



## Appeal of California First Bank

Two questions are presented by this appeal: (1) whether appellant and its Japanese **parent**, The Bank of Tokyo, Ltd. (BOT), were engaged in a single unitary business during the appeal years, and (2) if so, whether respondent properly determined that appellant must file a combined report which includes its foreign parent and use formula apportionment to compute its income derived from or attributable to California sources.

Appellant is a state-chartered, full-service bank which was established in 1953 to assist Americans of Japanese ancestry to reestablish their homes and businesses in the post-war period and to promote trade between California and Japan. By 1974, appellant had established a network of 22 branches throughout the state and branches in Nassau and Guam to facilitate foreign **transactions**.

During the appeal years, BOT owned 52 percent of appellant's stock, except for a 3 **1/2-month** period in late 1971 and early 1972 when **BOT's** interest fell to less than 50 percent due to the exercise of outsider rights. BOT is an international bank with 140 offices throughout the world, including 2 in California. Because of federal and state limitations on **BOT's banking** activities within California, its offices here are called agencies rather than branches. The California agencies accept no deposits.

Most of appellant's upper-echelon officers were former employees **or** officers of BOT, trained in international banking in Japan before being assigned to appellant. Appellant and BOT **also** had interlocking officers and directors. Staff hired in California by both appellant and BOT's California agencies belonged to the same pension plan, while appellant's staff from Japan belonged to BOT's pension plan.

BOT used appellant's computer system and appellant used BOT's telex equipment. Appellant also provided services to a number of **BOT's** customers. For example, after BOT made a loan, appellant served as **a** repository for the loan proceeds, a service the parent could not provide. BOT and appellant also cooperated with respect to other loan activities. Appellant made large unsecured loans on BOT's recommendation, with BOT acting as guarantor of the loans in the event of default. Appellant purchased participation loans from BOT, without **independent** credit evaluation, in reliance on **BOT's** credit experience with the borrower, and **BOT's** agencies purchased participation loans from appellant when the negotiated

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loan amount exceeded loan restrictions to which appellant was subject.

Approximately 20 percent of **appellant's** deposits were **made** by **BOT**. In addition, appellant established international centers in **BOT's** California agencies to provide foreign investment counseling, using the **agencies'** international banking expertise and experience to handle its international transactions. Appellant also referred to the connections it had with BOT in the literature it disseminated, encouraging potential customers to bank with appellant in order to benefit from **BOT's** world banking expertise and easy access to **BOT's** facilities throughout the world,

For the appeal years through 1971, appellant **filed** separate **California franchise tax returns**, reporting all of its income to **California**. For the rest of the appeal **years**, it filed combined **reports**, including its overseas banking activities in Nassau and **Guam**, but not any of its **parent's** activities. BOT filed a combined report for all **years**, but did not include **appellant's** activities,

When a taxpayer derives income from **sources** both within and **without** California, its tax liability is 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 unitary business with affiliated corporations, 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 **corporations**. (See Edison California Stores, Inc. v. McColgan, 30 Cal.2d 472 [183 P.2d 16] (1947).) A unitary business exists when **there** is unity of ownership, unity of operation, and unity of use (Butler Bros. v. McColgan, 17 Cal.2d 664, 678 [111 P.2d 334] (1941), *affd.*, 315 U.S. 501 [86 L.Ed. 991] (1942)) or when the operation of the business within California contributes to or is dependent upon the operation of the business outside this state, (Edison California Stores, Inc. v. McColgan, *supra*, 30 Cal.2d at 481,)

Appellant states that it was not engaged in a unitary business with **BOT**. It has presented no argument or **evidence, however**, to support its conclusion. Such **unsupported assertions** are insufficient to **overcome** the presumptive correctness of **respondent's** determination, (Appeal of Shachihata, Inc., U.S.A., Cal, St, Bd. of

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Equal., Jan. 9, 1979.) Therefore, we must conclude that respondent's determination of unity was correct.

For the years on appeal, appellant's income derived from or attributable to California sources must be determined in accordance with the provisions of the Uniform Division of Income for Tax Purposes Act (UDITPA) contained in sections 25120 through 25139, (Rev. & Tax. Code, § 25101.) Generally speaking, UDITPA requires that the business income of the unitary business be apportioned to this state by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor and the denominator of which is three. (Rev. & Tax. Code, § 25128.) The numerators of the respective factors are composed of the taxpayer's property, payroll, and sales in California; the ~~denominators~~ consist of the taxpayer's property, payroll, and sales everywhere. (Rev. & Tax. Code, §§ 25129, 25132, and **25134.**) Methods other than the standard three-factor formula may be used only in exceptional circumstances where **UDITPA's** provisions do not fairly represent the extent of the taxpayer's business activity in this state. (Rev. & Tax. Code, § 25137,) The party seeking to deviate from the standard formula bears the burden of proving that such exceptional circumstances are present. (**Appeal of New York Football Giants, Inc., Cal. St. Bd. of Equal., Feb. 3, 1977.**)

Appellant argues that separate **accounting** must be used to determine its California taxable income because there is no basis in the Revenue and Taxation Code for computing the worldwide combined income of the unitary group. Its contention is based on provisions in the code which limit certain deductions to United **States-**based activities or corporations. Appellant also argues that, because California income is measured in dollars and the financial records of BOT are properly kept using a foreign currency, there is no single unit of measure with which to establish the net income of the unitary group and that translating from one currency to another will result in an erroneous income figure because of currency fluctuations.

