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06.03.14 CHIEF COUNSEL RULING 2014-02

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Re: Chief Counsel Ruling Request for ************

Dear M*. *******:

This is in response to your April 24, 2013 Chief Counsel Ruling Request seeking guidance as to whether a series of asset sales described below are "occasional" within the meaning of title 18 of the California Code of Regulations ("Regulation"), section 25137, subsection (c)(1)(A).

FACTS

************, a ****** corporation incorporated on *****************, owns ***** percent of ************. ************, and certain of their affiliates, predecessor entities, and successor entities are collectively referred to herein as “the Company” or "Taxpayer."

Although the Company has a distinct historic presence in ********, it has invested in and subsequently divested itself of some of those assets and acquired others to develop a broader mix of ************ to maximize returns. However, these transactions accelerated dramatically upon emerging from bankruptcy in ********.

Company Background and Economic Challenges

The Company was founded in **** by M*. ***********, with the purchase of a ********* that subsequently became known as ***********.

In an attempt to maximize returns on invested capital, ************* invested in assets over time ranging from ************ as well as **************, acquiring *** *** between **** and ****. Its total ownership of ************ – ********* ****** ultimately reached more than 3 million households across the country. The Company also operated an interactive business which offered ************.

Between **** and ****, the ******* industry and the Company's ****** assets battled declining ************ to purvey their goods or services. Specifically, increased competition from other forms of ***** led to industry-wide decreases in ***** volume and revenues. The ability to obtain ******* was also adversely affected by changes to telemarketing regulations (such as "do not call" legislation) implemented in 2004, which historically reflected the largest single source of ******* for the ***** industry. All these factors placed an ongoing pressure on the profit margin and the cash flow declined as ******** pricing adapted to a more ******* and highly-competitive marketplace.

The global recession added an even greater burden on an already distressed industry, leading to unprecedented industry-wide revenue loss. The slumping retail market reduced demand for ******** associated with durable and retail consumer goods and services. Further, the rise in the national unemployment rate coupled with the deteriorating real estate and auto sectors led to a significant decline in ************. These factors culminated in the Company's filing for Chapter 11[1] bankruptcy ********.

Post-Bankruptcy Business Plan

On ********, the Company emerged from bankruptcy. During the bankruptcy proceedings, many of its former creditors cashed out to various investors for amounts significantly less than the face value of the debt rather than bear the risk that they might receive nothing as a result of the bankruptcy. For the most part, the new investors were interested in receiving short-term gains rather than operating the ******** content assets of the Company. Thus, the Company submitted Plan of Reorganization to the bankruptcy court that would accommodate the aim of such investors to liquidate their interests in the assets of the Company.

In order to monetize their investments, the new owners directed Company management to seek buyers for the Company's various assets. Pursuant to the terms of the Plan of Reorganization, the Company granted ******** to Company management with provisions that effectively awarded management for successfully finding buyers for the Company's assets. Thereafter, ****** investors and the Company's management were aligned in their mutual desire to find a buyer or buyers for all of the Company's assets.

During the second half of **** and into the spring of ****, the Company responded to many due diligence inquiries from interested buyers. This resulted in Company negotiations with ********** in the spring of **** for the sale of all assets of the Company. After that transaction fell through, the Company entered into a second round of negotiations with

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[1] Chapter 11, Reorganization, Title 11 United States Code sections 1101 to 1174.

********** in the **** for the sale of the ************. That transaction also fell through.

On *********, the Company entered into a definitive agreement with ******** to sell the assets of its ********** business. The ****** sale closed on *******. At the same time the Company was completing the sale of the ********* business, it was negotiating the sale of its ********properties to various third-party buyers including ***************, and ************. All of these sales were completed by ********.

The Company continued the process of converting assets to cash. The Company sold the assets of **********. to ********** on ********, the assets of ********* to ********** on **********, the assets of the ******** to ********* on ******, the assets of ********. to ******** on ********, and two office buildings in ****** California on ****** and ******. The Company is currently in the process of negotiating the sale of the assets *******.

These asset sales generated gross receipts and resulted in gains that constitute business income as defined in California Revenue and Taxation Code ("CRTC") section 25120 subject to apportionment.

ISSUE

Whether Taxpayer's asset sales that took place subsequent to its emergence from bankruptcy are "occasional sales" as defined in Regulation section 25137(c)(1)(A)?

HOLDING

Taxpayer's asset sales in implementing its Plan of Reorganization under Chapter 11 of the Bankruptcy Code are within Taxpayer's normal course of business and occurred frequently thus are not "occasional sales" within the meaning of Regulation section 25137(c)(1)(A) and the resulting gross receipts must be included in Taxpayer's sales factor for apportionment purposes.

DISCUSSION

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.[2] For taxable years beginning on or after January 1, 2011, “sales” means all gross receipts not otherwise allocable under California law.[3]

[2] CRTC section 25134.

[3] CRTC section 25120(f)(1).

However, the regulations for CRTC section 25137 provide special rules to exclude receipts from the sales factor when a substantial amount of gross receipts arise from an occasional sale of assets used in that taxpayer's trade or business. For these purposes, 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.[4]

The determinative factor for the analysis is whether the sale is considered to be occasional, an issue of facts and circumstances. Under the Regulation, a sale is considered "occasional" if:

1. the transaction is outside of the taxpayer's normal course of business AND
2. occurs infrequently [emphasis added].[5]

Chapter 11 of the Bankruptcy Code provides an opportunity for a debtor to reorganize its business or financial affairs or to engage in an orderly liquidation of its property either as a going concern or otherwise. Chapter 11 embodies a policy that it is generally preferable to enable a debtor to continue to operate and to reorganize or sell its business as a going concern rather than simply to liquidate a troubled business. Continued operation may enable the debtor to preserve any positive difference between the going concern value of the business and the liquidation value.[6]

Consistent with the policy of Chapter 11 of the Bankruptcy Code, Taxpayer's Plan of Reorganization under Chapter 11 of the Bankruptcy Code was designed with the intent and mechanism to achieve the goal of converting business assets to cash at the highest possible value by operating its ***** business as a going concern. To accomplish the goal of the Plan of Reorganization, negotiation and implementation of asset sale transactions became part of Taxpayer's normal course of business.

Taxpayer consummated more than ** asset sales transactions during 2012 and 2013 to implement its Plan of Reorganization. These transactions took place within a two-year period at short intervals on a regular basis. Although the aggregate of the gross receipts from the post bankruptcy asset sales meet the definition of "substantial" as defined in Regulation 25137(c)(1)(A)1, these receipts did not arise from transactions outside of the taxpayer's normal course of business and thus these asset sale transactions are not "occasional sales" within the meaning of Regulation section 25137(c)(1)(A)2. As such, the gross receipts arising from the post-bankruptcy asset sales must be included in Taxpayer's sales factor.

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[4] Regulation section 25137(c)(1)(A)1.
[5] Regulation section 25137(c)(1)(A)2.
[6] Collier on Bankruptcy, P 1100.01 Overview of Chapter 11 Policies.

Please be advised that the tax consequences expressed in this Chief Counsel Ruling are applicable only to the named taxpayer and are based upon and limited to the facts you have submitted. In the event of a change in relevant legislation, or judicial or administrative case law, a change in federal interpretation of federal law in cases where our opinion is based upon such an interpretation, or a change in the material facts or circumstances relating to your request upon which this opinion is based, this opinion may no longer be applicable. It is your responsibility to be aware of these changes, should they occur.

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

Very truly yours,

John Su
Tax Counsel IV