BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
TUNG-SOL LAMP WORKS, INC.)

Appearances:

For Appellant: C. E. Erkel, Attorney at Law.

For Respondent: James J. Arditto, Franchise Tax Counsel.

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 Tung-Sol Lamp Works, Inc., against proposed assessments of additional tax in the amounts of $460.89 and $23.26 for the taxable year ended December 31, 1938.

Appellant is a corporation organized under the laws of the State of New York and doing business in this State. It has a parent corporation of the same name incorporated under Delaware law, which has not qualified to do, and does not do, business in California. Appellant qualified and commenced to do business in this State on December 24, 1936, at which time it took over the business of a third corporation, Tung-Sol Lamp Works, Ltd., (Pacific Coast Division) a Delaware Corporation, which then withdrew from business in California. The entire capital stock of this company and Appellant are owned by the parent Delaware corporation, Tung-Sol Lamp Works, Inc.

The parent company is engaged in manufacturing miniature electric lamps, radio tubes and flasher devices. It sells these productsthroughout the United States to Appellant and independent distributors. The prices charged by the parent company and the term of sale and discount in connection with its sales to Appellant are identical with the prices and terms of its sales to independent distributors.

The Commissioner's notices of proposed assessment were dated February 20, 1941, and April 30, 1941, respectively. Each refers to Appellant's "return for the income year ended December 31, 1937, disclosing tax liability for the taxable year 1938," and provides that "Interest must be added at six per cent per annum from the due date, March 15, 1938, to the date of payment."

In determining the Appellant's tax liability for the taxable

year 1938, the Commissioner obtained the combined net income of Appellant, its predecessor and its parent company for 1936 and the combined net income of Appellant and the parent for 1937 and then allocated to California a portion of the sum of such combined net incomes for 1936 and 1937. The Appellant objects to this action upon the grounds, among others, that the Commissioner was not justified in including the 1936 income in the measure of the tax for 1938 and in combining the income of Appellant and its parent company in determining Appellant's tax liability.

We are completely unable to understand the Commissioner's position respecting the inclusion of income for 1936 and 1937 in the measure of Appellant's tax liability for the taxable year 1938. Even if the Appellant and its affiliated companies had failed to file returns for the income year 1936, as alleged by the Commissioner but not admitted by Appellant, the Commissioner was not warranted in basing the tax for 1938 on the income of the two prior years. Under such Sections as 4, 11, 13(a) and 23 of the Act, there can be no doubt but that Appellant's tax liabilit for 1938 should be measured by income for the year 1937 only. It is odd, to say the least, for the Commissioner to employ the following language in this connection in charging the Appellant with confusion: "Appellant's brief writer may be confused about the terms used. The income year precedes the taxable year. The 1937 income year becomes'the 1938 taxable year - the year in which the tax is paid. So when Appellant says 'the tax for the year ending December 31, 1938, should have been based upon Appellant's income in California for 1937' his confusion is apparent." (Brief for Respondent, page 10, lines 23-28) It is obvious that the Commissioner's statement and his action involve a good deal of confusion. It is equally obvious, however, that the confusion is not that of the Appellant. Since the 1936 income should not be included in the measure of Appellant's tax liability for the taxable year 1938, it is unnecessary to consider the Appellant's contention that the transfer of assets to it by its predecessor company in 1936 was a reorganization within the meaning of Section 13 of the Act,.

Basing his action upon Section 14 of the Act, the Commissioner determined that the Appellant and its parent company were engaged in the conduct of a unitary business and that it was necessary to allocate to California a portion of the combined net income of the two corporations in order clearly to reflect the income earned by Appellant in this State. The parent company was not qualified to do business in California and did not maintain any offices or do any business here. In so far as the application of Section 14 is concerned, the issue presented herein is, accordingly identical with that involved in the Appeal of P. Lorillard Company, (March 9, 1944). We there held that the third paragraph of that Section as amended in 193'7, rather than the first paragraph, authorized the Commissioner, in a proper case, to obtain the combined net income of a company doing business in California and its parent company not doing business in this State and then to allocate, under Section 10 of the Act, a portion of that income to California.

As in the Lorillard Appeal the Commissioner relies upon the first paragraph of Section 14 and states in support of his position merely that it is necessary to treat the two corporations as a business unit or as "one corporation" in order clearly to reflect the income earned in California. He has not in any way controverted or even questioned the allegations of the Appellant relating to the fairness of the arrangements between the Appellant and the parent company. Appellant alleges in this connection as follows:

> "Appellant maintains a sales organization and conducts selling operations in the Pacific Coast states in the United States. The parent company is engaged in the business of manufacturing items which are sold by appellant. Only a small portion of the items manufactured by the parent company are sold to appellant; most of the products manufactured by the parent company are sold to distributors, on a purchase and sale agreement, who do business in states in the United States in which appellant is not engaged in any activities. The prices and terms of sale of the merchandise from the parent corporation to appellant and the prices and terms Of sale of identical merchandise to the distributors of appellant are identical. The distributors who do business with the parent company under the same terms and conditions as appellant are not subsidiaries of the parent company or connected with it in any way or controlled by it in any way other than under the terms and conditions of contracts of sale."
> (Appellant's Opening Memorandum of Points and Authorities, page 3)

The Commissioner not having raised any question as to the correctness of these allegations of fact or asserted in any way the existence of any arrangement of any sort between Appellant and its parent company tending improperly to reflect the Appellant's net income from business done in this State, this matter is clearly controlled by our decision in the Lorillard Appeal. We must conclude? accordingly, as we found in that matter, that there is no indication herein of a determination by the Commissioner of the existence of any arrangement improperly reflecting the business done or the net income from business done in this State, as required by the pertinent portions of Section 14, and that the action of the Commissioner was, therefore, not authorized by that Section of the Act.

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 of Chas. J. McColgan, Franchise Tax Commissioner, upon the protest of Tung-Sol Lamp Works, Inc. against proposed assessments of

additional tax in the amounts of $460.89 and $23.26 for the taxable year ended December 31, 1938, pursuant to Chapter 13, Statutes of 1929, as amended, be and the same is hereby reversed. Said ruling is hereby set aside and the said Commissioner is hereby directed to proceed in conformity with this order.

Done at Sacramento, California, this 30th day of March, 1944, by the State Board of Equalization.

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

ATTEST: Dixwell L. Pierce, Secretary