

Speaker 1 ([00:00](#)):

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Speaker 2 ([00:15](#)):

Do want to alert the listeners that I have two very active dogs, three month old puppy in the room, so at any moment we could mute very quickly.

Speaker 2 ([00:28](#)):

Hello and welcome to GeTtin' SALTy, a state and local tax policy podcast hosted by Greenberg Traurig. My name is Nikki Dobay, shareholder in Sacramento, California, and Portland, Oregon offices. Welcome to 2024. I am super happy to be joined with this first episode of 2024 by my shareholder friend Shail Shah in the San Francisco office. And Shail, we are just going to have a little chat about some of the big events of 2023, some of the big cases you were following. You're going to get us up to speed on some California stuff as usual, and then we will just chat a little bit about what we think might happen in 2024. So thank you so much for joining me.

Speaker 3 ([01:15](#)):

Yeah, absolutely. I think we have a lot to talk about and hopefully an hour is enough to discuss all the things that are on the docket.

Speaker 2 ([01:22](#)):

Oh, this is a marathon today, we got four. No, no, that is not true. We will not be here for four hours. And I do want to alert the listeners that I have two very active dogs, three month old puppy in the room, so at any moment we could mute very quickly, but hopefully they'll just agree with all of our tax policy thought. So Shail, where would you like to kick us off today? I know you've been thinking about some cases in 2023, and so maybe what are a couple of your favorite cases that came down last year? I know it had been a little quiet on the litigation front for a couple years, but 2023 seemed like we had a lot of activity on the litigation front. So kick us off.

Speaker 3 ([02:09](#)):

Yeah, I'll start with the general theme, at least that I've been seeing in California. And there's been a case outside of California and it's around alternative apportionment, and it's the veteran case out of Michigan. I think that was a case that a lot of practitioners, companies, even government officials were keeping an eye on. And procedurally it was somewhat interesting because the appellate court actually came out in favor of the taxpayer. So there was this little, at least momentary champagne popping by taxpayers. And then unfortunately the Michigan Supreme Court reversed the appellate court ruling. But that one was... Sorry, go ahead, Nikki.

Speaker 2 ([02:51](#)):

Oh no. I'd just like to give a big shout-out to Lynn Gandhi for bringing that case. And as you mentioned, the appellate court decision was so strong in favor of taxpayers, and so it was really disappointing to see where the Supreme Court took this.

Speaker 3 ([03:09](#)):

Yeah. And the fact pattern veteran is not all that dissimilar to what we see with a lot of taxpayers. You have a out-of-state company that they're based in Minnesota, had very limited activity in Michigan except for this one cleanup, toxic cleanup project they had in Michigan. It happened to just coincide with when there was an asset sale. And ultimately the question there was two parts in front of the court. One was whether the receipts from the asset sale are included in the sales factor of Michigan, and then two, if they are, whether alternative apportionment is warranted?

Speaker 3 ([03:51](#)):

And I think it was fairly clear based off of Michigan's somewhat specific statute that the receipts are not included in the sales factor. And I think although there was a little bit of pushback from the taxpayer, I think overall that issue was pretty easily dismissed by both the appellate court and the Supreme Court. But then the question came around alternative apportionment and the appellate court looked at it and said, well, this seems like a perfect candidate for alternative apportionment. You have a company that's located outside of Michigan, historically very small sales factor in Michigan. And then suddenly at the time of the sale they had this huge, it was almost 10X sales factor.

Speaker 2 ([04:32](#)):

Yeah, I think it went from 7% to 70%. It was something astronomical. It was like one of those, you know it when you see it, and that seemed like you know it.

Speaker 3 ([04:46](#)):

Yeah. And it just, from everyone's perspective, including myself, I was like, if there is not a better case long-term apportionment, I don't don't know what it is, and the appellate court saw it that way and they said, look, clearly and this out-of-state company apportioning 70% of their income to Michigan does not reflect the business activity in Michigan because again, they only have the small activity for one year. But the Supreme Court disagreed, and I think it was shocking to a lot of us. The analysis was pretty twisted to say the least, and how they got there, and the dissent, it was a pretty fiery dissent. And the dissent really clearly said, look, this seems very unfair to subject this entire asset sale, a vast majority of this asset sale to tax in Michigan, and then also not provide any factor representation. And I know the US Supreme Court rejected the request for review, which was unfortunate. But Nikki, it begs the question, if alternative apportionment is not warranted in this situation, I don't know when can a taxpayer actually successfully bring an alternative apportionment petition to a state?

