BEFORE THE STAT.2 BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of )
)
KAISER-FRAZER SALES CORPORATION )
and KAISER MOTORS CORPORATION )

Appearances:

For Appellants: Thelen, Marrin, Johnson & Bridges and Barlow Ferguson, Attorneys at Law

For Respondent: Burl D. Lack, Chief Counsel; John S. Warren, Associate Tax Counsel

## O P I N I O N

These appeals are made pursuant to Section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of Kaiser-Frazer Sales Corporation and Kaiser Motors Corporation to proposed assessments of additional franchise tax against Kaiser-Fraeer Sales Corporation in the amounts of $10,796.32 and $9,522.69 for the taxable years 1948 and 1949, respectively and against Kaiser Motors Corporation in the amount of $550.04 for the taxable year 1949.

Kaiser Motors Corporation (formerly Kaiser-Frazer Corporation) commenced business in California in 1945. Kaiser-Frazer Sales Corporation was incorporated in 1946 as a wholly-owned subsidiary of Kaiser Motors Corporation, and commenced business in California on November 17, 1947. The parent corporation manufactured automobiles chiefly in the State of Michigan and the subsidiary sold the automobiles to dealers in California and elsewhere. The great majority of the property and employees and all of the sales of Kaiser Motors Corporation were outside of California. The operations of Kaiser-Frazer Sales Corporation were more evenly distributed among the states in which it did business. The comparison of their income-producing factors in California, expressed in dollars, is as follows:

| | Kaiser Motors Corporation | Kaiser-Frazer Sale3 Corporation |
|---|---|---|
| Property | $341,408.33 | $ 506,489.29 |
| Payroll | 205,408.66 | 341,833.04 |
| Sale3 | 0 | 15,164.823.06 |

The Franchise Tax Board determined that, for the year 1948, these two corporations, along with others operating solely outside of this State, were engaged in a unitary business. It allocated a part of the combined income of the entire group to this State in the proportion that the factors of property, payroll and sales in the State bore to the total property, payroll and sales everywhere. It then divided the California portion of the income between the two Appellants in the proportion that the California property, payroll and sales of each bore to the total California property, payroll and sales of both. The income of Kaiser-Frazer Sales Corporation so determined for 1948 was used as the measure of its tax for its second and third taxable years, 1948 and 1949, since it did not do business for a full twelve months in its first taxable year, 1947 (see former Section 13(c) of the Bank and Corporation Franchise Tax Act).

The Appellants contend that the California portion of the income should be divided between them in the proportion that the total property, payroll and sales in and out of the State, of each Appellant bears to the total of those factors of both Appellants. This method would result in a substantially lower tax on the sales corporation and a correspondingly higher tax on the parent corporation. Ordinarily, the aggregate taxes on the two corporations for a given year would be the same under either method, but here the tax on the sales corporation for both 1948 and 1949 is to be based on its 1948 income,

Appellants do not dispute the correctness of the first step, by which the income producing factors of the unitary business within the State are compared with those outside of the State to determine the portion of unitary income attributable to California, They state, however, that based on the same factors the parent contributes 79 cents and the subsidiary 21 cents to each dollar earned by the entire unitary business. These figures apparently do not reflect the contributions of other corporations in the unitary group but for the purpose of discussion we are assuming that they are accurate, On this basis they conclude that the parent has earned 79 cents of each dollar of unitary income assigned to California.

This conclusion ignores the significance of the allocation in and out of the State. That step determines the income earned in California; the income that is attributable to the activities and property in this State. It follows that only the instate factors should be employed in the division of that income between the corporations operating

here. In making that division the out of State factors are not relevant.

