BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of, the Appeal of)
)
JOHN BLAIR & COMPANY)

Appearances:

For Appellant: William H. Frewert, Certified Public Accountant;
Joseph G. Rose, Jr., Controller

For Respondent: Burl D. Lack, Chief Counsel

OPINION

This appeal is made pursuant to section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of John Blair & Company against proposed assessments of additional franchise tax in the amounts of $2,553.14, $4,686.58 and $5,203.86 for the income years 1958, 1959 and 1960, respectively.

Both parties to this appeal agree that appellant John Blair & Company is engaged in a unitary business and that its net income attributable to sources within California is to be determined by formula allocation. The sole question involved here concerns the factors which should be included in the allocation formula to be used.

Appellant John Blair & Company (hereafter "appellant") is a Delaware corporation which has been doing business in California since 1935. Its principal business activity is that of acting as sales agent for local radio and television stations for the sale of commercial broadcasting and telecasting' time.. Appellant maintains ten offices across the country, with its headquarters in Chicago; Illinois. Two offices are located in California, one in Los Angeles and the other in

San Francisco. During the years in question appellant leased all office space which it occupied,

In years prior to 1958 appellant had computed its net income allocable to California on the basis of a two-factor, formula, consisting of sales and payroll. Beginning with its franchise tax return for the income year 1958, however, appellant included a property factor in the allocation formula. The factors in the formula and the percentages of income allocable to California were computed as follows:

Income Year 1958	Total Within and Without California	Total Within California	Percent Within California
Property	$ 204,680	$ 13,680	6.684%
Payroll	2,243,310	235,447	10.495%
Sales	5,905,444	519,673	8.800%
		Total percent	25.979%
		Average percent (Amount allocable to California)	8.660%

Income Year 1959			
Property	$ 204,091	$ 15,628	7.657%
Payroll	2,561,358	263,253	10.278%
Sales	6,827,025	645,342	9.456%
		Total percent	27.391%
		Average percent	9.130%

Income Year 1960			
Property	$ 238,297	$ 18,246	7.657%
Payroll	2,767,408	291,607	10.537%
Sales	7,321,350	718,951	9.820%
		Total percent	28.014%
		Average percent	9.338%

The property included in the formula consisted of leasehold improvements such as carpeting and draperies, office furniture and fixtures, and two yachts. One of the yachts accounted for approximately 37 percent of the value of the property for the income years 1958 and 1959, and the second yacht, which was acquired after the first one was sold, accounted for approximately 13 percentof the value of the property for the income year 1960.

Respondent eliminated the property factor from the allocation formula on the ground that property was not a material income-producing factor in appellant's business. The percentage of net income allocable to California for each year in question was thereby increased asfollows:

1958	9.64769%
1959	9.86535%
1960	10.17855%

This appeal is taken from the proposed additional assessments which resulted from that adjustment by respondent.

Section 25101 of the Revenue and Taxation Code gives respondent wide discretion in choosing a formula which will carry out the statute's purpose of achieving a proper apportionment of income to this state. (El Dorado Oil Works v. McColgan, 34 Cal. 2d 731 [215 P.2d 4]; Pacific Fruit Express Co. v. McColgan, 67 Cal. App. 2d 93 [153 P.2d 607].) Respondent's choice of an allocation formula will not be set aside unless appellant establishes by clear and cogent evidence that the formula is manifestly unreasonable or that it results in the taxation of extraterritorial values. (Butler Bros. v. McColgan, 17 Cal. 2d 664 [111 P.2d 334], aff'd, 315 U.S. 501 [86 L. Ed., 991].)

Exercising the broad discretion granted to it by section 25101 of the Revenue and Taxation Code, respondent issued a related regulation (Cal. Admin. Code, tit, 18, reg. 25101, subd. (a)), which provides in part:

> ... In the case of personal service organizations; such as advertising agencies, business management firms., *etc.*, the property factor is generally omitted since it is not a material income-producing factor in this type of business.

It was in accordance with this regulation that respondent omitted the property factor from the allocation formula applied to appellant's unitary business income.

