

- Nikki Dobay: Hello and welcome to GeTtin' SALTy, a state and local tax policy podcast hosted by Greenberg Traurig. My name is Nikki Dobay, shareholder in the Sacramento, California and Portland, Oregon offices. I am very pleased today to have two of my colleagues joining me coming off of a big win in the first appellate district in California. Joining me today is Brad Marsh, shareholder and co-chair of the state and local tax group [00:00:30] here at Greenberg in the San Francisco office as well as Jen Vincent, one of our associates in the state and local tax group. Jen, you spend some time in Sacramento and San Francisco. So thank you both for being here today.
- Brad Marsh: Happy to be here, Nikki.
- Jan Vincent: Thank you for having us.
- Nikki Dobay: So Jen, you're new to the podcast and there is one order of business that I'm going to spring on you.
- Jan Vincent: Let's do it.
- Nikki Dobay: So [00:01:00] as folks join the podcast for the first time, the opening question for those folks is how did you get into state and local tax? Were you just born ready to litigate SALT cases or did you take a different path? And then I'll let you know what company you're in after you kind of share your story.
- Jan Vincent: So first I'll answer your question with a yes, I was born to litigate state and local tax cases. But my path to figuring that [00:01:30] out was not very winding, but potentially a little winding. I always knew I wanted to be a tax attorney starting in law school, really had some amazing professors that turned me onto it, really liked statutory interpretation and, you know, says every little girl, right?
- Nikki Dobay: Right. Yes. Yes. That's what I hear.
- Jan Vincent: Yeah. So knew I wanted to tax controversy. I actually worked for the IRS my third year in law school, so knew that I wanted to do that. Went to the NYU LLM [00:02:00] program and there, continued to focus on controversy. The jobs were mostly in Fed. So I got hired at GT originally to be a federal tax controversy attorney and that was in September of 2018. I don't know if you remember, but in about December of 2018, a big government shutdown happened and federal controversy ground to a halt.
- Nikki Dobay: Okay.
- Jan Vincent: Brad strode into my office like a hero and said, "Hey, I've [00:02:30] got some work for you. Do you want to try SALT?" I said, "I loved every SALT class I've ever taken. Let's rock." And here we are about eight years later, still rocking.

- Nikki Dobay: Well, that's a great story. And now I feel like the stories are starting to divide, not completely equally, but I think you're the third or fourth person who said you kind of knew this is what you wanted to do. Most people, I will tell you, most of us had no idea what we were doing. So we just fell into [00:03:00] it.
- Jan Vincent: I think tax in particular can get pretty nerdy and so you might tend to get a person that doesn't really want to stand up and speak, but if you have the skill to do that and statutory interpretation, it's such a lovely area of practice and so fun.
- Nikki Dobay: It is, for all those reasons. Well, Brad, we're glad you walked into Jen's office after the government shut down and all the stars aligned and we are here today to talk about this case that you [00:03:30] all recently won. And so I'm going to try to not butcher the name. So the case is Xavier Garcia-Rojas versus Franchise Tax Board and Brad is kind of laughing at me, so maybe I did. He's going to tell us the right way to say it. But Brad, can you kind of set the stage here with this case and be how you got involved in the case and what's going on and then we'll really dive into the decision.
- Brad Marsh: Sure. So first off, yeah, it's Xavier Garcia- [00:04:00] Rojas.
- Nikki Dobay: All right. Thank you. Much better.
- Brad Marsh: And Xavier came to us many years ago because the state of California wanted... He's a lifetime resident of Texas and he was a resident of Texas the whole time during this audit period. He never stepped foot in California and yet California wanted to tax all of his income. So that's how he came to us and [00:04:30] we said, "Well, Xavier, tell us more. Tell us more about what's going on. Maybe they're entitled to, maybe they're not." We learned that Xavier was a radiologist and for those of you that want to know more about that, basically what he does is he sits there and he reads images and studies, interprets them, things like CT scans, x-rays, MRIs, ultrasounds that are sent to him by doctors and hospitals around the country. And he does [00:05:00] all that work from his desk at home in Texas. And he has to do it there because it has to be on his special equipment because you need high resolution to read these images.
- He has no employees, no other parts of his business, doesn't have another office in another state, anything weird like that. We call him an independent contractor because I think that's what he is. The FTB says he's a sole proprietor, which is a less [00:05:30] defined term. But basically they're saying that because he used a Schedule C, which any independent contractor uses when they file their federal tax returns. But what he did is he did that function and he did it under one contract, one contract with a company called StatRad, which is located in California and for that he received his 1099. He wasn't an owner of StatRad and he read images, whatever they sent him, [00:06:00] he read.

