BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
ROYAL CROWN COLA CO.)

Appearances:

For Appellant: Stephen J. Schwartz
Attorney at Law

For Respondent: A. Ben Jacobson
Counsel

OPINION

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 Royal Crown Cola Co. against proposed assessments of additional franchise tax in the amounts of $12,883, $17,140, and $61,844 for the income years 1963, 1964, and 1965, respectively.

When this appeal was filed the issues were whether appellant had been engaged in a unitary business with its wholly-owned subsidiaries during the years in question; and, if so, whether the sales factor used by respondent in the formula

apportionment of the unitary income was fairly calculated to determine the portion of the income apportionable to California. Appellant has since conceded that the business was unitary, leaving only the propriety of the sales factor at issue.

Appellant is a Georgia corporation that has its commercial domicile in that state. It is engaged primarily in the business of producing and selling flavored soft drink syrup concentrates. For the most part the purchasers of these syrups are independently owned bottling companies that are franchised by appellant to produce and market soft drinks under the various trademarks and trade names owned by appellant. On occasion appellant has found it necessary to buy out a financially distressed franchisee in order to preserve an established market until a new franchisee could be found. During the appeal years appellant owned from five to seven bottling' companies acquired for this reason. One such company was Royal Crown Cola Bottling Company, Inc. , (Bottling Co.).'a California corporation having its principal place of business in Oakland, California.

For each of the years in issue, appellant and Bottling Co. filed separate California franchise tax returns based on their separate corporate accounting. Upon auditing the returns, respondent determined that appellant and its various subsidiaries had been engaged in a unitary business during these years, requiring the use of a combined report and an apportionment formula to determine the unitary net income derived from or attributable to sources within this state. The formula selected by respondent was the customary three-factor formula consisting of property, payroll, and sales. In composing the sales factor, respondent followed its usual practice of including all sales made by the various parts of the unitary business except for intercompany sales between the corporations included in the combined report. Thus, the factor included all soft drink sales by the bottling subsidiaries plus the sales of syrup concentrates to independent franchisees, but it excluded appellant's sales of syrup to its bottling subsidiaries.

Appellant contends that the use of the normal sales factor distorts the extent of its business activity in California. The only way to accurately reflect that activity, according to appellant, would be to' eliminate the sales of all the bottling subsidiaries from the sales factor and use only appellant's sales of syrup and other' raw materials to both the independent franchisees and the bottling

subsidiaries. In support of its position, appellant argues that the vast majority of its sales consisted of syrup concentrates and that the soft drink sales of Bottling Co., which operated at a loss, contributed nothing to the unitary income except for the profit appellant earned on its sales of syrup to Bottling Co.

The Franchise Tax Board has been given broad discretion to devise a formula for the apportionment of unitary income. (El Dorado Oil Works v. McColgan, 34 Cal. 2d 731 [215 P. 2d 4], appeal dismissed, 340 U. S. 801 [95 L. Ed. 589]; Pacific Fruit Express v. McColgan, 67 Cal. App. 2d 93 [153 P. 2d 607].) Where, as here, a taxpayer contends that the formula selected is arbitrary or produces an unreasonable result, he must prove it by clear and convincing evidence. (Butler Bros. v. McColgan, 17 Cal. 2d 664 [111 P. 2d 334], aff'd 315 U. S. 501 [86 L. Ed. 991]; McDonnell Douglas Corp. v. Franchise Tax Board, 69 Cal. 2d 506 [72 Cal. Rptr. 465, 446 P. 2d 313].)

The essence of appellant's attack against the sales factor selected by respondent is that the sales of the bottling subsidiaries, particularly those of Bottling Co., should be excluded from the factor because they were not as productive of income as the sales of syrup. This is but another form of the argument made in John Deere Plow Co. v. Franchise Tax Board, 38 Cal. 2d 214 [238 P. 2d 569], appeal dismissed, 343 U. S. 939 [96 L. Ed. 1345], where the taxpayer contended that the usual three-factor formula produced unreasonable results because the California portion of the business had higher operating expenses and was less profitable than the other parts of the national business. In sustaining the application of the standard formula, the court said:

> The fact that the taxpayer may show that according to a separate accounting system, the activities in the taxing state were less profitable than those without the state, or even resulted in a loss, does not preclude use of a formula as a method of apportionment of the unitary income. ... [T]he formula used must give adequate weight to the essential elements responsible for the earning of the income..., but its propriety in a given case does not require that the factors appropriately employed be equally productive in the taxing state as they are for the business as a whole. (38 Cal. 2d at p. 224.)

Thus, even if the sales of finished soft drinks by Bottling Co. (and the other subsidiaries) might not have been as profitable, according to appellant's separate accounting figures, as the sales of syrup, that is not a valid reason for excluding them from the formula, Moreover, we are not aware of any authority holding that only the sales of the principal products of a unitary business should be included in the sales factor,' and we cannot find any basis for such a holding ourselves.'

Appellant has submitted a table comparing its method' of computing the sales factor with that used by respondent. According to appellant's method, the sales attributable to California in each appeal year are from five to six percent less than under respondent's method,. and it is claimed that this shows a distortion of great magnitude in respondent's formula. It is not sufficient, however, 'simply to show that a different result obtains from the use of 'a different or revised formula. Discretion to select an appropriate formula is vested in the Franchise Tax Board, and the exercise of that discretion may be overturned only if the taxpayer proves by "clear and cogent evidence" that failure to make the.desired changes in the formula will result in the taxation of extraterritorial values. (Appeal of United Linen Supply Co., Cal. St; Bd. of Equal., Feb. 19, 1958.) Since no such evidence has been' produced,. the approach consistently followed with other taxpayers. must prevail here. (See Appeal of Campbell Chain Co. of California, et al., 'Cal-. St. Rd. of Equal., Oct. 27, 1964.)

O R DE R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

Appeal of Royal Crown Cola Co.

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 Royal Crown Cola Co. against proposed assessments of additional franchise tax in the amounts of $12,883, $17,140, and $61,844 for the income years 1963, 1964, and 1965, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 12th day of November, 1974, by the State Board of Equalization.

_____, Chairman

_____, Member Chairman

_____, Member

_____, Member

_____, Member

ATTEST: _____, Secretary