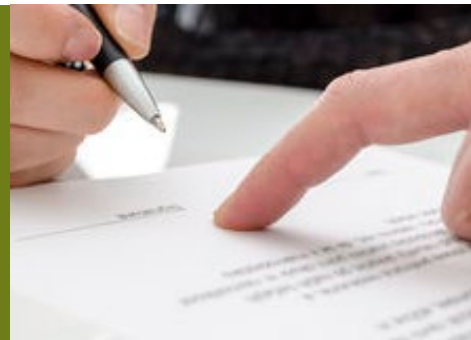




STATE OF CALIFORNIA  
**Franchise Tax Board**

# Section 25137 Petition Hearing

## Smithfield Packaged Meats Corporation



Kathy Shin – Legal Division  
Laurie McElhatton – Legal Division  
March 4, 2021

# California (CA) Revenue & Taxation Code Section 25137 (Section 25137)

“If the allocation and apportionment provisions of this act do not fairly represent the extent of the taxpayer's business activity in this state...”

# Section 25137 Two Prong Test Per *Microsoft*

The party invoking section 25137 has the burden of proving by clear and convincing evidence that:

1. the approximation provided by the standard formula is not a fair representation, and
2. its proposed alternative is reasonable.

# CA Supreme Court on Section 25137 in *Microsoft*

“the statutory touchstone remains an inquiry into whether the formula fairly represents a unitary business's activities in a given state, and when it does not, the relief provision may apply.”

# Section 25128

If an apportioning trade or business derives more than 50 percent of its “gross business receipts” from . . . an agricultural business activity . . .

“Gross business receipts” . . . other than gross receipts from the sales or other transactions within an apportioning trade or business.

# Smithfield's SSF (Single Sales Factor) Apportionment

## Annual Average

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Gross Receipts in CA

\$1 Billion

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Gross Receipts Everywhere

\$13.5 Billion

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# Smithfield's SSF (Single Sales Factor) Apportionment

## Annual Average

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Gross Receipts in CA	\$1 Billion
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Gross Receipts Everywhere	\$13.5 Billion
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<b>CA Apportionment %</b>	<b>7.7%</b>
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# CA Activity for Four Years 2014 – 2017

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CA Franchise Tax for 4 years:	\$7 Million
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# CA Activity for Four Years 2014 – 2017

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CA Franchise Tax for 4 years: \$7 Million

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CA Gross Receipts for 4 years: \$4 Billion

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# CA Activity for Four Years 2014 – 2017

CA Franchise Tax for 4 years: \$7 Million

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CA Gross Receipts for 4 years: \$4 Billion

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CA Tax as % of CA Gross Receipts 0.17%

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# Summary of Analysis

1. Difference in methods not proof of distortion.
2. *Moorman* upheld 20% SSF for manufacturer.
3. *Hans Rees'* with 80% v. Smithfield's 7.7% apportionment.
4. *Microsoft's* qualitative/quantitative analysis not applicable.
5. Fair apportionment does not have to reflect all income generating activities.
6. Three-factor is not a reasonable alternative.

# Section 25137 Two Prong Test Per *Microsoft*

The party invoking section 25137 has the burden of proving by clear and convincing evidence that:

1. the approximation provided by the standard formula is not a fair representation, and
2. its proposed alternative is reasonable.

# Section 25137 – Distortion

1. Difference in methods not proof of distortion.
2. *Moorman* upheld 20% SSF for manufacturer.
3. *Hans Rees'* with 80% v. Smithfield's 7.7% apportionment.
4. *Microsoft's* qualitative/quantitative analysis not applicable.
5. Fair apportionment does not have to reflect all income generating activities.

# Section 25137 Two Prong Test Per *Microsoft*

The party invoking section 25137 has the burden of proving by clear and convincing evidence that:

1. the approximation provided by the standard formula is not a fair representation, and
- 2. its proposed alternative is reasonable.**

# Section 25137 Reasonable Remedy Prong

**The three-factor formula is not a reasonable alternative because it does not remedy any distortion.**

# CA Based Company Hypothetical

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CA Property	99%
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CA Payroll	99%
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<b>CA Single-Sales Factor</b>	<b>7.7%</b>
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<b>CA Three Factor (205.7/3)</b>	<b>69%</b>
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Thank You