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07.30.15

Chief Counsel Ruling 2015-01

RE: Request for a Chief Counsel Ruling on Behalf of *****

Dear Taxpayer:

In your correspondence dated February 16, 2015, you requested a Chief Counsel Ruling from the Franchise Tax Board (“FTB”) regarding the franchise tax consequences of the sale by your company ("Company" or "Taxpayer") of one of its two lines of business as it relates to the applicability of California Code of Regulations, title 18 (“CCR”), section 25137(c)(1)(A).¹ Specifically, you requested FTB to rule that the sale was both "substantial" and "occasional" under CCR section 25137(c)(1)(A), with the result that the proceeds from the sale should be excluded from the California sales factor for

Up to the date of sale, the Company had two lines of business (“LOB 1” and “LOB 2”). LOB 1 was a business segment that manufactured, marketed, and sold branded and private label food products for human consumption. LOB 2 was and is a business segment dedicated to the manufacturing, marketing, and sale of pet food products. In, Taxpayer sold LOB 1 (“Transaction at Issue”). The sale generated approximately \$... billion of gross receipts and a gain of approximately \$... billion.

In accordance with California Code of Regulations section 25137(c)(1)(A), 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.² This rule applies when a sale is both “substantial” and “occasional.”

The Company has reviewed the facts set forth below and represents that the facts are true and all material facts have been disclosed. The Company represents that the issues in this ruling request are not the subject of an existing California audit, protest or litigation concerning the Taxpayer or a group member.

¹ Unless otherwise specified, “section” or “§” references are to the California Revenue and Taxation Code currently in effect and “Regulation section” or “Regulation §” references are to the applicable California regulations promulgated there under.

² CCR section 24137(c)(1)(A).

FACTS

A. Company History of Acquisitions and Dispositions

The Company was incorporated in ***** and headquartered in *****. Prior to the sale, it manufactured, marketed, and sold branded and private label food products for human consumption and pet consumption. These two lines of business were unitary for franchise tax purposes. For ::::, revenues from these two lines of business each made up approximately 50 percent of the overall business as reported in the Company's annual filings.

Between :::: and ::::, the Company acquired :::: brands and related assets to expand both lines of business. Additionally, the Company previously disposed of :::: brands and related assets, with the most recent being :::: years ago.

B. Transaction at Issue

In ::::, the Company sold LOB 1 to an unrelated party for a purchase price of approximately \$::: billion as reported in the Company's public filings. Once LOB 1 was sold, the Company changed its name and its focus shifted entirely to its remaining line of business.

According to Taxpayer, as a result of the sale, the Company realized a gain for tax purposes of approximately \$::: billion. The company apparently realized a loss from ongoing operations for the :::: taxable year.

ISSUE

Whether gross receipts arising from the sale of LOB 1 constitute an incidental or an occasional sale within the meaning of the California Code of Regulations section 25137(c)(1)(A), such that the gross receipts should be excluded from the sales factor.

HOLDING

Based on the accuracy and completeness of the facts and representations provided by the Taxpayer, and subject to examination by the Internal Revenue Service and/or FTB of the facts, the sale of LOB 1 is both substantial and occasional under CCR section 25137(c)(1)(A).

DISCUSSION

A. Application of CCR Section 25137(c)(1)(A)

For California apportionment purposes, the sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the taxable year, and the denominator of which is the total sales of the taxpayer everywhere during the taxable year. (Rev. & Tax. Code, § 25134.) For taxable years beginning on or after January 1, 2011, "sales" means all gross receipts not otherwise allocable under California law. (Rev. & Tax. Code, § 25120.)

CCR section 25137(c)(1)(A) provides that gross receipts are excluded from the sales factor when they arise from a sale that is both substantial and occasional. CCR section 25137(c)(1)(A) states in pertinent part:

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.

(1) For purposes of this subsection, 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.

(2) For purposes of this subsection, a sale is occasional if the transaction is outside of the taxpayer's normal course of business and occurs infrequently.

This regulation applies where a substantial amount of gross receipts arise from an occasional sale of property held or used in the regular course of the taxpayer's business. In situations where the elements of the regulation are met, the gross receipts from the transaction are excluded from the sales factor numerator and denominator. Hence, CCR section 25137(c)(1)(A) includes two elements that must both be met before the gross receipts from the sale are excluded. The sale must be both "substantial" and "occasional."

1. The Sale LOB 1 was "Substantial"

CCR section 25137(c)(1)(A) defines a sale as "substantial" if excluding the sale receipts results in a five percent or greater decrease in the sales factor denominator of the taxpayer. As outlined below, excluding the gross receipts from the sales factor denominator in this case decreases the Company's sales factor denominator by approximately 33 percent. Therefore, this sale meets the definition of "substantial" under the regulation.