So he was licensed in 27 states. So he's not really paying attention. The image comes in, he looks at it, okay, broken bone or whatever he's reading for. And again, California wanted income for all of that. They wanted all of that income attributable to California because they said that he was conducting a unitary business with California. And so to make a long story short, we filed claims with the state. [00:06:30] The state ignored those claims. We at some point, after failing to get the attention of the state, had to deem them denied and went ahead and filed this lawsuit. In part of the lawsuit, they did sort of concede a little bit of the case. They decided that they would only tax the portion of the revenue related to California images.

Nikki Dobay: Okay.

Brad Marsh: But that wasn't enough because our position was is there's no income that California should be able to tax.

Nikki Dobay: [00:07:00] So yeah, as you're describing this to me, if the listeners could see us, they'd one, see that I have one horn coming out of my head because I'm standing in front of a picture of a Highland cow. But two, they would also see my confused state because everything you're describing seems to be the income of a non-resident that doesn't really have a source to California. So this unitary [00:07:30] concept is not one we hear in the individual context generally. So how did we get there and I'll let you or Jen decide who's going to answer that one.

Jan Vincent: I'll take this. Basically the statute says that when there's a non-resident with California source income, then California can tax that, but California can't tax non-California source income of a non-resident. And [00:08:00] the question then becomes, okay, how do we decide if something is California sourced income? And the board has promulgated regulations on this that tell us, okay, here's how we look at it. And the regulations basically say, okay, if you're conducting business outside the state, that's not California source.

Nikki Dobay: Yep.

Jan Vincent: If you're conducting business both within the state and without the state and the funds are super separate, then the part within the state gets taxed [00:08:30] by the state and the part without is taxed separately. There's a third piece that says if you're conducting both within and without, and the parts are make up a unitary business, then we apportion income according to a certain formula, but the statute doesn't define unitary business. What is a unitary business has been decided in case law for centuries, for a century, I think.

Nikki Dobay: Yeah.

Jan Vincent: And so what it comes [00:09:00] down to and where it comes from is it starts with a railroad company.

Nikki Dobay: Yeah.

Jan Vincent: Properties all across the nation and they sell a few of these parcels and they report their taxes in such a way that I believe California resulted in a loss and the other states had gains and California went, "No, wait, hold on. All of this is part of on business unit and you need to apportion all of the income and all of the expenses. You can't just shield income from California [00:09:30] by generating losses in this state only and then having massive gains elsewhere."

So that's where the unitary principle comes from. And there's a few seminal cases on it like for example, we have A&M Castle, which is a metal manufacturer and they purchase a wholly owned sub that does alloy work, special alloy work. And the way that they reported, they reported separately [00:10:00] and what ended up happening is a ton of income got shielded from California by that separate reporting.

Nikki Dobay: Yep.

Jan Vincent: The board came out and the court came out and said, "Hold on, these two are linked inextricably." And tests have formed over time to determine if two businesses are unitary and it's the contribution and dependency test is kind of forefront of tests right now, which says that if the two business contribute to and are dependent on each other, then that's a unitary business and then we have to get [00:10:30] to a portioning. The reason we got to unitary in Garcia-Rojas is because that's the only statute under which the board would have a right to tax this non-resident's business income. So they said, "Hey, he's conducting a unitary business. Every report that he reads is a separate business and therefore he's conducting business both within and without the state." So it's this essentially legal fiction that's created to make him fit into this tiny [00:11:00] concept that quite frankly, he doesn't belong in, factually.

Nikki Dobay: Now usually in the unitary business context, there has to be... There's often two entities. We usually see this when we're talking about corporate taxpayers. So was the FTB's position that the company that he was contracting with, he was part of a unitary business with that, or just that his business in and of itself [00:11:30] was a unitary business?

Jan Vincent: It was the latter. So their position is that his business was a unitary business because he was reading reports both within and without the state of California. And the Court of Appeal I think rightfully caught onto that and said, "Hey, look, we can't apply a unitary concept this way. We have one business activity here. One thing cannot be unitary with itself." And so that's where we landed.

Nikki Dobay: All right. Thank you, Jen. I was starting [00:12:00] to feel crazy for a minute, I'm glad that you've helped me there. Go ahead, Brad. Thank you.

Brad Marsh: Well, I was just going to say there was a reason why the franchise tax board sort of had the courage, we'll call it, to take this position and that's because of a decision by the Office of Tax Appeals here in California known to us practitioners as Bindley and that was a decision where they decided at the OTA, and then the OTA made that [00:12:30] decision precedential, that more or less, and the reasoning is not very detailed in the opinion, but that a person, it looked like they were deciding a person could be unitary with themselves in that decision. And so this looked like a twist on Bindley. And of course the Court of Appeal in our case was not impressed with the academic rigor of the Bindley analysis.