Appellant contends that in this case the general rule should be departed from and the property factor included in the allocation formula because a large amount of property is used by appellant in the course of its business, and such property is a material factor in the production of appellant's income. In support of this contention appellant cites our decision in Appeal of Farmers Underwriters Association, Cal. St. Bd. of Equal., Feb. 18, 1953. We there upheld respondent's inclusion of the property factor in the allocation formula of a service corporation which owned and used a substantial amount of property in the conduct of its business,. The record in that appeal shows that the taxpayer's total investment in property ranged from $1,347,397 to $2,669,458 during the years in question, and consisted principally of land and buildings, furniture, office equipment and supplies, and motor vehicles used in the business.

Conversely, respondent argues that we should here be governed by our decision in Appeal of Woodward, Baldwin & Co., Inc., Cal. St. Bd. of Equal., May 28, 1963, a case arising under facts substantially similar to those in the instant case and raising the same issue, in which we held that respondent had properly excluded the property factor from the allocation formula applied to a personal service corporation. The value of all property used in the unitary business in that case ($110,262) constituted approximately 2.2 percent of total property, payroll, and sales ($4,992,497). We determined that inclusion of that relatively small property factor, equally weighted with the sales and payroll factors, was likely to result in distortion of the income allocation.

Reviewing our prior decisions we observe that the value of the property with which we are here concerned is equal to about one-tenth that which was involved in Appeal of Farmers Underwriters Association, supra, in which we approved the inclusion of a property factor in the apportionment formula. On the other hand, it is only twice as much as that involved in Appeal of Woodward, Baldwin & Co., Inc., supra, and in that case we approved respondent's omission of the property factor. Also;

the ratio in this case of the value of total property owned by appellant to its nationwide total of property, payroll, and sales is almost identical to that which existed in the Woodward appeal. The danger of distortion by inclusion of a relatively small property factor is in this case emphasized by the fact that a yacht constitutes a very substantial share of appellant's total property.

In a further attempt to establish the unreasonableness of respondent's exclusion of the property factor, appellant claims that it resulted in the allocation to California of an amount of net profit, expressed as a percentage of sales, which is substantially more than the national figure reached by expressing total net profit as a percentage of total sales. Appellant states that standard rates prevail throughout the country but that operating expenses are higher in California than in other locations.

The courts have repeatedly held that separate accounting figures cannot be used to impeach the validity of an allocation formula. (John Deere Plow Co. v. Franchise Tax Board, 38 Cal. 2d 214 [238 P.2d 569], appeal dismissed, 343 U.S. ,939 [96 L. Ed. 1345]; Edison California Stores, Inc. v. McColgan, 30 Cal. 2d 472 [183 P.2d 163; Butler Bros. v. McColgan, supra, 17 Cal. 2d 664 [111 P.2d 334], aff'd, 315 U.S. 501 [86 L. Ed. 9913.) Appellant nevertheless argues that in its case, because of the simplicity of its operations and the similarity of the services it renders in its various locations, such a comparison is valid and relevant in determining the reasonableness of respondent's formula.

It is undisputed that appellant is engaged in a unitary business operation. By definition, the activities of the different segments of a unitary business are interrelated (Butler Bros. v. McColgan, supra; Edison California Stores, Inc. v. McColgan, supra) and the underlying concept of unitary income is that it is derived from the business as a whole. Variations in conditions such as costs in the different states where the business functions are to be expected, and merely to emphasize them by use of separate accounting figures does not establish the invalidity of a formula, reasonable on its face, which is applied in accordance with the unitary concept. (John Deere Plow Co. v. Franchise Tax Board, supra.).

Having reviewed the record carefully, we conclude that appellant has failed to establish by clear and cogent evidence that the two-factor formula applied by respondent has resulted in the taxation of income earned outside California, and we therefore sustain respondent's action.

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 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of John Blair & Company against proposed assessments of additional franchise tax in the amounts of $2,553.14, $4,686.58 and $5,203.86 for the income years 1958, 1959 and 1960, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 4th day of March, 1965, by the State Board of Equalization.

John W. Lynch, Chairman

Paul R. Leake, Member

[illegible], Member

Richard Nevins, Member

_____, Member

ATTEST: [illegible], Secretary