



BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of )  
 )  
PUBLIC FINANCE COMPANY, PUBLIC FINANCE )  
CORPORATION OF EL CAJON, PUBLIC FINANCE )  
CORPORATION OF LOS ANGELES, PUBLIC )  
FINANCE CORPORATION OF NORWALK, PUBLIC )  
FINANCE CORPORATION OF SAN DIEGO, and )  
PUBLIC FINANCE CORPORATION OF WILMINGTON )

Appearances:

For Appellants: Bryan Purteet, H. Allen Smith, and  
Spencer E. Van Dyke, Attorneys at Law

For Respondent: Crawford H. Thomas, Associate Tax Counsel

Amici Curiae: John Lawrence Kelly, Sheppard, Mullin,  
Richter, Bnlthis & Hampton, George R.  
Richter, Jr., and Edwin H Franzen,  
Attorneys at Law

OPINION

These appeals are made pursuant to Section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the protests of the corporations named below to proposed assessments of additional franchise tax in the amounts and for the years set forth below. Appellants having paid the amounts indicated, which include interest, the appeals will be treated as from the denial of claims for refund in accordance with Section 26078 of the Revenue and Taxation Code,

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	<u>Taxable Year</u>	<u>Amount Assessed</u>	<u>Amount Paid</u>
Public' Finance Corporation of San Diego, as Successor in Interest to Public Loan Corporation	1952	\$42,043.16	\$53,542.27
	1953	42,401.98	50,912.69
Public Finance Company	1952	793.12	1,021.20
	1953	1,036.17	1,271.86
Public Finance Corporation of El Cajon	1952	276.92	339.93
	1953	342.25	420.10
Public Finance Corporation of Los Angeles	1952	1,193.78	1,465.42
	1953	1,460.07	1,792.18
Public Finance Corporation of Norwalk	1952	535.98	657.94
	1953	635.03	779.48
Public Finance Corporation of Wilmington	1952	169.00	207.45
	1953	169.00	207.45

For the purpose of convenience, Public Loan Corporation, rather than its successor, Public Finance Corporation of San Diego, will hereafter be referred to as an Appellant,

Appellants Public Loan Corporation and Public Finance Company were doing business in California in 1951. In the following year all the Appellants engaged in business in this State, All were wholly-owned subsidiaries of American Investment Company of Illinois, which also owned the capital stock of many other corporations that did business in other states. The entire group was engaged, directly or indirectly, in the business of making small loans,

The issues presented are (1) whether the group of corporations was engaged in a unitary business, and (2) if it was, whether the income attributable to California sources was properly determined by the use of an allocation formula,

American Investment Company of Illinois, the parent corporation, was a Delaware corporation with principal offices in Springfield, Illinois, and executive offices in St. Louis, Missouri. During the calendar year 1951, it owned the entire capital stock of approximately 145 corporations, including Appellants Public Loan Corporation and Public Finance Company. During the calendar year 1952, it owned the entire capital stock of approximately 159 corporations, including all of the Appellants. All of the subsidiaries, except Public Finance Company, were engaged in operating offices for the making of small loans to individuals. Public Finance Company furnished accounting and supervisory services to the operating subsidiaries. It apportioned charges for these services among the subsidiaries on the basis of the dollar value of loans outstanding in each office,,

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American Investment Company did not itself make loans to individuals but it supplied the subsidiaries with the funds which they lent to individual borrowers, American obtained these funds from its own capital" and through borrowing from banks and others, American was able to obtain money at an interest rate of approximately 3-1/2%. It charged its subsidiaries 8%. 3

The Boards of Directors of the subsidiaries included officers of the parent and the officers of the parent were also officers of the various subsidiaries, The operations of the group were coordinated by dividing the country into eight geographical divisions, each of which was under the control of an Executive Supervisor. Each local office was directed by a manager who had charge of the office and the local employees, Centralized training programs were conducted for the employees of all the corporations, thereby developing a pool of well trained branch managers, supervisors, and other executives,, Employees were interchanged among the various corporations. Common employee benefit plans, including a retirement plan, a thrift account plan, a profit sharing plan, a group insurance plan, and a medical plan, were maintained and made available to the employees of all corporations in the group,

Appellant Public Finance Company filed franchise tax returns for the income years 1951 and 1952 in which it apportioned its income to sources within and without the State by the use of an allocation formula consisting of the factors of property, payroll, and gross receipts. All of the other Appellants filed franchise tax returns in which they computed California income 'by the use of separate accounting,

The Franchise Tax Board determined that the entire group of corporations was engaged in one unitary business, It allocated the combined income within and without the State by the use of a formula consisting of the factors of average loans outstanding, payroll, and interest earned, The income so allocated to California was then apportioned among the corporations doing business within this State and the assessments in question herein were issued.

Appellants contend that they are not engaged in a unitary business and that in any event they are engaged in a type of business in which income attributable to a particular state may best be determined by separate accounting.

The California Supreme Court, in Edison California Stores v. McColgan, 30 Cal, 2d 472, has set forth the test to be used in determining whether or not a group of corporations is engaged in a unitary business:

"If the operation of the portion of the business done within the state is dependent upon or contributes to the operation of the business without the state, the operations are unitary; otherwise, if there is no such dependency, the business within the state may be considered to be separate."

