



## **California Court of Appeals Hands Big Loss to Franchise Tax Board on the Issue of What Is a Unitary Business**

**by Robert S. Horwitz**

A California nonresident is taxable by California on income earned from sources in California. Where two or more commonly owned companies carry on a trade or business within and outside of California, the net income is allocated and apportioned between California and other states under the Uniform Division of Income for Tax Purposes Act (“UDITPA”). In *Appeal of Bindley*, 2022-OTA-179P, the California Office of Tax Appeals (“OTA”) held that an Arizona screenwriter who wrote screenplays for two California LLCs operated a unitary business and thus could be taxed under the unitary business regulations. The OTA has applied *Bindley* to other cases to hold nonresidents taxable in California. See, *Appeal of Bass*, 2022-OTA-145; *Appeal of Daker*, 2020-OTA-096. On May 1, 2026, the California Court of Appeal in *Garcia-Rojas v. Franchise Tax Board*, \_\_ Cal.App.5<sup>th</sup> \_\_ (Case No. A172054) smacked down the holding of *Bindley*.

### **Background Facts**

Xavier Garcia-Rojas is a radiologist who resides in Texas. In 2017, he became an independent contractor for StatRad, engaged to read images and provide reports collected at medical facilities in California and other states. StatRad paid for Dr. Garcia-Rojas to be credentialed in California and other states, provided hospital privileges for him in California and other states, and paid for California medical malpractice insurance.

Dr. Garcia-Rojas did not file California income tax returns. He was contacted by the Franchise Tax Board, which requested him to file returns and report the income from StatRad apportionable to California. He filed returns for 2018, 2019, and 2020, paid the tax, and filed a refund claim. When the FTB failed to respond, he sued for a refund in superior court. The superior court granted summary judgement for the FTB, holding that Dr. Garcia-Rojas had a sole proprietorship that was a unitary business and he thus had to apportion income to California.

### **Analysis**

The court of appeals began its analysis with a discussion of the basics of the taxation of California nonresidents. California taxes the gross income of nonresidents



“derived from sources within this state.” Cal. Rev. & Tax. Code sec. 17041. To compute the taxable income of a nonresident who has sources both within and out of California, the income is allocated and apportioned under regulations prescribed by the FTB. Cal. Rev. & Tax. Code sec. 17954, If a nonresident’s business is a sole proprietorship that carries on a unitary business inside and outside of California, the net income derived from within the state is determined in accordance with UDITPA. 18 Cal. Code. Regs. Sec. 17951-4(c).

The court of appeals stated that the superior court erred in holding that Garcia-Rojas operated a unitary business and noted that the FTB cited no authority to support its claim that a sole proprietor engaged in one business activity and receiving compensation from one corporation is a unitary business. No court has applied the unitary business theory to a single person or a sole proprietorship engaged in one business activity.

According to the court “unitary business has a long ‘recognized meaning in California” of “two or more business entities that are commonly owned and integrated in a way that transfers value withing the affiliated entities.” Dr. Garcia-Rojas operated at most a sole proprietorship engaged in one business activity. Neither the California Supreme Court nor any appellate court has applied the unitary business theory to facts such as these.

In addressing the FTB’s reliance on the OTA’s decision in *Bindley*, the appeals court stated, “that decision is not binding on this court” and “its reasoning is unconvincing.” *Bindley* focused on “tests to determine whether two *different* businesses are unitary. It ignored that there must be separate business activities to unite.” (Emphasis in original.) Furthermore, the court stated that the regulation the FTB relied on applies “only if [there are] two or more businesses of a single taxpayer.” Since the FTB failed to show that Dr. Garcia-Rojas had a unitary business, the court reversed and remanded the case to the superior court.

### **Take-Away**

Whether the FTB will request a rehearing or file a petition for review with the California Supreme Court is unknown. It has 15 days from the date the opinion was filed to request a rehearing. If it does not request a rehearing or the request is denied, it has 30 days after the decision becomes final to petition the California Supreme Court for review. Given how aggressive the FTB has been in seeking to tax



nonresidents, I think the odds are in favor that the FTB will petition for rehearing or for review by the Supreme Court. The opinion will not have precedential value if a petition for review is filed and granted.

Assuming the FTB does not seek review or rehearing or the opinion is affirmed, it will have a major impact on the FTB's efforts to extend the unitary business theory to tax nonresidents who have sole proprietorships. It may also support challenges to the FTB's efforts to tax nonresident partnerships on gain from the sale of an interest in a partnership that does business in California.

Nonresident taxpayers who paid the FTB tax on the theory that their sole proprietorship was a unitary business should consider consulting an experienced tax professional to determine whether they should file a claim for refund based on the *Garcia-Rojas* decision.

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