Speaker 2 ([06:08](#)):

Shail, you're really bringing me down. That's a really pessimistic outlook on this issue. So tell me there's some better news in California.

Speaker 3 ([06:18](#)):

Well, there is, and it's somewhat related around factor representation. Michigan was the wah-wah trombone, boo, everyone was pretty upset. But there's been surprisingly in California some decent taxpayer wins. And the first one I want to discuss is the Southern Minnesota Beet Sugar Cooperative case, which was an office of tax appeal decision. And that while it was not an alternative apportionment decision, it was a factor representation decision. And California has a statute around co-ops. And co-ops, so if you meet the statutory definition of co-ops, you're able to take a deduction for a portion of your income related to co-op activity. And in this case, you had a co-op. The co-op had acquired a non co-ops,

and they both filed a unitary return to California. And what the taxpayer did when they filed their return was they took the deductions for the co-op entity, but all the receipts that were generated within the unitary group, they included everything in their sales factor.

Speaker 3 ([07:31](#)):

And what the FTB said was, well, since you're taking a deduction for the co-op revenue, you have to exclude that portion of receipts from the sales factor. And they went back and they were talking about, there's this really old case in California called Chase Brass, and they said, well, you have to have some correlation between income and receipts. And the OTA said no. And the OTA said, you know what? Gross receipts means gross receipts. And there is a distinction between what goes in your sales factor and what's included in income. And the bottom line is you include everything in your gross receipts. And the fact that you can take a deduction later on to arrive to California taxable income is a completely separate analysis from what's included in the sales factor.

Speaker 3 ([08:21](#)):

So, I'll say I was shocked that the OTA came out in favor of the taxpayer, largely because again, I'm pessimistic about California having practiced in this state for over 16 years. It is, as you're aware, it's rare to see a taxpayer win in California. But it was a great case. And I'll say one more thing about it. There was these hints along the way with the OTA that they had an expansive view of gross receipts based off of other decisions that was Bed Bath & Beyond decision. There was other decisions that had come out earlier. So they laid the groundwork, but this was the big put a stop to the FDB shenanigan decision.

Speaker 2 ([09:07](#)):

So Shail, is this trend going to continue? Is the OTA our savior when it comes to alternative apportionment in gross receipts?

Speaker 3 ([09:16](#)):

I think at least when it comes to gross receipts, I think the OTA has a pretty liberal view of what constitutes gross receipts. Of course, that cuts both ways. There maybe instances where that favors the state, but for most out-of-state taxpayers, that tends to favor the taxpayer. And there was another case in which there is not a decision yet, but we can read between the lines because of the subsequent filings that have been issued at the OTA, but there was a Microsoft case. And that case, which went through oral arguments last year, and a decision has not been published yet, but I'll talk about procedurally why I think the taxpayer probably prevailed on some of the issues. But in Microsoft, everyone here knows 965 under TCJA, corporations had to repatriate a bunch of foreign earnings back into the United States.

Speaker 3 ([10:19](#)):

And Microsoft did that. And Microsoft filed a waters edge return in California. And California provides a 75% DRD for dividends from CFCs. And Microsoft took the DRD, but they included the full amount. These were billions and billions of dollars of foreign earnings that repatriated back into the US. And Microsoft included the full amount and the sales factor. And FTB came in and said, well, since, a similar argument that they made with Minnesota Beet Sugar, they're saying, well, since you're taking a 75% DRD, only 25% of the receipts should be included in sales factor, and you should remove 75% of it. And the taxpayer made a similar argument that the Minnesota Beet Sugar Council made in front of the OTA, which was largely, look, these are gross receipts. The fact that we take a deduction after the fact doesn't

prevent us from including this into our sales factor. And we don't have a decision yet. But we do know the Franchise Tax Board filed a petition for rehearing, which typically-

Speaker 2 ([11:30](#)):

Which they wouldn't have done if they won.

Speaker 3 ([11:32](#)):

Yeah. So look, I'm not going to say who won or lost, but I'm just saying that if we're reading that the tea leaves here, it seems like it's likely that the Franchise Tax Board lost. And the FTV alleged all these errors, but they really didn't address any of the really technical issues that the OTA discussed in their petition for rehearing. It almost seemed like the FTB is trying to get an out on some procedural nuance. But I would be very, very, very shocked, and that's three verys there, if the OTA overturns its own decision, because I don't think the FTB really put forth any technical arguments as to why they thought the OTA, or why they thought Microsoft's arguments were incorrect.

