BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
ATLANTIC, GULF AND PACIFIC)
COMPANY OF MANILA, INC.)

Appearances:

For- Appellant: David L. Kimport
Attorney at Law

For Respondent: Brian W. Toman
Counsel

O P I N I O N

This appeal is made pursuant to section 25666 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Atlantic, Gulf and Pacific Company of Manila, Inc., against proposed assessments of additional franchise tax in the amounts and for the years as follows:

Appeal of Atlantic, Gulf and Pacific Company of Manila, Inc.

Income Year	Taxable Year	Proposed Assessment
1966	1966	$228.00
1966	1967	228.00
19'67	1967	268.00
1967	1968	632.00

Income Year	Proposed Assessment
1968	$ 3125.00
1969	72 1.00
1970	463.00
1971	989.00
1972	200.00
1973	200.00
1974	2,422.00
1975	2,898.00
1976	6,049.00

Appellant, a Philippine corporation with its principal office in Manila, is engaged in various business activities, including construction, metal fabrication, equipment manufacture, and machinery sales. Virtually all of these activities are conducted in the Philippines; appellant neither concludes nor solicits sales in California, nor does it maintain any inventory here.

In 1966, appellant's machinery sales division established an office in San Francisco for the purpose of assisting in the procurement of equipment for sale in the Philippines, While appellant's machinery sales division procures equipment worldwide, a significant portion of this equipment is purchased from sources in the United States. Appellant's San Francisco office (hereinafter referred to as "AGP San Francisco") assists in the placing of two types of orders: "stock orders" and "CUS orders."

Stock orders are for items which appellant maintains in its inventory in Manila. When necessary, appellant, from its headquarters in Manila, orders replacement items from its usual sources or requests AGP San Francisco to locate new suppliers. In all cases, orders are placed as necessary by appellant's headquarters in Manila; AGP San Francisco has no standing instructions with regard to stock orders. To expedite the ordering process, appellant occasionally sends a telex to AGP San

Francisco from Manila with instructions concerning a desired purchase. After such an order has been placed by AGP San Francisco, it is confirmed in Manila and a purchase order is prepared and signed there. Stock orders are paid for by letters of credit opened by appellant in Manila in favor of AGP San Francisco.

CUS orders result from a customer's request for particular equipment meeting specific specifications. Upon receipt of pertinent information from Manila, AGP San Francisco contacts various suppliers throughout the United States, locates the desired equipment, obtains price quotations and other details pertaining to freight and cargo charges, and relays this information to its office in Manila. Appellant's home office then computes the landed costs of the equipment and advises the customer of availability and price. If the customer desires to purchase the equipment, he enters into a purchase agreement with appellant- in Manila. Appellant's office in the Philippines then forwards the order while the customer opens a letter of credit in favor of AGP San Francisco. Upon receipt of the order and the letter of credit, AGP San Francisco forwards the order to the appropriate supplier; the letter of credit is then negotiated, and the funds are used to pay for the equipment ordered.

Occasionally, appellant's headquarters in Manila will telex detailed instructions regarding CUS orders to AGP San Francisco which, in turn, will order the desired equipment directly. AGP San Francisco exercises no independent judgment concerning such orders; it operates solely upon orders from Manila. The telex order is then confirmed in Manila with a purchase order prepared and signed there.. When necessary, AGP San Francisco handles customer complaints relative to CUS orders by contacting and attempting to resolve the customer's complaint with the U.S. supplier.

After an order has been filled, AGP San Francisco arranges for shipping. Heavy or bulky equipment is normally shipped to Manila from the nearest appropriate port while small or lightweight items are forwarded to San Francisco to be held until orders of sufficient quantity and bulk are accumulated for shipment to Manila. Upon arrival in San Francisco, the goods are consigned to a freight forwarder and maintained in a forwarder's warehouse until a full shipment is ready. Appellant does not maintain any warehouses in the United States; all items are directly consigned to freight forwarders for storage and later shipment.