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In our opinion, American Investment Company and its various subsidiaries were engaged in a unitary business. We see no substantial difference between the economies resulting from the centralized purchasing of shoes considered in the Edison California Stores case, supra, and those flowing from the centralized borrowing of money by these Appellants. There was as much relationship between the loans made in California and in Maine by members of this group as there was between the sales of shoes in California and in Georgia by the corporations there under scrutiny. Certainly a large volume of business, centralized management, centralized accounting and services, and centralized control are income producing factors as valuable to a financial business as to a shoe business,

In recent appeals we have concluded that the test adopted in the Edison case is met if the unitary features are sufficient to reflect themselves in earnings of the group materially greater than they would have been if each segment had operated without the benefit of its connection with the other parts; (Appeals of Beatrice Foods Co. and Meadow Gold Dairies, Inc., decided November 19, 1958.) It is readily apparent that the purpose and necessary effect of central procurement of money, centralized-accounting and supervision, centralized employee training programs, the management pool thereby developed, the opportunity for interchange of personnel and the common employee benefit plans which existed, were to contribute to increased earnings for the group. American Investment Company recognized this. In its annual report for 1948 it made the following comment:

"In August, 1948, the Company purchased, for cash, all of the stock of the Ohio Wimsett System Company, which had operated one office in Omaha, Nebraska, since 1928. The change in management resulted in a prompt increase in earnings." (Emphasis added,)

We are aware of only three cases in which courts have considered whether groups of corporations engaged in operations similar to those involved herein were engaged in unitary businesses. In each of these cases the court held that the taxpayer was thus engaged. (Beneficial Loan Society of Oregon v. State Tax Commission, 95 Pac. 2d 429; Household Finance Corp. v. State Tax Commission, 128 Atl. 2d 640; Household Finance Corp. v. State Tax Commission, 142 Atl. 2d 807. In Household Finance Corp. v. State Tax Commission, 128 Atl. 2d 640, the court stated:

"Household seems to lose sight of the unitary type of its operations described in the Court below as a 'national ganglion!'. The vast financial combine which it is, necessarily must have an operating business head. Judgments, decisions and policies made and administered out of headquarters tie together and coordinate the activities of its many field offices. It is by the use of sound business judgment at the seat of management,

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that the lifeblood of a financial operation like Household is channeled to those field functions requiring additional capital, Through the operation of its headquarters, and the combined borrowing power which the complex gives thereto, the most advantageous rates of interest may be attained with resultant benefit to all parts of the corporate body, The **branches** in Maryland, some peculiarly so because of their geographical proximity to territory where similar business was **prohibited**, contributed to the whole; and, **naturally**, obtained many benefits **therefrom**. It indeed, would be difficult to envisage a **better** illustration of a unitary **function** than this huge financial **concern**. We, therefore, decide Household was engaged in a unitary enterprise."

Having determined that the group was engaged in a unitary business the necessity of using a formula to determine the income attributable to California sources is **clear**. Formula methods of allocating income were approved in the cited decisions. The contention that separate accounting should not be used in connection with a unitary business has been answered by the following statement of the California Supreme Court in John Deere Plow Co, v. Franchise Tax Board, 38 Cal, 2d 214:

"But in so arguing plaintiff fails to take into account the underlying concept of formula apportionment in the allocation of income from a unitary business; that the unitary income is derived from the functioning of the business as a whole, to which the activities of the various states contribute; and that by reason of such interrelated activities in the integrated overall enterprise, the business done **within** the state is not **truly** separate and distinct from the **business** done without the state so as reasonably to permit of a segregation of income under the separate accounting method rather than use of the formula method in assigning to the taxing state its fair share of taxable **values**."

See also Butler Brothers v. McColgan, 17 Cal, 2d 664, aff'd. 315 U. S. 501, wherein the California Supreme Court pointed out, at page 668, that formula allocation is required in the case of a unitary business to prevent **overtaxation** to the corporation or **undertaxation** by the State. In our opinion, Appellant has failed to show by "**clear and cogent**" evidence that the formula selected by the Franchise Tax Board has resulted in the taxation of **extraterritorial values**. We have concluded, accordingly, that the action of the Franchise Tax Board must be sustained.

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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, pursuant to Section 26077 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying **the** claims of the following corporations for refund of franchise tax **in** the amounts and for the years indicated be and the same is hereby sustained:

	<u>Taxable Year</u>	<u>Amount</u>
Public Finance Corporation of San Diego, as Successor in Interest to Public-Loan Corporation	1952	\$53,542.27
	1953	50,912.69
Public Finance Company	1952	1,021.20
	1953	1,271.86
Public Finance Corporation of El Cajon	1952	339.93
	1953	420.10
Public Finance Corporation of Los Angeles	1952	1,465.42
	1953	1,792.18
Public Finance Corporation of Norwalk	1952	657.94
	1953	779.48
Public Finance Corporation of Wilmington	1952	207.45
	1953	207.45

Done at San Francisco, California, this 29th day of December, 1958,  
by the State Board of Equalization,

George R. Reilly, Chairman

J. H. Quinn, Member

Paul R. Leake, Member

Robert C. Kirkwood, Member

ATTEST: Dixwell L. Pierce, Secretary