



This Week in State Tax (TWIST)

March 9, 2026



California: Trial court says taxpayer is agricultural entity for corporate tax purposes

A California Superior Court, in a proposed decision, held that a taxpayer was entitled to use a three-factor apportionment method, rather than California's default single sales factor apportionment method. The taxpayer operated a business that raised and harvested hogs, processed meat, and sold fresh and packaged pork products. In 2014, the tax year at issue, the taxpayer operated several types of facilities, including farms, feed mills, harvesting facilities, and meat packing facilities. Only one of the taxpayer's 30 processing facilities was in California. The taxpayer initially filed its 2014 California income tax return as a non-agricultural business apportioning income to California based upon the prescribed single sales factor formula. California law mandates single sales factor apportionment unless the taxpayer engages in a statutorily enumerated activity, including agricultural business activity, which requires that more than 50 percent of gross receipts be derived from agricultural activities. The taxpayer then filed a refund using a three-factor apportionment method, arguing that (1) it was an agricultural business, (2) the regulation applicable to agricultural business activities was overly narrow and invalid, and (3) it was entitled to alternative apportionment as the single sales factor formula did not fairly represent its in-state business. The state Franchise Tax Board (FTB) did not act on the claim, and the taxpayer treated the refund claim as denied and appealed to the court.

At trial, the FTB argued that the taxpayer was not an agricultural business because the applicable regulations apply a "product-based" approach that looks solely at the character of the final product sold by a taxpayer to determine if it is engaged in agricultural activities. The Court disagreed, noting that all the activities related to hog production qualified as agricultural business activity. The court ultimately found that over 60 percent of the taxpayer's total receipts from fresh pork products and packaged meat products were attributable to the hog production and harvesting activities (i.e., agricultural business activities). Thus, the taxpayer was entitled to use a three-factor apportionment method. The court also noted that the regulation which used a product-based approach to determine "agricultural business activity" was inconsistent with the statutorily prescribed test that specifically looks at a taxpayer's activities and gross receipts derived therefrom, and is thus invalid both under California law and as applied to the taxpayer in this case.

The court also upheld the taxpayer's alternative apportionment argument, finding that using a three-factor apportionment method was a reasonable method to fairly represent the taxpayer's business activity in California. Although not statutorily defined, the court noted that business activity "encompasses more than simply the ultimate revenue-generating item ... It also includes activities of employees, as reflected in the payroll factor, and the use and availability of real and tangible and intangible personal property." Here, all the taxpayer's hog production facilities, harvesting facilities, and processing facilities (except one small plant) were outside of California. These facilities were necessary for the taxpayer's business and were the primary drivers of its income.

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Moreover, the taxpayer's employees at these various facilities were necessary to engage in its business. Thus, according to the court, a single sales factor did not fairly represent the taxpayer's business because it disregarded substantial activities, which occur "almost entirely" outside of California. Applying a three-factor method, the taxpayer's business activities in California were just over one percent of its total activities, contrasted with the single sales factor which attributed over 6.5 percent of the income to California. This 600 percent difference justified the use of alternative apportionment as applied to the taxpayer. Please contact [Candace Axline](#) and [Geoffrey Way](#) with questions about *Smithfield Packaged Meats Corp. v. Franchise Tax Bd.*, Cal. Super. Ct., No. 21STCV39637 (Feb. 26, 2026).

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