In order to facilitate its operations, appellant maintains several bank accounts in San Francisco. These accounts include: (i) a general operating account consisting of funds transferred directly from Manila for the payment of all operating expenses,, salaries, rents, and other such expenses resulting from the operation of AGP San Francisco; (ii) "purchase clearing accounts" maintained for the purpose of depositing money obtained from negotiation of letters of credit opened by customers with respect to CUS orders and by appellant with respect to stock orders; and (iii) a "'special account" maintained by appellant for the deposit of any excess funds in the "purchase clearing accounts." AGP San Francisco has no control over money deposited into this last account and funds deposited therein are withdrawn by the Manila office from time to time. In addition to the activities described above, information obtained by respondent reveals that during the appeal years AGP San Francisco also aided in cost estimating on project:; on which appellant planned to bid.

Appellant did not file California returns for the years in issue. After audit and the gathering of relevant information, respondent issued the subject: proposed assessments on the basis that appellant had been doing business in California and was thereby subject to the franchise tax.. Appellant protested respondent's action; *however,* after revision for an item not herein in issue, respondent affirmed the proposed assessments, thereby resulting in this appeal.

Respondent's primary contention is that appellant was doing business in this state during the appeal years and was thereby subject to the franchise tax. In the alternative, respondent asserts that the activities performed by AGP San Francisco gave rise to California source income, thereby subjecting appellant to the corporation income tax. Appellant argues that the activities of AGP San Francisco during the 'appeal years constituted activities entirely within foreign commerce and that, consequently, it was not subject to the franchise tax. Additionally, appellant maintains that it did not derive any income from California sources and was therefore not subject to the corporation income tax.

The first issue presented for our determination is whether appellant was subject to the franchise tax during the years in issue. The secondary question of whether the activities; performed by AGP San Francisco

gave rise to California source income such that appellant was subject to the corporation income tax arises only if it is determined that appellant was not subject to the franchise tax.

The franchise tax is imposed upon "every corporation doing business within the limits of this state . . . for the privilege of exercising its corporate franchises within this state ...." (Rev. & Tax. Code, § 23151, subd. (a).) "'Doing business' means actively engaging in any transaction for the purpose of financial or pecuniary gain or profit." (Rev. & Tax. Code, § 23101.) The corporation income tax was adopted to complement the franchise tax and was intended to apply to corporations deriving income from California sources, but not sufficiently involved in California activities to be subject to the franchise tax. The principal reason for enacting the corporation income tax was to avoid repeated declarations of the United States Supreme Court that a state tax upon interstate commerce was prohibited by the Commerce Clause. (See, e.g., Atlantic & P. Teleg. Co. v. Philadelphia, 190 U.S. 160 [47 L.Ed. 995] (1903); Crutcher v. Commonwealth of Kentucky, 141 U.S. 121 [35 L.Ed. 649] (1831); Brown v. Maryland, 25 U.S. (12 Wheat.) 419 [6 L.Ed. 6783 (1827).)

Subsequent rulings of the Court created various exceptions to this prohibition, largely based upon semantical or formalistic considerations. (See Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279-287 [51 L.Ed.2d 326] (1977), and the discussion therein of the origin of the "Spector rule," Spector Motor Service v. O'Connor, 340 U.S. 602 [95 L.Ed. 573] (1951).) Recently, however, the Court has abandoned this risid approach in favor of a more functional analysis. Thus, in Complete Auto Transit, Inc. v. Brady, supra, the Court overruled a series of cases which had held that any state tax on "the privilege of doing business" applied to an activity that is wholly in interstate commerce was per se unconstitutional. It held that such a tax is valid when it: (i) is applied to an interstate activity with substantial nexus to the taxing state: (ii) is fairly apportioned: (iii) does not discriminate against interstate commerce; and (iv) is fairly related to the services provided by the state. In applying this multifactor test to the circumstances of this appeal, we must examine the relationship between appellant and this state; we begin with the "nexus" requirement.

