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# Alert | State & Local Tax (SALT)

**March 2024**

## Gross Receipts Means Gross Receipts: Appeal of *Microsoft*

On Feb. 14, 2024, the California Office of Tax Appeals (OTA) denied the Franchise Tax Board (FTB)'s petition for rehearing, confirming its opinion in *Appeal of Microsoft Corporation*. The decision allows Microsoft to include 100% of its foreign dividends in the sales factor denominator.

### Case Overview

Microsoft, a water's-edge filer in California, appealed the FTB's denial of its claim for refund totaling approximately $93.9 million for fiscal year ending June 30, 2018. The primary issue involved the treatment of dividends under Revenue and Taxation Code (R&TC) section 24411 and whether those receipts should be included in the denominator of the sales factor.

### OTA's Findings and Rulings

- *Inclusion of Dividends in Sales Factor*: The OTA concluded that the gross amount of the dividends, even when subject to a 75% deduction under R&TC section 24411, should be included in the sales factor. The opinion rejected the FTB's longstanding interpretation of factor-to-income representation under the "matching principle" set forth in FTB Legal Ruling 2006-01.
- *Use of Alternative Apportionment Method*: Based on Microsoft's facts, the OTA also rejected the FTB's argument that the qualifying dividends should be excluded from the sales factor as a substantial and occasional sale under Regulation section 25137(c)(1)(A). The OTA determined that the FTB had not demonstrated that the standard apportionment formula resulted in distortion or an unfair

representation of Microsoft's business activity in California. Therefore, the OTA concluded that the use of an alternative apportionment method under R&TC section 25137 was not warranted.

### Potential Implications in California

- *Broader Inclusion of Dividend Income*: The opinion suggests that the OTA liberally construes the inclusion of the gross dividend income in the sales factor calculation. For many water's-edge filers in California, this decision could result in a decrease of California apportionable income if receipts from foreign dividends are fully included in the sales factor.
- *Broader Interpretation of What Constitutes Gross Receipts for Sales Factor Purposes*: A string of recent OTA decisions, including *Appeal of Southern Minnesota Beet Sugar Cooperative and Subsidiary*, 2023 – OTA – 342P (Mar. 17, 2023), *Appeal of Bed, Bath, & Beyond, Inc.*, 2022-OTA-134 (Mar. 17, 2022), and now the *Microsoft* case, illustrates the OTA's willingness to liberally construe the term "gross receipts" for purposes of what should be included in the sales factor.

### Implications for Businesses

- Water's-edge filers in California should reassess their apportionment calculations, especially those with significant dividend income, to determine whether a claim for refund should be filed.
- Taxpayers should also take a second look at the various components of their sales factor to consider whether all gross receipts are being properly included.

### Final Thoughts

The FTB is unable to appeal an adverse OTA decision; thus, the *Microsoft* decision is final. It remains to be seen whether this opinion will be marked precedential. Both the opinion and the petition for hearing denial will be published on the OTA's website in the coming months.

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