



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
NEW JERSEY ZINC SALES COMPANY)

Appearances;

For Appellant: Butler; Van Dyke & Harris (by brief)
Butler, Reckers & Montgomery (by letter)
For Respondent: James J. Arditto, Franchise Tax Counsel
(by brief)

O P I N I O N

This appeal is made pursuant to Section 25 of the Bank and Corporation Franchise Tax Act (Chapter 13, Statutes of 1929, as amended) from the action of the Franchise Tax Commissioner in overruling the protest of New Jersey Zinc Sales Company to his proposed assessments of additional tax in the amount of \$661.68 for the taxable year ended December 31, 1938, based upon the income of the company for the year ended December 31, 1937. Appellant stipulated by letter that notice of the hearing had been received and that this appeal might be submitted upon the briefs on file and without oral argument. Respondent made the same oral stipulation.

In computing the additional assessment the Commissioner, by use of a three-factor (sales, property and payroll) formula, measured the tax by a percentage of the combined net income of a parent corporation and four subsidiary companies of which Appellant was one. The New Jersey Zinc Company, the parent company, owned and controlled the New Jersey Zinc Company of Pennsylvania, the Mineral Point Zinc Company, the Bertha Mineral Company, and the New Jersey Zinc Sales Company. The New Jersey Zinc Company of Pennsylvania and the Mineral Point Zinc Company operate smelters.

Appellant, a foreign corporation, performs the selling functions for the entire group. None of the other four companies does any business within the state, Appellant maintains offices in California from which it sells chiefly zinc pigment, together with a minor amount of other products manufactured by other companies of the affiliated group.

For the income year 1937 Appellant filed its California franchise tax return showing a net income from California operations of \$4.22, notwithstanding that the affiliated group of corporations had realized a total net income from its entire operations everywhere of \$2,917,963.83. For many years the method of accounting used by the New Jersey Zinc Company was such that all profits from the operation of its business and the

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business of the several affiliated corporations and from the sales of products accrued to the parent company and none to the subsidiary companies." (Appellant's Memorandum of Points and Authorities in Support of New Jersey Zinc Sales Company From Action of Franchise Tax Commissioner Upon Taxpayer's Protest Page 2, Lines 20 to 24.) Appellant's California franchise tax returns for prior years have consistently shown either losses or insignificant income, although the affiliated group as a unit made substantial profits during such periods.

In prior years negotiations were carried on between the Commissioner's office and Appellant to determine the tax liability and Appellant's proposal of computing gross income upon the basis of a certain percentage of sales was accepted by the Commissioner. The percentage agreed upon was four and three-quarter per cent for 1934, four per cent for 1935, and three and a-half per cent for 1936.

Appellant now proposes that the tax be computed on either of two bases: (1) "Commission method" and (2) An allocation method (similar to the method used by the Commissioner) based solely upon the sales of zinc pigment. Of the total sales of the affiliated group 25.78 per cent were sales of zinc pigment.

If the commission method were to be used Appellant suggests that it be regarded as receiving seven and a half per cent commission on the California sales, from which would be deducted the California expenses to arrive at the net California income. Appellant's proposed deductions for research and advertising expenses in connection with zinc pigment sales is based upon the percentage of California pigment sales to its total pigment sales, and for general overhead expense is based upon the percentage of California sales to the total sales of all products.

It does not appear whether or not seven and a half per cent would constitute a fair commission. If the commission method were used there would still be difficulty in apportioning selling expenses and other deductible items to this State. We are not prepared to say that the Commissioner was wrong in rejecting this method,

If solely zinc pigment sales were to be considered and if the profits from those sales were to be allocated, property used and payroll expenses in connection with other sales should not be included in the allocation formula. Appellant has not submitted data to make a correct computation of the tax computed by this method. On the contrary, in the computation submitted by Appellant in its brief it has used the same allocation percentage used by the Commissioner in allocating the net income of the affiliated corporations' entire operations. It does not appear whether, employing this method suggested by Appellant and considering only property used and payroll expenses in making zinc pigment sales, the tax would be higher or lower than found by the Commissioner.

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(Statutes of 1937, p. 2337) provides, in part,

"In the case of two or more corporations or banks or of one or more banks and one or more corporations owned or controlled directly or indirectly by the same interests, the commissioner may permit or require the filing of a combined report and such other information as he deems necessary and is authorized to impose the tax due under this act as though the combined, entire net income was that of one corporation, or to distribute, apportion, or allocate the gross income or deductions between or among such corporations or banks, if he determines that such consolidation, distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any such corporations or banks."

In view of the bookkeeping methods used, whereby all profits from the operations of the business of the New Jersey Zinc Company and affiliated corporations accrued to the parent company, it was necessary to include in the income of Appellant some income which appeared on the books to be income of the parent company but which was, in fact, income of Appellant. Part of the income shown on the books of the parent company was, in fact, income of the other subsidiary companies which income was not taxable by California since none of their activities was in California.

The allocation formula used by the Commissioner tends to exclude not only the income of the parent company but also the income of the other affiliated companies as none of those companies has property or payroll or makes sales within the State of California. If the Commissioner had apportioned only the income of the parent company and of Appellant, Appellant might well have argued that the Commissioner was attempting to tax the income of the other three subsidiary corporations because of the fact that part of the income shown on the books of the parent company was, in fact income of the other three subsidiary companies,

"One who attacks a formula of apportionment carries a distinct burden of showing by 'clear and cogent evidence' that it results in extraterritorial values being taxed" Butler Bros. v. McGolgan, 315 U.S. 501, 507. Appellant has not shown that the method used by the Commissioner results in extra-territorial values being taxed.

O R D E R

Pursuant to the views expressed in the opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED, AND DECREED that the action

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of Chas. J. **McColgan**, Franchise Tax Commissioner, in overruling the protest of New Jersey Zinc Sales Corporation, a corporation, to a proposed assessment of additional tax in the amount of \$661.68 for the year ended December 31, 1938, based upon the income of said company for the **year** ended December 31, **1937**, pursuant to Chapter 13, Statutes of 1929, as amended, be and the same is hereby sustained.

Done at Sacramento, California, this 14th day of June, 1943,
by the State Board of Equalization.

R. E. Collins, Chairman
Wm. G. Bonelli, Member
J. H. Quinn, Member
Geo. R. Reilly, Member

ATTEST: Dixwell L. Pierce, Secretary