in this state, and (2) its proposed alternative of including gross receipts from the sale of its Alaska automobile

² *Amarr* concludes that Regulation section 25137(c)(1)(C) does not apply to tax years beginning on or after January 1, 2011, and that is true if a taxpayer elected to use a single-sales factor for the 2011 and 2012 tax years.

³ Other reasons aside from the promulgation of Regulation section 25136-2(h)(3)(B) support the determination that Regulation section 25137(c)(1)(C) is inapplicable for the 2016 tax year, such as Regulation section 25137(c)(1)(C)'s use of the phrase "income producing activity," which is a term of art used primarily in cost-of-performance and not market-based sourcing regimes.

⁴ In general, OTA is precluded from determining the federal constitutionality of California statutes and regulations. (Cal. Const., art III, § 3.5; Cal. Code Regs., tit. 18, § 30104(a); see also *Appeal of Acosta and Castro*, 2022-OTA-235P.)

dealerships in its California sales factor is reasonable. (*Microsoft Corp. v. Franchise Tax Bd.* (2006) 39 Cal.4th 750, 765.)

HOLDING

Gross receipts from appellant’s sale of its Alaska automobile dealerships were properly excluded from appellant’s California sales factor pursuant to Regulation section 25137(c)(1)(A) as receipts arising from a substantial and occasional sale.⁵

DISPOSITION

FTB’s deemed denial of appellant’s claim for refund for the 2016 tax year is sustained.

DocuSigned by:

Ovsep Akopchikyan

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Ovsep Akopchikyan
Administrative Law Judge

We concur:

DocuSigned by:

Asaf Kletter

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Asaf Kletter
Administrative Law Judge

DocuSigned by:

Josh Lambert

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Josh Lambert
Administrative Law Judge

Dated: 3/8/2024

⁵ To the extent appellant raises other arguments that this Opinion does not specifically address, this panel has reviewed those arguments and considers them unpersuasive.