We have previously considered, and rejected these same arguments in **the Appeal of New Home Sewing Machine Company**, decided by this board on August 17, 1982. For the reasons stated in that opinion, we **must** reject appellant's arguments as **unconvincing**.

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Appellant contends that in determining the California tax liability of a subsidiary, a tax based on a combined report is totally invalid unless the subsidiary is wholly owned, even when the subsidiary and its parent are engaged in a unitary business. It argues that combination will adversely affect the minority shareholders of the subsidiary. We considered and rejected this argument in the Appeal of Oakland Aircraft Engine Service, Inc., decided by this board on October 5, 1965, stating:

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 that 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.

Appellant has presented no argument on this point which persuades us to deviate from our conclusion in Oakland Aircraft.

Appellant contends that a bank is taxable in only one state and that its income must be determined on a separate accounting basis because of section 23181, which was adopted to comply with a federal statute governing state taxation of national banks. Section 23181, subdivision (a), provides, in relevant part:

Except as otherwise provided herein, an annual tax is hereby imposed upon every bank located within the limits of this state according to or measured by its net income, . . . With respect to the taxation of national banking associations, the state adopts the method numbered (4) authorized by the act of March 25, 1926, amending Section 5219 of the Revised Statutes of the United States, Title 2, Section 548, United States Code,

Appellant's argument is that, since section 23181 was designed to comply with the federal statute regarding state taxation of national banking associations,

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language which is the same in both statutes must follow federal interpretations and California must also be considered to have adopted the federal **concept** of "net income,"

Appellant contends that **California's** use of the language "located within the limits of this state" must be interpreted to mean that the **bank's** principal office is located in this state because, appellant asserts, that is the federal interpretation of that language. No authority is cited by appellant, **however**, which supports such an interpretation of that language. In any **case**, we fail to see the relevance of appellant's argument, since it is a California state bank, with its headquarters located in San Francisco, which is clearly 'located within the limits of this **state.**'

With regard to **California's** purported adoption of the federal concept of net **income**, appellant argues that, by complying with the **federal** statute, California has thereby "determined that banks should be taxed based on an income calculated under separate accounting, as in, the federal **system**, rather than formula apportionment since the federal system does not use formula apportionment." (App. Br. at 66.) Again, appellant has cited no authority which supports such a conclusion. Section 25101, which authorizes the formula apportionment method, is, by its **terms**, applicable to both banks and corporations. **In** addition, the predecessors of section 25101, back to 1929, when the predecessor of section 23181 was promulgated, have always been expressly applicable to banks. (See former **§ 10**, Bank and **Corp.** Franchise Tax Act, enacted by Stats, 1929, ch. 13, **p. 24**; former **§ 24301**, adopted by Stats, 1949, **ch. 55**'9, **p. 1000**, eff. July 1, 1951,)

Although the predecessor of section 23181 was enacted to comply with federal requirements **regarding** state taxation of national **banks**, it **does** not follow that the state is therefore required to adopt the federal, method of computing the tax or the tax base. Compliance with the federal statute is designed "only to prohibit discrimination in practical operation against national banks as a **class**" and the states are allowed considerable freedom to work out an equitable tax **system** within that restriction, (**Security-First Nat. Bk. v. Franchise Tax Board**, 55 Cal.2d 407, 414 [359 P.2d 625] (1961).) A state tax on national banks **is valid** "so long as the resulting burden does not exceed the burden to which state banks, mercantile, **business**, manufacturing, and

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financial corporations are subject." (Security-First Nat. **Bk.** v. Franchise Tax Board, **supra.**) Therefore, California is not required to adopt the **federal** system of taxing banks so long as national banks *are* treated the same as state banks and other corporations. In California, all unitary businesses are subject to filing a combined report and determining their income attributable to California by formula apportionment. Because appellant is engaged in a unitary business, it is subject to formula apportionment in determining its California income, as are all other unitary businesses.

Appellant has also contended that California's statutory scheme of taxing unitary businesses is unconstitutional. However, article III, section 3.5, of the California Constitution precludes this board from determining that the statutes involved are unconstitutional or unenforceable. We do note, however, that constitutional objections substantially the same as some of those raised by appellant were considered by the United States Supreme Court in Container Corp. v. Franchise Tax Board, -- U.S. -- **[77 L.Ed.2d 545]** (1983) and rejected.

We find that appellant has failed to show any error in respondent's determination of unity and also has failed to show that the allocation and apportionment provisions of UDITPA did not fairly reflect the extent of its business activity in California. Respondent's action, therefore, is 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 26077 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claims of California First Bank for refund of franchise tax in the amounts of **\$106,779.17, \$18,097.10, \$27,869.00, \$227,182.96, \$303,486.86, and \$107,719.19** for the income years 1968, 1969, 1970, 1971, 1973, and 1974, respectively, be and the same is hereby sustained.

**Done** at Sacramento, California, this 25th day  
Of June , **1955**, by the State **Board** of Equalization,  
with Board Members Mr. Dronenburg, Mr. Collis, Mr. Bennett  
and Mr. Nevins present.

Ernest J. Dronenburg, Jr., Chairman

Conway H. Collis, Member

William M. Bennett, Member

Richard Nevins, Member

Member