Speaker 2 ([12:20](#)):

So Shail on this topic, well one, it sounds like we're going to find out what the OTA ultimately does with this petition for rehearing. So that is definitely something to keep on our radar because if the tea leaves that you're reading are correct, it seems like the Microsoft decision will be very favorable for taxpayers and really a good counterbalance to what we're seeing in so many other states where they're trying to just take this very expansive view of what comes into the tax base, but a very limited view of what should be included in the factor for purposes of representation. So for once, it's good to see California being a leader on some of these issues. So any final thoughts on those decisions or alternative apportionment or what we might see in 2024 on that issue?

Speaker 3 ([13:12](#)):

Yeah, I think the other consideration is, so the Minnesota Beet Sugar case is precedential. That means taxpayers can rely on that decision. Assuming Microsoft is favorable to the taxpayer, it'll be interesting to see if the OTA also designates that as precedential. There is the Smithfield case, which is making its way through the California Superior Court. Last I saw, I think the trial is supposed to start in the summer of summer of 2024. And that case also has an alternative apportionment bent to it. The taxpayer is arguing that one, either they qualify as an agricultural business and under the California Revenue Taxation code that provides the taxpayer the ability to use a three factor apportionment formula. And in the alternative, they have argued that if they don't qualify as an agricultural business, that they're entitled to three factor under alternative apportionment.

Speaker 3 ([14:13](#)):

So that case is out there, we'll see what happens. But having done this for a while and practicing in California for a while, a lot of these things are very cyclical. And alternative apportionment is, I remember when I first started my career in the mid 2000s, it was a very popular mechanism for taxpayers to get relief. And it was largely around COP and asking for market day sourcing. And now it's in fashion again, it's like in vogue to [inaudible 00:14:45] apportionment. And so it's somewhat interesting how the cycles work.

Speaker 2 ([14:49](#)):

Well, and it's also interesting because as so many of the states shift to single sales factor and have moved away from, and it's been what? Almost about 10 years, 10, 11 years since California moved to single sales. So it's somewhat expected that you would see there are definitely situations where taxpayers, it will be more beneficial to use a three factor. And so they will definitely want to assert that. And sorry for the squeaking folks. She's only three months old and there's only so much I could do. But there's one other big case I want to talk about in California, Shail, because this one I think is pretty significant when it comes to regulations in California, and that's the American Catalog Mailers Association case. And so catch us up on that case and what is the real significance there?

Speaker 3 ([15:44](#)):

Yeah, that's a really interesting nerdy procedural case. So I think a lot of people know that the MPC came out with their guidance on public law 86-272, and the MTC had a working group that included individuals from the franchise tax board that were part of that group. And I think the goal of the group was to modernize the interpretation of PL 86-272. Now, I know we're on a podcast and I'm air quoting here, but-

Speaker 2 ([16:17](#)):

And I may have a different impression of that process.

Speaker 3 ([16:22](#)):

In air quotes, it's to modernize 86-272. And historically, California has issued a publication on their interpretation of 86-272. It's been around for a long time. And then in response to the MTC's guidance, the FTB issued what's called the technical advice memorandum. And what that is, is that is a memo from FTB Legal to FTB Audit on legal's interpretation of 86-272 in light of the MTC's interpretation of 86-272. And generally, not surprisingly to anybody listening to this podcast is that the MTC in California's interpretation of 86-272 is that it has very limited protection. And basically if you sneeze in California, sneezing is a service and therefore you've broken 86-272. It's a fairly, it's-

Speaker 2 ([17:22](#)):

Yeah, it's like if you have a functional website, then you've blown your protection. And any good business person has a functional website. So 86-272 gone ergo.

Speaker 3 ([17:34](#)):

Yeah, if you look at the interpretation, you have to be put forth unless you are some sort of a caveman company under a rock, no one would qualify for 86-272 [inaudible 00:17:50] FTBs.

Speaker 2 ([17:50](#)):

That really just takes me back to the Saturday Night Live sketch, the Caveman Lawyer. So I think that's what we can use for this. So unless you're a caveman lawyer, you've blown your 86-272 protection.