Nikki Dobay: Yeah. I think one of my favorite lines in the decision is the board's [00:13:00] contrary arguments fail to persuade and then they go into their discussion of Bindley. And as a person that focuses on the unitary business concept fairly regularly in the corporate context, this just seems very much like the board trying to stick a square peg into a round hole. So this is a pretty impactful decision because it did overrule [00:13:30] this Bindley case, which I will say seemed to be ill-founded. I'll try to use all the bad adjectives myself so you guys don't have to, but what else are kind of some of the highlights from this case that the listeners should know about?

Jan Vincent: I think the biggest highlight is that we have a sole proprietorship regulation, right? The regulation that we're talking about says, if you have a sole proprietorship conducting [00:14:00] unitary business, then we can apportion. And the court of appeal nailed it right on the head. If you're conducting one business activity, it doesn't matter what you are, you're not unitary and according to the case law, you can't be. So what that does is it overturns Bindley and it opens the door to a lot of individuals who have had the Bindley decision kind of shoved down their throats as terms of now you owe tax in California even though you've never been there, you didn't reach into [00:14:30] the state, you don't have nexus, you don't meet any of the doing business standards. Those people are now in a position where they're armed with this court of appeals decision to say, "I am not, as an individual, conducting one business activity unitary."

Brad Marsh: Be a good time to file a claim for refund for a bunch of people too.

Nikki Dobay: I was going to ask for final thoughts, Brad, but you might have just nailed that one.

Well, thank you both for unpacking this. [00:15:00] I will say I was at the ABA meeting this week and people are asking questions about this case. So I told them all the podcast was coming out and they would get more from the folks that actually litigated it. But thank you for walking us through that. I can't let you go without a surprise non-tax question. I know this is everybody's favorite part. So I won't say it's a trick question, but it's a really easy one for me because

I just went to a concert this past week. So what's the last concert [00:15:30] you went to?

I was going to the ABA meeting, which was in DC. So I went a couple days early and got to see Ani DiFranco, who many people know is one of my favorite singer songwriters in Baltimore just a week ago. It was a great show, had a really good time. So I figured I could talk about that and ask you guys what your last concert was. So I'm going to start with Brad because I'm going to put him on the spot a little bit quicker than you, Jen.

Brad Marsh: [00:16:00] So I'm calling my last concert the last musical performance that I attended.

Nikki Dobay: Okay.

Brad Marsh: Because I mostly go to small shows.

Nikki Dobay: Okay.

Brad Marsh: And there was maybe 200 people maximum. I don't know if that qualifies as a concert.

Nikki Dobay: That qualifies. Yeah. It sure does. Yeah.

Brad Marsh: I was out in Point Reyes in California and I saw a collection of two artists that I like that probably no one's heard of. One of them is called The Fruit Bats.

Nikki Dobay: I know The Fruit Bats.

Brad Marsh: Okay. He was playing [00:16:30] with his buddy Vetiver, Andy Cabic and they did sort of a program together that they've done for many years and they're recording it. It actually may be issued as an album, I think. So that was the last one I went to. It was about a month and a half ago.

Nikki Dobay: And thumbs up, thumbs down?

Brad Marsh: A thumbs up.

Nikki Dobay: Thumbs up.

Brad Marsh: I like every one of both of their songs.

Nikki Dobay: All right, great. All right, Jen.

Jan Vincent: Yeah. So I have not been to a concert in a while, so that's [00:17:00] why when you asked that question, you saw me get a little deer in the headlights.

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Nikki Dobay: Okay.

Jan Vincent: There are a lot of musical performances at my house.

Nikki Dobay: Okay.

Jan Vincent: My kids really like putting on little shows and dance shows for us, but the last concert I went to was Laney Wilson at Capital One in Sacramento. We're big country music fans in this house. She was doing her tour and it was, wow, just wow, really good. Her voice is unbelievable.

Nikki Dobay: I should know this. Is she in the High Women? I think it's Marin [00:17:30] Morris is in the High Women. That's Brandi Carlisle's female supergroup.

Jan Vincent: Oh, I don't know.

Nikki Dobay: I'll get back to you...

Jan Vincent: The American, the Country Music Awards a few, I want to say 2025, late 25.

Nikki Dobay: All right. You should check out the High Women though, Jen.

Jan Vincent: Okay.

Nikki Dobay: I think you'd like it.

Jan Vincent: All right.

Nikki Dobay: I think it's up your alley.

Jan Vincent: I like Mary Morris, so if she's in it, then yeah, sure.

Nikki Dobay: All right. Well, thank you both so much for catching us up on this [00:18:00] case. I know that there's probably more to come on it and we'll get back on the podcast to talk about that. Thank you to the listeners for catching up with us once again. Contact information for Brad and Jen and I will be in the show notes and I will be with you again on the next GeTtin' SALTy.