



STATE OF CALIFORNIA
Franchise Tax Board

Section 25137 Petition Hearing

Jack In The Box Inc. & Subsidiaries



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May 14, 2025

Overview

1. Taxpayer's business activities
2. Standard apportionment formula
3. Taxpayer's petition should be denied because:
 - a) Taxpayer failed to show the standard formula is an unfair reflection of its business activities in CA
 - b) Taxpayer's proposed alternatives are unreasonable

Taxpayer's Business Activities

1. Retail sales activities:

- Sales revenue from sales of food and beverages (i.e., burger sales)

2. Franchisor activities:

- Royalty revenue
- Franchise fee revenue
- Rental revenue

Section 25137 – Burden of Proof

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.

Applicable Standard Apportionment

- Section 25128.7 – Single sales factor
- Section 25135 – Sales of tangible personal property
- Section 25136 – Sales from the lease or rental of real property
- CCR 25137-3 – Sales from royalties and franchise fees

Illustration – Taxpayer's Tax Return Per Standard Apportionment Provisions

Taxpayer's Income Tax Base:

Taxable Year 20XX	
Income from Retail Activities	\$100
Income from Franchisor Activities	\$200

Taxpayer's Apportionment Formula:

CA Gross Receipts from Retail Activities	\$60
CA Gross Receipts from Franchisor Activities	<u>\$30</u>
Total California Sales (numerator)	\$90
EW Gross Receipts from Retail Activities	\$100
EW Gross Receipts from Franchisor Activities	<u>\$200</u>
Total Everywhere Sales (denominator)	\$300

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...”

- » Taxpayer is Jack in the Box Inc. & Subs
- » Third-party franchisees are unrelated and independent

Illustration – *Third-Party Franchisee Tax Return*

Third-Party Franchisee Income Tax Base:

Taxable Year 20XX

Income from Retail Activities

\$100



Third-Party Franchisee Apportionment Formula:

Total California Sales (numerator)

\$80



Total Everywhere Sales (denominator)

\$100



Illustration – Tax Return Comparison Per Standard Apportionment Provisions

Taxpayer's Tax Return

Taxpayer's Income Tax Base:

Taxable Year 20XX	
Income from Retail Activities	\$100
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Total Everywhere Sales (denominator)	\$300

Franchisee's Tax Return

Third-Party Franchisee Income Tax Base:

Taxable Year 20XX	
Income from Retail Activities	\$100

Third-Party Franchisee Apportionment Formula:

Total California Sales (numerator)	\$80
Total Everywhere Sales (denominator)	\$100

Illustration – *Taxpayer's Argument*

Taxpayer's Tax Return

Taxpayer's Income:

Taxable Year 20XX	
Income from Retail Activities	\$100
Income from Franchisor Activities	\$200

Taxpayer's Apportionment Formula:

CA Receipts from Retail Activities	\$60
CA Receipts from Franchisor Activities	\$30
<i>Receipts from Third-Party Activities</i>	\$80
Total California Sales (numerator)	\$170
EW Receipts from Retail Activities	\$100
EW Receipts from Franchisor Activities	\$200
<i>Receipts from Third-Party Activities</i>	\$100
Total Everywhere Sales (denominator)	\$400

Franchisee's Tax Return

Third-Party Franchisee Income Tax Base:

Taxable Year 20XX	
Income from Retail Activities	\$100

Third-Party Franchisee Apportionment Formula:

Total California Sales (numerator)	\$80
Total Everywhere Sales (denominator)	\$100

U.S. Supreme Court

“the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated”

Container Corp. of Am. v. Franchise Tax Bd. (1983)
463 U.S. 159, 170.

Illustration – *Taxpayer's Argument*

Taxpayer's Tax Return

Taxpayer's Income:

Taxable Year 20XX	
Income from Retail Activities	\$100
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Taxpayer's Apportionment Formula:

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Total California Sales (numerator)	\$170
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EW Receipts from Franchisor Activities	\$200
<i>Receipts from Third-Party Activities</i>	\$100
Total Everywhere Sales (denominator)	\$400

Franchisee's Tax Return

Third-Party Franchisee Income Tax Base:

Taxable Year 20XX	
Income from Retail Activities	\$100

Third-Party Franchisee Apportionment Formula:

Total California Sales (numerator)	\$80
Total Everywhere Sales (denominator)	\$100

Taxpayer's assertions to "same underlying business activities" do not prove distortion.

- Clear distinction between Taxpayer's business activities and third-party franchisee's business activities.

Taxpayer's Business Activities

1. Burger sales
(from sales at Taxpayer operated restaurants)
2. Franchisor activities

Franchisee's Business Activities

1. Burger sales
(from sales at franchisee operated restaurants)

Taxpayer's assertion that fees are based on percentage of third-party sales does not prove distortion.