The Due Process Clause requires "some definite link, some minimum connection, between a state and the

person, property or transaction it seeks to tax." (Miller Bros. Co. v. Maryland, 347 U.S. 340, 344-345 [98 L.Ed. 744] (1954).) In this context, the requirements of due process are similar to those of the Commerce Clause. (See Exxon Corp. v. Wisconsin Dept. of Revenue, 447 U.S. 207 [65 L.Ed. 2d 66] (1980); Central R. Co. of Pa. v. Pennsylvania, 370 U.S. 607 [8 L.Ed.2d 720] (1962).)

Appellant argues that the activities conducted in California by AGP San Francisco merely assist in the export of machinery and equipment from the United States to the Philippines. Appellant cites International Textbook Co. v. Pigg, 217 U.S. 91 [54 L.Ed. 678] (1910), to support its position that such incidental activity is so closely related to its foreign machinery and sales business as not to provide a basis for the imposition of the franchise tax. (See also, Michigan-Wisconsin-P.L; Co. v. Calvert, 347 U.S. 157 [98 L.Ed. 583] (1954).) Under appellant's reasoning, such accessorial activities would be immune from the franchise tax because they are concomitant to its foreign business and would consequently be insufficient to establish the required nexus. That analysis, however, was recently abandoned in Washington Rev. Dept. v. Stevedoring Assn., 435 U.S. 734 [55 L.Ed.2d 682] (1978) in which the Supreme Court expressly rejected similar arguments. The Court concluded that although stevedoring was incidental to interstate transportation, under Complete Auto Transit, Inc. v. Brady, supra, even such interstate commerce may be made to pay its way.

The current rule is expressed in Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425 [63 L.Ed.2d 510] (1980):

> The requisite "nexus" is supplied if the corporation avails itself of the "substantial privilege of carrying on business" within the State, and "[t]he fact that a tax is contingent upon events brought to pass without a state does not destroy the nexus between such a tax and transactions within a state. for which the tax is an exaction." [Citation.] (445 U.S. 425, 437.)

During the years in issue, appellant utilized the ports and other facilities **in this state for the purpose of shipping goods overseas. In addition, numerous accessorial services essential to its foreign machinery and sales business were performed at its San Francisco office. Under such circumstances, this "substantial privilege" afforded by California to appellant is suff i-**

cient to constitute the required nexus. Accordingly, we are not required to determine if appellant's activities in this state constituted activities exclusively within foreign commerce.

The multifactor test set forth in Complete Auto next requires that a state tax be fairly apportioned and not discriminate against interstate commerce. California's franchise tax satisfies both of these requirements, and appellant has not sought to argue otherwise. The franchise tax as applied to appellant, and other taxpayers similarly situated, is measured by the amount of business income attributable to California sources determined by applying an apportionment of income formula which has consistently been upheld by the courts. (See, e.g., Mobil Oil Corp. v. Commissioner of Taxes, supra; Edison California Stores, Inc. v. McColgan, 30 Cal.2d 472 [183 P.2d 16] (1947); Butler Bros. v. McColgan, 17 Cal.2d 664 [111 P.2d 334] (1941), affd., 315 U.S. 501 [86 L.Ed. 991] (1942).) Moreover, California's franchise tax does not discriminate against interstate or foreign commerce. The franchise tax applies to "every corporation doing business within the limits of this state . . . ." (Rev. & Tax. Code, § 23151, subd. (a) (emphasis added).) The tax covers both California and foreign enterprises; it is not measured by the local or interstate character of the taxed business.

Finally, the Commerce Clause requires that a state tax on interstate commerce be fairly related to the services provided by the state. Appellant argues that the benefits afforded to it in California come from the City and County of San Francisco, and that it derives little, if any, benefit from services paid for from the General Fund. In essence, appellant alleges that California provides it nothing as the required constitutional quid pro quo for the tax.

