BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
AIMOR CORPORATION)

Appearances:

For Appellant: David M. La Salle
Attorney at Law

For Respondent: Michael E. Brownell
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 Aimor Corporation against proposed assessments of additional franchise tax in the amounts of $1,325.82, $1,644.43 and $1,974.15 for the income years ended September 30, 1974, September 30, 1975, and September 30, 1976, respectively.

Appeal of Aimor Corporation

The major issue presented by this appeal is whether appellant, its Japanese parent, and its parent's Japanese subsidiary are engaged in a single unitary business.

Aimor Corporation ("appellant"), a California corporation, is a wholly owned subsidiary of Aimor Electric Works, Ltd. ("AEW"), a Japanese corporation. AEW manufactures portable radio-cassette units and stereo equipment. Although headquartered in Japan, AEW exports all its products. Appellant serves as its United States distributor and deals only in AEW products.

AEW also owns 100 percent of Aimor Electronics Company, Ltd. ("AEC"), a Japanese corporation. AEC manufactures automobile sound systems for sale to other stereo companies. AEC manufactures its items in accordance with specifications provided by the buyer., and the buyer's name and trademark rather than AEC's are placed on the product. AEC sells a portion of its products to AEW for resale. These sales amounted to over $5,500,000, $2,700,000 and $5,300,000 for the income years ended in 1974, 1975, and 1976, respectively. None of the AEC products were sold to appellant, either directly or through AEW.

During the years on appeal, Sakuro Otsuki, the owner of 80 percent of the issued and outstanding stock of AEW, was the chairman of the board and president of AEW, AEC, and appellant. The corporations had no other interlocking officers or directors.

Appellant reported its income on a separate accounting basis for the years on appeal. After an audit, respondent determined that appellant, AEW, and AEC constituted a unitary business operating within and without California and redetermined appellant's California income on a formula apportionment basis. Respondent issued proposed assessments for the years at issue which were revised following appellant's protest and then affirmed, giving rise to this appeal.

A taxpayer that derives income from sources both within and without California must measure its California franchise tax liability by its net income derived from or attributable to sources within this state. (Rev. & Tax. Code, § 25101.) If the taxpayer is engaged in a unitary business with affiliated companies, the amount of income attributable to California sources must be determined by applying an apportionment formula to the

total income derived from the combined unitary operations of the affiliated companies. (See Edison California Stores, Inc. v. McColgan, 30 Cal.2d 472 [183 P.2d 16] (1947).)

The California Supreme Court determined that the existence of a unitary business had been established by the presence of: (i) unity of ownership; (ii) unity of operation as evidenced by central purchasing, advertising, accounting, and management divisions; and (iii) unity of use in a centralized executive force and general system of operation. (Butler Bros. v. McColgan, 17 Cal.2d 664 [111 P.2d 334] (1941), affd., 315 U.S. 501 [86 L.Ed. 991] (1942).) Later, the court held that a unitary business exists when the operation of the portion of the business done within California depends upon or contributes to the portion of the business done outside California. (Edison California Stores, Inc. v. McColgan, supra.) The existence of a unitary business is established if either the three unities *or* the contribution or dependency-test is satisfied. (Appeal of F. W. Woolworth Co., Cal. St. Bd. of Equal., July 31, 1972.)

Appellant and AEW clearly form a unitary business since they are vertically integrated businesses. (See Appeal of Kikkoman International, Inc., Cal. St. Bd. of Equal., June?%, 1982.)) Apparently, appellant does not question this determination. It does assert, however, that respondent erred in including AEC in the unitary group.

Respondent's determination that AEC is engaged in the unitary business conducted by AEW and appellant is presumed correct, and the burden is on the taxpayer to prove that it is erroneous. (Appeal of John Deere Plow Co. of Moline, Cal. St. Bd. of Equal., Dec. 13, 1961.) In order to prevail, appellant must prove that "the unitary connections relied on by respondent are so lacking in substance as to compel the conclusion that a single integrated economic enterprise did not exist." (Appeal of Kikkoman International, Inc., supra.) We find that appellant has not met this burden.

The ownership requirement must be met in order to satisfy either the three unities or the contribution or dependency test. (See Appeal of Revere Copper and Brass Incorporated, Cal. St. Bd. of Equal., July 26, 1977.) That requirement is clearly met in this appeal since AEW owns 100 percent of both AEC and appellant.

The relationship between AEC and AEW contains elements of dependency and contribution which prevent us from finding that AEC is a separate business. Most significant is the sale of AEC's products to AEW. Appellant attempts to minimize the importance of these sales by explaining that they are consummated only to enable AEW to export the products on AEC's behalf and that there is no actual transfer of possession of the products to AEW. Appellant explains that although AEC sells its products to customers located outside Japan; it cannot directly export its products because it lacks an export department. According to appellant, the routine manner for a Japanese company without an export department to export its products is through the use of Japanese credit companies, and some of AEW's exports are handled in this way. However, a number of AEC's customers want to avoid paying the ten to fifteen percent commission charged by such credit companies. In order to accommodate these customers, AEC's products are sold to AEW, which does have an export department, and it then exports the products to AEC's customers. Appellant states that AEW charged AEC's customers only two to three percent for this service, thereby allowing the customers to realize a substantial saving.

