

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
HOYA LENS OF AMERICA, INC.)

For Appellant: Henry Y. Ota
Attorney at Law

For Respondent: Noel J. Robinson
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 Hoya Lens of America, Inc., against proposed assessments of additional franchise tax in the amounts of \$15,193, \$46,953, and \$68,703 for the income years ended September 30, 1976, September 30, 1977, and September 30, 1978, respectively.

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The question presented by this appeal is whether appellant has established error in respondent's determination that appellant was engaged in a single unitary business with its parent corporation and other affiliated companies.

Incorporated on September 18, 1975, appellant is a California corporation with its principal place of business in Torrance, California. Appellant is a **second-tier** subsidiary wholly owned by Hoya Lens Corporation, a Japanese company. The parent company in turn is a wholly owned subsidiary of Hoya Corporation also based in Japan. Hoya Corporation and various subsidiaries, including appellant, form a vertically integrated operation engaged in the manufacturing and marketing of **high-quality** optical lenses.

Performing a marketing role in the United States, appellant imports, processes, and distributes finished corrective lenses, eyeglass frames, and other optometric products. Like its foreign-market counterparts in Australia (Hoya Lens of Australia) and Thailand (Hoya Lens of Thailand), appellant obtains a substantial portion of its optical products from the common parent company. Thus, approximately 67 percent of appellant's eyewear inventory and 33 percent of its unfinished lens **stock come from Hoya Lens Corporation, which manufactures** the products in Japan. These lens products are also transferred to Hoya Corporation for apparent distribution through its domestic Japanese marketing system.

Another Hoya Corporation subsidiary, Hoya Electronics, Inc., produces state-of-the-art electronic and photographic lenses. These highly technical optical products are distributed in the United States by Hoya Optics, a California corporation with headquarters in **Menlo** Park. Hoya Optics similarly purchases the majority of its products from Hoya companies (1976 - 92%; 1977 - 78%; 1978 - 91%). These purchases amounted to **\$2,138,633, \$3,179,420, and \$4,899,067** for its income years ended in 1976, 1977, and 1978, respectively. **Comparing** sales during the appeal years, the gross receipts of Hoya Optics were approximately one-half those of appellant.

In addition to distributing lens products, Hoya Corporation conducts research and development of new optical lens products, manufactures quality crystal glass. through its subsidiary, Hoya Crystal Corporation, and provides financing for consumer purchases of optometric lenses and **lenswear** through the Hoya Credit Company. For

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the years **under** review, approximately 24 percent of the sales of Hoya Corporation were made to subsidiaries and 50 percent of its costs of sales consisted of purchases from subsidiaries. In addition to intercompany purchasing, Hoya Corporation engaged in intercompany financing by making loans to its affiliates and undertaking to pay their obligations.

On its California franchise tax returns for the appeal years, appellant reported its income on a separate accounting basis. After an audit conducted in 1979 and 1980, respondent determined that appellant, **Hoya** Lens Corporation, Hoya Corporation, and Hoya Optics were engaged in a single unitary business. Consequently, appellant's California income was redetermined by formula apportionment of the combined incomes of these four Hoya entities. Appellant subsequently protested the proposed assessments, noting that the combined report failed to include the income of several other subsidiaries of the "**Hoya** Group." (Resp. Br., Exh. A.)

Acting on the protest, respondent conducted a second audit and agreed to add to the combined report the incomes of the other Hoya companies listed in the consolidated financial reports of Hoya Corporation. Thus, respondent determined that appellant was engaged in a single unitary business with Hoya Electronics, Inc., Hoya Lens of Australia, Hoya Lens of Thailand, Hoya Crystal Corporation, and Hoya Credit Company as well as the first three Hoya companies. Despite the inclusion of these other subsidiaries, appellant protested again the proposed assessments of additional franchise tax resulting from the application of apportionment procedures to the expanded combined report.

When the income of a taxpayer is derived from sources both within and without this state, its franchise tax liability will be measured by its net income derived from or attributable to sources within this state. (**Rev. & Tax. Code, § 25101.**) If the taxpayer is engaged in a single unitary business with affiliated corporations, the 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. (Edison California Stores, Inc. v. McColgan, 30 Cal.2d 472 [183 P.2d 16] (1947).)