- Fee structure does not change the business activities of *the Taxpayer*.
 - » Taxpayer's licensing activities generated its franchise fee income.
 - » Fee structure is simply a way to calculate the amount owed to Taxpayer for this licensing.

Taxpayer's assertions based on various numerical comparisons do not prove distortion.

- Taxpayer's numerical comparisons of sales, operating income, and restaurant locations do not distinguish between activities of Taxpayer and the activities of third-party franchisees, and
- Therefore, cannot show that **Taxpayer's** business activities are not fairly reflected in the standard apportionment formula.

Example 1 – *Taxpayer's numerical comparisons do not measure Taxpayer's business activities.*

- Taxpayer's argument that franchised restaurants account for 90 percent of JIB systemwide sales, but franchised restaurant gross receipts are not reflected in the formula is misleading.

Franchised Restaurant Sales	\$3,167,920
Systemwide Operating Profit	<u>\$3,504,727</u>
Franchised Restaurant Contribution to Systemwide Sales	<u>90%</u>

- “Franchised restaurant sales” are revenues of the franchisees, not the Taxpayer, and are irrelevant for Section 25137 consideration.

Example 2 – *Taxpayer's numerical comparisons do not measure Taxpayer's business activities.*

- Taxpayer's argument taxing 60 percent of Taxpayer's income when only 40 percent of its systemwide (both company-operated and franchisee-operated) restaurant locations are in California is misleading.
- Restaurant location count alone conflates Taxpayer's burger sales activities with the Franchisee's burger sales activities, and does not show distortion as to Taxpayer's business activities.

Relevant Case Law

“a simple comparison of the varying levels of taxation from differing apportionment methods, by itself, does not demonstrate that the standard apportionment formula unfairly reflects the extent of a taxpayer’s activity in this state.”

Appeal of Merrill, Lynch, Piece, Fenner & Smith (June 2, 1989)
89-SBE-017.

Relevant Case Law (Continued)

“does not authorize deviations from standard [apportionment] provisions merely because a purportedly better approach exists.”

Appeal of Kikkoman International, Inc. (June 29, 1982) 82-SBE-098.

Taxpayer's assertion that other FTB statutes and regulations allow third-party activity does not prove distortion.

- Taxpayer's argument is circular.
- Various examples provided by Taxpayer are not applicable:

Examples:	Not applicable because:
Independent contractors	Franchisees are not independent contractors.
CCR 25136-2 (sales of other than sales of TPP)	Sales of other than sales of TPP not applicable to receipts at issue.
CCR 25129, 25130, 25137(b)(1)(B)-(C) (property owned by others)	Property factor not at issue.
CCR 25137-1 (partners and partnership interest)	Taxpayer not a partner nor has partnership interest at issue.
Freight forwarders	Taxpayer not a freight forwarder.

Standard Apportionment Properly Reflects Change in Taxpayer's Business Activity

- Standard apportionment percentages:

09/2014	09/2015	10/2016	10/2017	10/2018	10/2019	10/2020
43.4375%	42.8552%	43.4884%	43.3759%	51.0370%	61.7416%	62.6134%

- Increase in apportionment formula due to changes in Taxpayer's business.

Standard Apportionment Properly Reflects Change in Taxpayer's Business Activity (Continued)

- Increase in apportionment formula due to changes in Taxpayer's business:
 - Refranchising strategy

FYE 2017	Taxpayer-Operated	Franchisee-Operated	Total
California	170	769	939
Out-of-State	106	1206	1312
Everywhere	276	1975	2251
Percentage of Systemwide Stores in CA	62%	39%	42%

FYE 2018	Taxpayer-Operated	Franchisee-Operated	Total
California	109	827	936
Out-of-State	28	1273	1301
Everywhere	137	2100	2237
Percentage of Systemwide Stores in CA	80%	39%	42%

– Qdoba sale (March 2018)

Taxpayer's Argument Would Lead to Slippery Slope

- Section 25137 cannot be invoked due to apportionment percentage changes caused by a taxpayer's shift in business strategy or business decisions.
- Section 25137 should not be subject to manipulation.

Taxpayer's Alternative Formulas

Taxpayer has not met its burden to prove that its proposed alternatives are reasonable:

1. Ratio of restaurant locations conflates Taxpayer's activities with the activities of unrelated third-parties and does not properly account for differences in Taxpayer's business activities.
2. Inclusion of third-party franchisee's receipts is merely a circuitous offer of a remedy without evidence to show how the exclusion of receipts by the standard formula is distortive.

Closing Considerations

- Section 25137 can only be invoked upon showing clear and convincing evidence the formula does not fairly represent a **taxpayer's** business activities.
- Arguments that conflate Taxpayer's activities with those unrelated third-parties does not show distortion as to Taxpayer's business activities in the state.
- Arguments of better, alternative formulas; reliance solely on numerical metrics that do not measure Taxpayer's business activities are also not sufficient to invoke Section 25137.

Thank You