The invalidity of Appellants' method is demonstrated by the results that it would obtain. Applying their method, there would be an equal division of the California portion of unitary income between two corporations engaged in a unitary business and with matching total factors of property, payroll and sales, even though one did 99% of its business in California and the other did only 1% of its business here. In fact, the distortion is illustrated clearly in the present case, where, by Appellants' method, the corporation that did the greater share of the business in California would be assigned the lesser share of the California income,

The Appellants and the Franchise Tax Board have quoted from a recognized authority on income allocation, Altman and Keesling, Allocation of Income in State Taxation, Second Edition, 1950. The following statement is made therein at page 176:

> "It sometimes happens that two or more members of an affiliated, related, or controlled group of taxpayers engaged in the conduct of a unitary business are doing business in the same state, Thus, for instance, a parent manufacturing corporation may have a selling subsidiary which maintains a sales office or otherwise conducts its business in the same state in which the manufacturing operations are carried on. When this occurs, after the portion of the income from the unitary business attributable to the state is determined in the manner above outlined, it is necessary to make a further apportionment between the members of the group engaged in conducting the business within the state. In many instances, it is immaterial how the apportionment between the taxpayers within the state is made, since the tax consequences will be the same in any event. There may be instances, however, where one of the taxpayers had losses from other transactions which could be offset against its portion of the income from the unitary business. Again, it may happen that the taxpayers may fall into different tax categories, as would be the case if one were an individual and the others were corporations. In such instances, the method of making the intrastate apportionment between the taxpayers becomes important, It is believed that in most instances a method similar to the one

used for making the interstate apportionment may be used for the intrastate apportionment, Thus, if the state uses the three-factor formula of property, payroll and sales for the interstate apportionment , the intrastate apportionment could be made on the basis of the ratio which the intrastate portion of each of these factors in the case of each taxpayer doing business in the state bears to the total intrastate portion of these factors of all the taxpayers so doing business in the state,

"Another method which may be used in lieu of the foregoing would be first to determine the portion of the entire income from the unitary business of the entire group which is attributable to the activities both within and without the state of each of the members doing business in the state, If the three-factor formula is used, this apportionment could be made on the basis of the ratio which the total property, payroll and sales of such taxpayers doing business in the state bears to the total property, payroll and sales of all members of the group. After it is determined how much of the total unitary income is attributable to activities both within and without the state of the members doing business within the state, then the apportionment of each member's share within and without the state could be made separately in the usual manner in the case of each such member.

"It is difficult to say what the policies of the various states are with respect to this problem. A few of the states have elaborate and detailed provisions which are apparently designed to give the tax administrator the broadest possible freedom in adjusting income and deductions between and among affiliated, related, or controlled taxpayers and in determining the income reasonably attributable to the taxing state. These states include California, Georgia, Kansas, Maryland, Montana, New York, North Carolina, North Dakota, and Utah. In these states there can be little question that the administrator is authorized to require the furnishing of information showing the entire income of an affiliated, related, or controlled group of taxpayers and may determine the income attributable to the state of any members doing business therein by means of a formula in much

> the same manner as would be employed in case the business were operated by a single entity. In practice, this method is extensively followed in California."

The first paragraph of this quotation clearly supports the position taken by the Franchise Tax Board. The Appellants do not advocate the use of the alternative method set forth in the second paragraph, They do contend that the last paragraph shows that the Franchise Tax Board has not always followed the method which it here prescribes. Appellants contend that their own method, contrary to that of the Franchise Tax Board, adheres to the theory that the business is operated by a single entity.

We do not believe that the last paragraph quoted above has the significance attached to it by the Appellants nor do we believe that the method which they suggest adheres more closely to the unitary principle than the method used by the Franchise Tax Board. The Board's method gives equal weight to each unit of value of the California factors of each corporation, which are the factors responsible for the earning of the California income, and we conclude that it is reasonably suited to arrive at a proper division of that income between the Appellants,

## O P I N I O N

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, pursuant to Section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protests of Kaiser-Fraaer Sales Corporation and Kaiser Motors Corporation to proposed assessments of additional franchise tax against Kaiser-Frazer Sales Corporation in the amounts of $10,796.32 and $9,522.69 for the taxable years 1948 and 1949, respec-

tively, and against Kaiser Motors Corporation in the amount of $550.04 for the taxable year 1949 be and the same is hereby sustained.

Done at Sacramento, California, this 7th day of November, 1958, by the State Board of Equalization,

Geo. R. Reilly, Chairman

J. H. Quinn, Member

Robert E. McDavid, Member

Robert C. Kirkwood, Member

_____, Member

ATTEST: Dixwell L. Pierce, Secretary