While we agree that, due to the nature of these sales, the advantages usually realized because of intercompany sales, such as a guaranteed market for products or a guaranteed source of supply, are not present, the sales between AEC and AEW are not without benefits to both companies. Because of AEC's relationship with AEW, AEC is able to fulfill its customers' desire to avoid paying the credit companies' ten to fifteen percent commission without incurring the expense of establishing and maintaining its own export department. AEW appears also to benefit from this arrangement since it receives from AEC's customers a two to three percent commission on all products it buys from AEC. Since these sales totaled several million dollars in each year of the appeal, the commissions received by AEW are not nominal amounts. Such cooperation for mutual benefit is the hallmark of a unitary business.

The presence of an interlocking executive force is another unitary factor. (Appeal of Arkla Industries, Inc., Cal. St. Bd. of Equal., Aug. 16, 1977.) AEC, AEW, and appellant share the same president and chairman of the board, Mr. Sakuro Otsuki. Appellant attempts to show that Mr. Otsuki spent little time at AEC during the appeal years in order to demonstrate that centralized management was not present. We are not convinced by the evidence

presented,, which consisted only of the testimony of an officer of appellant who works and resides in California. Nor are we convinced that operational differences between AEC and AEW preclude effective centralized management. Appellant stresses that AEC manufactures products for identified customers in accordance with their specifications, whereas AEW designs its own products with no specific customer in mind. We believe that these differences are inconsequential since both AEW and AEC produce radio and stereo equipment. Without evidence proving the contrary, we can only assume an interlocking executive force, with its attendant mutual cooperation and exchange of information, is of benefit to both companies. (Appeal of Anchor Hocking Glass Corporation, Cal. St. Bd. of Equal., Aug. 7, 1967.)

Appellant argues that because there is no direct contribution or dependency between appellant's operations within California and AEC's business in Japan, the two companies cannot be engaged in a unitary business. We cannot agree since it is not necessary for each part of a unitary business to be directly related to each other part. (Grolier Society, Inc., Cal. St. Bd. of Equal., Aug. 19, 1975; Appeals of Monsanto Co., Cal. St. Bd. of Equal., Nov. 6, 1970.) The taxpayer in Appeals of Monsanto Co., supra, argued that its subsidiary, Chemstrand Corporation, was not a part of the parent's unitary business because it did not contribute to or depend on the California operation and because it had no direct dealings with the California operation. In rejecting this argument, we stated:

> The argument misconceives the unitary business concept. All that need be shown is that during the critical period Chemstrand formed an inseparable part of appellant's unitary business wherever conducted. By attempting to establish a dichotomy between appellant's California operations and Chemstrand, appellant would have us ignore other parts of appellant's business which cannot justifiably be separated from either Chemstrand or the California operations.

AEC contributes to and depends upon AEW and therefore is Unitary with AEW. Because appellant is also unitary with AEW, AEC and appellant are both parts of the parent's unitary business.

Appellant contends that even if AEW, AEC, and it constitute a unitary business, it should be allowed to use a special formula on the ground that the standard formula does not "fairly represent the extent of the taxpayer's business activity in this state." (Rev. & Tax. Code, § 25137.) The burden of proving that such circumstances exist is on the party seeking to deviate from the standard formula. (Appeal of New York Football Giants, Inc., Cal. St. Bd. of Equal., Feb. 3, 1977.) We believe that appellant has failed to meet this burden. Appellant contends that the standard formula should not be used because California income is measured in dollars whereas the financial records of AEC and AEW are maintained in yen. Appellant also contends that the method respondent used to convert the Japanese financial information from yen to dollars was unfair in that it failed to adequately reflect fluctuations in the exchange rate between the two currencies. However, appellant has not shown specifically how these factors affected its unitary enterprise. Furthermore, it has not shown that the difficulties caused by the use of two currencies prevented formula apportionment from fairly representing its business activity within California. (Appeal of New Home Sewing Machine Company, Cal. St. Bd. of Equal., Aug. 77, 1982.) Appellant, therefore, has not proven that it is entitled to use a method other than the standard apportionment formula.

Finally, appellant raises, several constitutional objections to the use of worldwide apportionment. We cannot decide these constitutional issues because section 3.5 to article III of the California Constitution prevents this board from determining that the statutory provisions are unconstitutional or unenforceable. Furthermore, this board has a well established policy of abstention from deciding constitutional issues in an appeal involving proposed assessments of additional tax. (Appeal of New Home Sewing Machine Company, supra; Appeal of Shachihata, Inc., U.S.A., Cal. St. Bd. of Equal., Jan. 9, 1979.) This policy is based upon the absence of any specific statutory authority which would allow the Franchise Tax Board to obtain judicial review of a decision in such cases and upon our belief that judicial review should be available for questions of constitutional importance. Since we cannot decide the remaining issues raised by appellant, respondent's action in this matter must be sustained.

Appeal of **Aimor Corporation**

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 **Aimor** Corporation against proposed assessments of additional franchise tax in the amounts of **$1,325.82, $1,644.43** and **$1,974.15** for the income years ended September 30, 1974, September 30, 1975, and September 30, 1976, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 26th day of October , 1983, by the State Board of Equalization, with Board **Members Mr.** Bennett, Mr. Collis, Mr. Dronenburg, **Mr. Nevins** and Mr. Harvey present.

William M. Bennett , Chairman

Conway H. Collis , Member

Ernest J. Dronenburg, Jr. , Member

Richard Nevins , Member

Walter Harvey* , Member

*For Kenneth Cory, per Government Code section 7.9