



MULTISTATE INCOME/FRANCHISE TAX

California court issues Proposed Statement of Decision addressing agricultural business and alternative apportionment

Tax Alert

Overview

On February 26, 2026, the Los Angeles County Superior Court (Department 73) filed a Proposed Statement of Decision (the “Proposed Decision”) in *Smithfield Packaged Meats Corp. (f/k/a John Morrell & Co.) v. California Franchise Tax Board*, Case No. 21STCV39637. The Proposed Decision addresses the appropriate apportionment methodology for Smithfield Packaged Meat Corp.’s (“Smithfield”) multistate business income subject to California corporation franchise tax for tax year ending 2014.

In the Proposed Decision, the court concluded that Smithfield qualifies as an “agricultural business” under California Revenue and Taxation Code (“CRTC”) section 25128(b) and therefore must use an equally weighted three-factor apportionment formula based on property, payroll, and sales. Additionally, the court concluded that, even if Smithfield did not qualify as an agricultural business, the company would alternatively be entitled to relief under CRTC section 25137 because the application of California’s single sales factor formula does not fairly represent the extent of Smithfield’s business activity in California.

This Tax Alert summarizes the Proposed Decision, which remains subject to objection under California Rule of Court 3.1590 and is not yet a final judgment.

Background

Smithfield filed a refund claim for the 2014 tax year asserting that it overpaid California corporation franchise tax by apportioning income using California’s single sales factor formula. Smithfield advanced two principal arguments.

First, Smithfield asserted that it derived more than 50 percent of its gross receipts from “agricultural business activity” within the meaning of CRTC section 25128(b), requiring use of the equally weighted three-factor apportionment formula applicable to agricultural businesses. Second, in the alternative, Smithfield asserted that the application of California’s single sales factor formula did not fairly represent its business activity in California and that relief was available under CRTC section 25137.

The Franchise Tax Board (“FTB”) denied the refund claim, relying in part of Cal. Code Regs., tit. 18, section 25128-2 (the “Regulation”), which applies a product-based approach in determining whether receipts are derived from agricultural business activity.

Smithfield’s agricultural business status

In the Proposed Decision, the court concluded that Smithfield qualified as an agricultural business for the 2014 tax year under CRTC section 25128(b), finding that the statutory test focuses on receipts derived from agricultural

business activities, rather than the character of the taxpayer's final products. Based on the trial record, the court concluded that Smithfield's hog production, harvesting, and related activities constitute agricultural business activity within the meaning of CRTC section 25128(d).

After reviewing Smithfield's business records and expert testimony, the court determined that approximately 61.34 percent of Smithfield's total gross receipts for 2014 were attributable to agricultural business activities, exceeding the statutory 50 percent threshold required to qualify as an agricultural business.

Treatment of Regulation section 25128-2

According to the Proposed Decision, the Regulation's product-based approach, under which receipts from processed products are treated as non-agricultural, impermissibly narrows the scope of the statute by disregarding underlying agricultural activities that generate those receipts. The court explained that whereas CRTC section 25128(b) looks expressly and exclusively to receipts from a taxpayer's agricultural business activities, the Regulation looks expressly and exclusively to receipts from the sale of certain products and, in doing so, disregards the examination of business activities required under CRTC section 25128.

Therefore, the court found the Regulation invalid as applied to Smithfield to the extent it excludes receipts attributable to hog production and harvesting activities.

Alternative apportionment under CRTC section 25137

In addition to its holding under CRTC section 25128(b), the court concluded in the alternative that Smithfield would be entitled to alternative apportionment relief under CRTC section 25137.

The court found that the single sales factor formula attributed approximately 6.6533 percent of Smithfield's income to California, while evidence presented at trial indicated that only approximately 1.02 percent of Smithfield's income generating activities occurred in the state. Based on this disparity, the court determined that Smithfield proved by clear and convincing evidence that the application of the single sales factor formula does not fairly represent Smithfield's business activity in California.

The court concluded that the equally weighted three-factor apportionment formula is a reasonable alternative method within the meaning of CRTC section 25137.

Procedural status and next steps

The Proposed Decision was issued pursuant to California Rule of Court 3.1590 and is subject to objection by either party before becoming final. The court directed the FTB to compute Smithfield's refund consistent with application of the three-factor apportionment formula. As of the issuance of the Proposed Decision, no final judgment has been entered.

Considerations

Although the Proposed Decision arises under California law and involves a taxpayer engaged in agricultural business activity, the court's analysis of single sales factor apportionment and alternative apportionment under provisions based on the Uniform Division of Income for Tax Purposes Act ("UDITPA") reflects potential issues that may arise in other jurisdictions and across a range of industries. In particular, the court's discussion of whether a single sales factor formula fairly represents a taxpayer's income generating activities may be relevant in states that apply a similar alternative apportionment framework.

The Proposed Decision also illustrates the interaction between a single sales factor apportionment methodology and statutory alternative apportionment provisions, as well as the types of factual considerations examined by a court in evaluating whether an apportionment methodology fairly represents a taxpayer's business activity in a state.

Any consideration of alternative apportionment provisions under applicable state law generally occurs within state-specific procedural and timing frameworks, which may include requirements relating to filing mechanics, evidentiary standards, and statutes of limitation.

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