Speaker 3 ([18:04](#)):

Blown 86-272. Yeah. So the American Catalog Mailers Association, they are a trade group, and they sued the FTB basically saying that the FTB's interpretation of 86-272 is invalid. And there were a couple of hurdles they had to get over. One was standing because again, they're not taxpayers, they're a trade group representing taxpayers. And they got over the standing issue. And the recent decision that came

out from the California Superior Court was, look, they didn't necessarily provide any guidance on whether the FTB's interpretation of 86-272 is incorrect. But what they did say was that the guidance set forth by the FTB are regulations and regulations in California have to go through the Administrative Procedures Act. And like I said, Nikki, this is a very nerdy procedural area and I love it.

Speaker 2 ([19:08](#)):

Bring it on. This is a very nerdy podcast.

Speaker 3 ([19:12](#)):

So regulations in California have to go through the Administrative Procedures Act, and there are elements that have been set forth through case law in California on what constitutes a regulation. And if you meet that criteria, you go through the AP process. And so what the court did was they looked at the term, they looked at the FTB's publication, and they said, okay, is there broad applicability? The answer was yes, because it deals with 86-272, and it's not specific to a taxpayer or an industry specific. It applies to everybody.

Speaker 3 ([19:46](#)):

And then two, are they providing any interpretation of a law or regulation? And they are providing interpretation of a federal law, which 86-272. So the court said, well, that fits the definition of a regulation in California, and you FTB did not go through Administrative Procedures Act. And I think it's a big deal for this specific issue for 86-272, but it's even a bigger deal should the FTB lose an appeal. And I would imagine they're going to appeal this case, that this could blow up decades of legal rulings and publications issued by the FTB that they routinely rely on, routinely cite when auditing taxpayers or arguing in front of the OTA. And there is this, like I said, for lack of a better phrase, this body of underground regulations in California that the FTB has promulgated over decades.

Speaker 2 ([20:44](#)):

And Shail, I'm pretty sure it was one of the cases that came out of the OTA earlier this year where the taxpayer had asked the OTA to address the validity of a regulation and the OTA declined to do so saying that they didn't have the authority to do that. Again, assuming this gets appealed and we get a favorable decision from the appellate court, this could significantly shift any deference that the FTB or CDTFA are provided in front of the OTA as well. You could see a lot of ripple effects from this decision.

Speaker 3 ([21:23](#)):

Yeah. And I think those are two separate issues. And I'll address the second one, we can talk about the first one, but you're right, if you think about even going back to Minnesota Beet Sugar case, the FTB relied heavily on legal ruling 2006-1, which was their interpretation of what constitutes, or what goes into the sales factor. But now, if all those rulings are invalid because they did not go through the APA, then you're right, the OTA cannot provide any deference to those because they're actually invalid, they're nothing, they're worth just the paper that they're written on.

Speaker 2 ([22:04](#)):

They're the FTB position, but that's the same as the taxpayer's position. So in theory, they should be weighted equally.

Speaker 3 ([22:14](#)):

Exactly. So you have that issue. The issue that you brought up, that was the Janice Case that went through tax appeal.

Speaker 2 ([22:24](#)):

Okay. Okay.

Speaker 3 ([22:25](#)):

Slightly different issue. That issue dealt more with the OTA's jurisdiction to invalidate a regulation. And that again, was somewhat an interesting case because the OTA stepped into the shoes of the board of equalization when the BOE was dismantled. And the BOE in years past, they have invalidated regulations when there was a direct conflict between a statute and a regulation. And in Janice there was a direct conflict between a statute and a regulation. And the OTA said they did not have the authority to invalidate the reg. They did reach out to the attorney general's office and they are requesting an opinion from the AG's office on whether either through statute or through regulations, they have the ability to invalidate a regulation. So there's more to come there, we'll see what happens. But all of these procedural issues are all falling at the same time. And if these all cut in favor of the taxpayer, I think it would, not I think, I know it's going to radically change the way controversy is managed in California.

Speaker 2 ([23:43](#)):

Yeah. And this is a difficult place to be in also because taxpayers want guidance from the agency, we generally want to know what their positions are because one, they may be favorable and that would be helpful, or if they're not favorable, at least we know where we're at with respect to how we would potentially assert a position. So if the FTB, CDTFA, the umpteen other agencies you all have in California, have to go through the APA process to provide any sort of written guidance, that's a slow [inaudible 00:24:22] process. And you could see just the agency providing guidance coming to a screeching halt, but they could still take those positions on audit, and now we're just in a black box about their position. So these issues are always, they cut a little bit of both ways, but I think you're right. If the American Catalogs Mailers Association case continues down the path that it's on, it could very much change how you all work in California.

