BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
OAKLAND AIRCRAFT ENGINE SERVICE, INC.)

Appearances:

For Appellant: Merritt G. Smalley,
Attorney at Law

For Respondent: Wilbur F. Lavelle,
Assistant Counsel

O P I N I O N

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 Oakland Aircraft Engine Service, Inc., against a proposed assessment of additional franchise tax in the amount of $6,878.37 for the income year ended February 28, 1953.

Appellant, a California corporation, was, at all times here material, a subsidiary of Transocean Air Lines, also a California corporation, which owned 76 percent of appellant's stock, Transocean operated within and without California, while appellant did business only in this state. The combined operations were so integrated, however, as to constitute a unitary business for tax purposes.

By use of a formula composed of the factors of property, payroll and sales, respondent allocated $700,828.81 of the combined unitary income of the two corporations to California, and by a formula composed of the same factors, further allocated that amount between appellant and Transocean Air Lines. Appellant agrees with respondent's use of a formula to determine the California portion of the combined unitary income, and further agrees that the figure of $700,828.81, and the total tax thereon of $28,033.15, is correct. It is to the further apportioning of the $700,828.81 that appellant objects.

Appellant contends that its separate accounts should be used to determine its share of the net income allocated to California. Appellant's separate accounts show $54,753.27 net income for the income year ended February 28,1953. Respondent, by formula, allocated $209,153.73 of the combined net income to appellant for that period.

The Appeal of Kaiser-Frazer Sales Corp. and Kaiser Motors Corp., Cal. St. Bd. of Equal., Nov. 7, 1958, touched upon the problem presented by this appeal. In that case two corporations engaged in a unitary business were involved. The Franchise Tax Board under the provisions of section 25101 (formerly section 24301) of the Revenue and Taxation Code apportioned the combined net income within and without California by use of the customary formula. The board then, by use of a formula, apportioned the California income between the two corporations. Although the question there was which of two formulas to use in apportioning the income between the corporations, we sustained in principle the use of a formula rather than separate accounting to achieve that purpose.

Appellant attempts to distinguish the Kaiser-Frazer case on the basis that in Kaiser-Frazer both corporations operated within and without the state. Here, appellant operated only within the state. Both cases, however, concern two corporations engaged in a unitary business with income from within and without the state. Both involve the allocation of the California income, and the total tax thereon. The authority upon which Kaiser-Frazer was based is equally applicable here. In Altman and Keesling, Allocation of Income in State Taxation, (2d ed. 1950), quoted at great length in that case, it is stated at pp. 176-177 that:

> 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 .... 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.

Once a business has been determined to be unitary, then the formula method of allocation must be used to determine the income from sources within the state. (Superior Oil Co. v. Franchise Tax Board, 60 Cal. 2d 406 [34 Cal. Rptr. 545, 386 P.2d 33].) Having employed the formula method to determine that

portion of the combined income which is attributable to California, it would be completely inconsistent to then revert to separate accounting to find that portion of the California income which is attributable to one of the corporations engaged in the unitary business. Appellant's argument in favor of using separate accounting for the second step is essentially the same as that made in Edison California Stores v. McColgan, 30 Cal. 2d 472, 482-483 [183 P.2d 16], with respect to the first step. The court's rejection of the argument applies here:

> The plaintiff's evidence, however, consisted solely of the presentation of its separate accounting, and the accuracy and reasonableness of the entries thereof.... The plaintiff does not establish the unreasonableness of the formula allocation method by showing the reasonableness of its book entries.... There is no necessary inconsistency between the accuracy and fairness of the taxpayer's accounting and the different result obtained by the formula method of allocating income. For taxation purposes the one does not impeach the other.

Appellant contends that respondent's use of the formula method is inequitable because there are minority shareholders who will be adversely affected. Whenever two corporations are engaged in a unitary business, there is the possibility that minority shareholders will be adversely affected or, on the other hand, benefited, by the allocation for tax purposes of more or less income to their corporation than is reflected by separate accounting. It must be remembered, however, that we are dealing with a franchise tax upon the corporation, a taxable entity distinct from its shareholders. We cannot alter the impact of the tax upon the corporation in order to adjust for indirect effects upon the stockholders.

Accordingly, we conclude that respondent's action in using the formula method to allocate the combined California net income was correct.

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,

Appeal of Oakland Aircraft Engine Service, Inc.

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 Oakland Aircraft Engine Service, Inc.; against a proposed assessment of additional franchise tax in the amount of $6,878.37 for the income year ended February 28, 1953, be and the same is hereby sustained.

Done at Sacramento, California, this 5th day of October, 1965.

, Chairman

, Member

, Member

, Member

, Member

Attest: , Secretary