Respondent's determination that appellant is engaged in a single unitary business with its parent and other affiliated companies is presumptively correct, **and**

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the burden is on appellant to show that the determination is erroneous. (Appeal of John Deere Plow Co. of Moline, Cal. St. Bd. of Equal., Dec. 13, 1961; Appeal of Kikkoman International, Inc., Cal. St. Bd. of Equal., June 29, 1982.) Appellant must, therefore, prove by a **preponderance** of the evidence that, in the aggregate, 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 Saga Corporation, Cal. St. Bd. of Equal., June 29, 1982.)

In the instant appeal, appellant asserts that it is not engaged in a unitary business with Hoya Lens Corporation, Hoya Corporation, and subsidiaries of Hoya Corporation. However, aside from such conclusory statements, appellant has not offered any evidence to support this contention. Because it is well settled that unsupported statements denying respondent's finding of a unitary business are not sufficient to overcome the presumption of correctness attached to respondent's determination (Appeal of New Home Sewing Machine Company, Cal. St. Bd. of Equal., Aug. 17, 1982; Appeal of Shachihata, Inc., U.S.A., Cal. St. Bd. of Equal., Jan. 9, 1979), we must conclude that appellant has failed to carry its burden of proof. --

Rather than presenting any facts tending to show **error** in respondent's determination of unity, appellant has chosen to challenge the proposed **assessments** by making the following constitutional arguments against the unitary method of taxation:

(1) Assuming the existence of a unitary business, appellant avers that requiring foreign-based **multinational** corporations to file a combined report with United States subsidiaries interferes with foreign relations of the United States in violation of the supremacy clause of the United States Constitution and hinders foreign and interstate commerce contrary to the commerce clause of the United States Constitution;

(2) Appellant contends that application of the unitary method of apportionment and taxation to **the** incomes of multinational corporations based in Japan **violates** the Treaty of Friendship, Commerce and Navigation (4 **U.S.T.** 2063 (April 2, 1953)) between the United States and Japan and the Convention between the United States and Japan for the Avoidance of **Double** Taxation (23 **U.S.T.** 967

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(March 8, 1971)) and is therefore invalid under the supremacy clause of the United States Constitution; **and**

(3) Appellant argues that a tax measured in part **by** the incomes of foreign-based multinational corporations which have no nexus with the State of California is arbitrary and thus violative of the due process clause of the Fourteenth Amendment to the United States Constitution.

This board has a well-established policy of abstention from deciding constitutional questions in appeals involving proposed assessments of additional tax. (Appeal of Maryland Cup Corp., Cal. St. Bd. of Equal., March 23, 1970; Appeal of Humphreys Finance Co., Inc., Cal. St. Bd. of Equal., June 20, 1960.) As we observed in Appeal of Shachihata, Inc., U.S.A., supra, this policy is based on the absence of authority permitting the Franchise Tax Board to obtain judicial review of a decision in a case of this type, and on our belief that such review should be available for questions of constitutional importance. Moreover, we believe that section 3.5 of article III of the California Constitution precludes our finding that the statutory provisions involved are unconstitutional and unenforceable. (Appeals of Fred R. Dauberger, et al., Cal. St. Bd. of Equal., March 31, 1982.) Since appellant has failed to demonstrate error in respondent's determination and the issues it does raise are better addressed to a different forum, respondent's action in this **matter 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 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Hoya Lens of America, Inc., against proposed assessments of additional franchise tax in the amounts of \$15,193, \$46,953, and \$68,703 for the income years ended September 30, 1976, September 30, 1977, and September 30, 1978, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 8th day of January, 1985, by the State Board of Equalization, with Board Members Mr. Dronenburg, Mr. Collis, Mr. Bennett, Mr. Nevins and Mr. Harvey present.

Ernest J. Dronenburg, Jr., Chairman
Conway H. Collis, Member
William M. Bennett, Member
Richard Nevins, Member
Walter Harvey*, Member

*For Kenneth Cory, per Government Code section 7.9