Speaker 3 ([24:59](#)):

Yeah, it's a great point. You're right, it is a double-edged sword. You don't realize it until you work in other states how much guidance California has compared to other states. And oftentimes it's great, because I know a lot of my peers who practice heavily in states outside of California oftentimes look to California guidance to analogize when there's a lack of guidance in their own state. So you're right, it could cut both ways. And maybe the best case scenario for taxpayers is that FTB still continues to issue guidance, but it is very clear that no difference can be given any of the guidance unless it's gone through the APA and it becomes a regulation.

Speaker 2 ([25:42](#)):

Yeah. And that's a really great point, and I think really where things probably should be because if it goes through the APA process, obviously stakeholders have had the ability to weigh in, and so then perhaps differences provided. But to the extent it hasn't and it hasn't gone through that extensive process, why should it have any more weight than the taxpayer's position? Well, I think we've spent all of our time on California, it's crazy how that seems to happen, but a lot going on. Are there any other cases that we

should have on our radar in California or things that are coming up and maybe teasers for the next California litigation podcast?

Speaker 3 ([26:30](#)):

I think those are the big cases right now in California, there's been a litany decisions coming out of the OTA around personal income apportionment rules. And so BINLEY was really the big case that came out. There was a Larsson case, there were a few other cases, and I think we're going to see litigation around that issue because in a nutshell, there are a lot of instances where there is an individual who is outside of California and may earn income through a 1099 and sporadically the OTA has latch on this concept of self unity where sole proprietor is unitary with him or herself, and because they're unitary with him or herself, they're required to apportion their income. And then you look at the market-based sourcing rules, and then suddenly somebody who's sitting outside of California is paying taxes in California only because they received a 1099. And a lot of these decisions are patchwork decisions. So I think that is one area I would not be surprised if we start seeing litigation.

Speaker 2 ([27:53](#)):

All right. All right. And that's akin to some of those investee apportionment cases that we're seeing around the country as well. This definitely seems to be an area where the states are really taking a different view of how to tax members of LLCs or partnerships or whatnot. So definitely more to come. So well Shail, thank you so much. I can't let you go without a surprise non-tax question. So I thought, what could I ask the guy from Southern California as I sit in my house where we're under a blizzard warning. So this is what the question's going to be. If you were in a blizzard, I don't know if you've ever been in a blizzard, how would you prepare?

Speaker 2 ([28:37](#)):

So I don't think this is actually a blizzard, so I haven't prepared at all, and I would probably be pretty bad at preparing. But when my husband did ask me if I was prepared, I said, well, I have a lot of noodles and there's plenty of wine, so I think I'll be fine, and the dogs have food. So I didn't do a lot of prep, but how would you prepare for a blizzard? I really am curious about how you might go about this if you were ever put in this situation.

Speaker 3 ([29:06](#)):

So you're right, Nikki. I've never been in a blizzard. I've never shoveled-

Speaker 2 ([29:14](#)):

I mostly just wanted that on the air.

Speaker 3 ([29:14](#)):

I've never shoveled snow. I have never seen a snowblower in my life.

Speaker 2 ([29:19](#)):

You've never seen a snowblower. One just went by my window this morning.

Speaker 3 ([29:25](#)):

So I would make sure I have beer, wine, and that the internet's working so I can watch sports. And I think that's pretty much it.

Speaker 2 ([29:36](#)):

Wow. You really know nothing about a blizzard.

Speaker 3 ([29:39](#)):

No, absolutely no idea. Earthquakes and wildfires.

Speaker 2 ([29:43](#)):

All right, you got me there.

Speaker 3 ([29:45](#)):

Yep.

Speaker 2 ([29:48](#)):

All right. We'll expand it to natural disaster, but hopefully neither of us will be in a natural disaster anytime soon. But I mostly just wanted you to say whether or not you'd been in a blizzard before, so you'll have to come to Bend in the wintertime. Well, thank you again for joining me and catching us up on what's been going on with California litigation. Again, I know we'll be back in just a few months talking about more because the cases always seem to be coming out. And thank you to the listeners especially for enduring any of the squeaker noises today. She will not always be a three-month-old puppy, but she is pretty darn cute. So if you have questions about anything Shail and I talked about, please feel free to reach out. Our contact information will be in the show notes and I look forward to being with you in a few weeks on the next, GeTtin' SALTy.