This constitutional requirement was explained in Ingels v. Morf, 300 U.S. 290 [81 L.Ed. 653] (1937), where the United States Supreme Court noted:

> To justify the exaction by a state of a money payment burdening interstate commerce, it must affirmatively appear that it is demanded as reimbursement for the expense of providing facilities, or of enforcing regulations of the commerce which are within its constitutional power. [Citations.) This may appear from the statute itself [Citations], or

> from the use of the money collected to defray such expense. (300 U.S. 290, 294.)

Revenue and Taxation Code section 26481 provides, in pertinent part, as follows:

> All moneys received by the State Treasurer from the Franchise Tax Board representing amounts imposed by this part shall be deposited by him in a special fund in the state Treasury, to be designated the Bank and Corporation Tax Fund, and moneys in said fund shall, upon order of the Controller, be transferred into the General Fund. . . .

Funds in the General Fund are expended to pay for, among other things, the California court system, the operation of state administrative agencies, education, and various other facilities of which appellant has, or may, avail itself. (Office of the State Controller, State of California Preliminary Annual Report 1980-81 Fiscal Year, at p. 9 (1981).) While appellant has argued that California supplies it with insufficient services to justify imposition of the franchise tax, it is evident from the above that this state provides appellant "the benefit of a trained work force, and "the advantages of a civilized society,'" (Exxon Corp. v. Wisconsin Dept. of Revenue, 447 U.S. 207, 228 [65 L.Ed.2d 66] (1980), quoting Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434, at 445 [60 L.Ed.2d 336] (1979).) Accordingly, as we have found that the multifactor test set forth in Complete Auto has been satisfied, we must conclude that respondent properly determined that appellant was subject to the franchise tax during the appeal years.

Appellant's principal argument in the instant appeal has been that it is not subject to the franchise tax because respondent's regulations provide that "[a] foreign corporation engaged wholly in interstate commerce is not "doing business" and is not subject to [the franchise] tax. . .." (Cal. Admin. Code, tit. 18, reg. 23101.) Appellant maintains, as previously noted, that the activities of AGP San Francisco are inseparable from its foreign business and do not provide a basis for imposition of the franchise tax.

The subject regulation was intended to conform California law with the decisions of the United States Supreme Court cited above holding that states could not impose a franctiise tax on business engaged wholly in interstate or foreign commerce. Subsequent to Complete

Auto, however, the quoted provision in respondent's regulation no longer accurately states the law. The reach of the Bank and Corporation Franchise Tax Law is coextensive with the state's constitutional power to tax. (Butler Bros. v. McColgan, supra; Luckenbach S.S. Co. v. Franchise Tax Board, 219 Cal.App.2d 710 [33 Cal. Rptr. 544] (1963); see also Matson Nav. Co. v. State Bd. of Equalization, 3 Cal.2d 1 [43 P.2d 805] (1935).) Therefore, after Complete Auto, the franchise tax may be applied to a business engaged exclusively in interstate or foreign commerce provided it meets the four-point test set forth therein, respondent's regulation notwithstanding.

For the reasons set forth above, respondent's action in this matter will be sustained.

Appeal of Atlantic, Gulf and Pacific Company of Manila, Inc.

O R D E R

Pursuant to the views expressed in th'e 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 Atlantic, Gulf and Pacific Company of Manila, Inc., against proposed assessments of additional franchise tax in the amounts and for the years as follows:

Income Year	Taxable Year	Proposed Assessment
'1966	1966	$228.00
1966	1967	228.00
1967	1967	268.00
1967	1968	632.00

Income Year	Proposed Assessment
1968	$ 325.00
1969	'721.00
1970	463.00
1971	989.00
1972	'200.00
1973	200.00
1974	2,422.00
1975	2,898.00
1976	6,049.00

be and the same is hereby sustained.

Done at Sacramento, California, this 17th day of November , 1982, by the State Board of Equalization, with Board Members Mr. Bennett, Mr. Collis, Mr. Dronenburg and Mr. Nevins present.

William M. Bennett, , Chairman

Conway H. Collis , Member

Ernest J. Dronenburg, Jr. , Member

Richard Nevins , Member

, Member