Total Gross Receipts	Sales Factor Denominator Including the Sale	Sales Factor Denominator excluding the Sale	Difference	Percentage Decrease in Denominator
\$*****	\$*****	\$*****	\$*****	33%

2. The Sale of LOB 1 was “Occasional”

CCR section 25137(c)(1)(A) defines a sale as “occasional” if the transaction is outside of the taxpayer’s normal course of business and occurs infrequently.³ Here, the Company sold all assets of LOB 1 in an effort to focus on LOB 2. As outlined above, since the Company acquired businesses and related assets to expand both lines of business. Additionally, the Company disposed of businesses and related assets. In Legal Ruling 97-1, the FTB discussed the rationale of CCR section 25137(c)(1)(A):

The exclusion from the sales factor pursuant to 18 CCR § 25137(c)(1)(A) of substantial amounts of gross receipts from an incidental or occasional sale of a fixed asset is based on the rationale that such gross receipts do not fairly reflect the taxpayer’s day-to-day business activity and therefore cause excessive income to be apportioned to the state where the occasional sale took place. *This is especially so if the growth of built-in appreciation occurs over a substantial period of time, because taking the gross receipts into account in the year of a recognition event does not reflect the gradual effects of appreciation over several years* [emphasis added].

The same rationale can be applied to gross receipts from an incidental or occasional sale of intangible property held or used in the regular course of taxpayer’s trade or business. There is no logical basis for distinguishing between fixed assets and intangibles. Accordingly, under authority of section 25137, gross receipts from an incidental or occasional sale of intangible property held or used in the regular course of taxpayer’s trade or business will be excluded from the sales factor, if substantial.⁴

Turning first to the question of whether the transaction occurred outside of the normal course of the taxpayer’s business activity, in considering whether certain receipts constituted business income—which requires an analysis similar to that required by the regulation—the Court in *Hoechst Celanese Corp. v. Franchise Tax Bd.* (2001) 25 Cal.4th 508, 526 held that the “controlling factor” for determining whether a transaction occurred outside the normal course of taxpayer’s business activity is the “nature of the particular transaction” generating the income. The Court explained that “[r]elevant considerations include the frequency and regularity of similar transactions, the former practices of the business, and the taxpayer’s subsequent use of the income.” (Ibid.) Here, the disposition of an entire line of business is an extraordinary corporate occurrence. Taxpayer has made no representation that the taxpayer’s regular business activity included liquidating an entire line of business. Furthermore, there is no history to suggest that Taxpayer had any previous plan to methodically sell off the assets of an entire business line. For that reason, the department concludes that the sale in question is outside of the normal course of the taxpayer’s business.

³ CCR section 25137(c)(1)(A)(2).

⁴ California Franchise Tax Board, Legal Ruling 97-1, October 15, 1997.

We turn now to the query of whether the sale in question was occasional within the meaning of CCR section 25137(c)(1)(A). In this inquiry, case law considering whether income is "business income" under the transactional test (codified in R&TC § 25120(a)) can be useful, although it does not control whether a sale is occasional under CCR section 25137(c)(1)(A). For example, in *Appeal of New York Football Giants, Inc.*,⁵ the Board held that a professional sports team playing one game in California in a taxable year was occasional. Also, in *Appeal of the Learner Company*,⁶ the Board held that trips made by the taxpayer's officers once or twice a year were infrequent and occasional.

The State Board of Equalization ("Board" or "BOE") provided context to the meaning of "occasional" under Regulation section 25137(c)(1)(A) in *Appeal of Triangle Publications, Inc.*⁷ There, the Board recognized that the sales of two corporate divisions and a building during a four-year period were "occasional" under Regulation section 25137(c)(1)(A).

The facts and circumstances surrounding the nature of the Taxpayer's business and its divestiture of LOB 1 lead to the conclusion that the sale of LOB 1 was occasional. Although the taxpayer from time to time acquired or disposed of brands and their associated assets to expand or redirect their business, there is no indication that such activity was a regular and systematic occurrence in the corporate life of Taxpayer. Moreover, this is apparently the only time that Taxpayer disposed of an entire line of business, including all the brands within that line. For these reasons, the department concludes that the transaction in question occurred infrequently. Because the sale is both outside the course of the Taxpayer's normal business operations and it occurred infrequently, the sale is occasional under CCR section 25137(c)(1)(A).

HOLDING

Thus, based on the accuracy and completeness of the facts and representations provided by the Taxpayer, the sale of LOB 1 is both substantial and occasional under CCR section 25137(c)(1)(A).

Please be advised that the California franchise tax consequences expressed in this Chief Counsel Ruling are applicable only to the corporations and shareholders addressed in the "Ruling" above and are based upon and limited to the facts and representations you have submitted to the FTB. In the event of a change in relevant legislation, judicial or administrative case law, a change in federal interpretation of federal law, or a difference in the material facts or circumstances relating to and on which this ruling is based, this ruling may no longer be applicable. It is your responsibility to be aware of and promptly notify the FTB should any of these circumstances occur.

⁵ *Appeal of New York Football Giants, Inc.*, 77-SBE-014, February 3, 1979 and 77-SBE-015, June 28, 1979.

⁶ *Appeal of the Learner Company, et al.*, 80-SBE-103, September 30, 1980.

⁷ *Appeal of Triangle Publications, Inc.*, 84-SBE-096, June 27, 1984.

This letter is a legal ruling by the Franchise Tax Board's Chief Counsel within the meaning of paragraph (1) of subdivision (a) of the California Revenue and Taxation Code section 21012. Please attach a copy of this letter and your request to the appropriate returns when filed or in response to any notices or inquiries that might be issued.

Very truly yours,

Elizabeth Rodoni
Tax Counsel