



Appeal of Putnam Fund Distributors, Inc., et al.

<u>Appellant</u>	<u>Income Year</u>	<u>Franchise Tax</u>	<u>Penalty</u>
Putnam Fund Distributors, Inc.	1955	\$ 43.48	\$ 10.87
	1955	43.48	10.87
	1956	25.00	6.25
	1957	25.00	6.25
	1958	37.76	9.44
	1959	318.23	79.56
	1960	1,859.00	464.75
	1961	7,388.04	1,847.01
	1962	3,237.85	809.46
	1963	1,747.52	436.88
	1964	2,342.40	585.60
Mutual Fund Associates, Inc., Successor in Interest to MFA Liquidating Co.	1965	25,344.00	
Mutual Fund Associates, Inc.	1966	25,314.00	

After the oral hearing in this matter, respondent conceded that an error had been made in computing **appellants'** payroll factor. Respondent has informed us that the proposed assessments for the income years 1965 and 1966 should accordingly be reduced to \$24,187 and \$23,775, respectively.

I

The initial question in this appeal is whether appellants and their affiliated corporations were conducting a unitary business during the income years 1960 through 1966. Appellants and their affiliates are involved in the mutual fund industry, and some understanding of that industry is essential to the resolution of this issue. 1/

1/ The discussion which follows is taken largely from A Study of Mutual Funds, House Report No. 2274, 87th Cong., 2d Sess. (1962) (hereinafter referred to as "Mutual Funds"); and from Report of Special Study of Securities Markets of the Securities and Exchange Commission, Part 4 House Document No. 95 88th Cong., 1st Sess. (1963) (hereinafter referred to as the "Special Study").

Appeal of Putnam Fund Distributors, Inc., et al.

As a general **rule**, mutual funds are either publicly-owned corporations or trust entities. **They** sell shares to the public and use the proceeds from such sales to invest or trade in the stock market. **The** funds may earn money from many sources, notably from appreciation in the value of their portfolio securities, but the sale of new shares to the public is the principal means through which they acquire capital for investment. (Mutual Funds, p. 4.)

During the appeal years mutual funds were one of the more rapidly growing segments of the securities business. While there are several reasons for this success, two unique features of mutual funds contributed substantially to their growth. First, unlimited numbers of new shares in the funds are continuously offered for sale to the public. These shares are not traded on exchanges or generally in the over-the-counter market, but instead are sold to the public primarily through underwriters acting under contract with the funds. Second, federal regulations require mutual funds to redeem **their** outstanding shares at the discretion of the shareholder. A fund's principal underwriter may and often does act as the fund's agent for such redemptions. This constant offering and redemption of shares has led to the creation of large, permanent sales organizations which characterize the mutual fund industry and **which have** greatly facilitated its growth. (Mutual Funds, pp. 6-7; Special Study, pp. 96-97.)

Mutual funds often employ outside organizations to act as investment advisor, administrative manager, or both. The compensation received by these advisors and managers is normally computed as a percentage of the fund's "**net** asset value," which is essentially the market value of the securities in the fund's portfolio. Therefore increases in the amount of money invested by a fund will automatically increase the managing company's income or at least decrease its loss. Since the sale of new shares is the funds' major source of investment capital, **it** is apparent that promoting such sales is one important means by which a managing company may seek to augment its income. (Special Study, p. 97.)

The size of a fund's portfolio may also affect its manager's income in another way. When a fund with a sufficiently large portfolio buys or sells securities through a broker, it may receive free research services

Appeal of Putnam Fund Distributors, Inc., et al.

and other benefits which brokers regularly offer to volume customers. Presumably the more securities which a fund 'buys and sells, the more benefits it will earn. According to respondent these benefits, which may be termed "reciprocity," indirectly profit the managing company by reducing the expenses of operating the funds.

With this background, we turn to the group of corporations involved in this appeal. The parent organization, Putnam Management Company (Putnam), is a Massachusetts corporation headquartered in Boston. Its business is to organize mutual funds and then serve as the funds' management and investment advisor. The services it provides for the funds include research on the stock market and recommendations as to the purchase, holding and sale of portfolio securities. In addition, Putnam also performs most of the clerical, bookkeeping, publicity and administrative functions required in the funds' day-to-day operations. It performs all these services at its own cost. Its fee for these services is usually one-half of one percent of each fund's net asset value per year, but may vary depending on the size of the fund.

Putnam Fund Distributors, Inc. (PFDI), is also a Massachusetts corporation. Its main offices are in **Boston**, but it maintains branch offices in San Francisco, Los Angeles, and various other cities around the United States. PFDI is the principal underwriter for and general distributor of shares in the funds managed by Putnam. It sells such shares indirectly to the public through orders placed by independent brokers. It charges an eight and one-half percent commission on the sales, but returns seven percent to the broker and retains only one and one-half percent. PFDI also serves as a transfer agent for the Putnam funds when shareholders wish to redeem their shares.

At all times relevant to this appeal PFDI was wholly owned by Putnam or by Putnam's predecessor **company**. A majority of **PFDI's** officers and directors were also officers or directors of Putnam, and there were numerous personnel transfers between the two companies. **PFDI** and Putnam used the same law and accounting firms and their employees were covered by the same employee benefit plans. It also appears that, at least since **1965**, **Putnam** and PFDI have shared the same office buildings and equipment.

Putnam Programs Corp. '(Programs) has been a wholly owned subsidiary of Putnam since its organization

Appeal of Putnam Fund Distributors, Inc., et al.

in 1961. Its business is to create and sell "plan investments" which enable investors to purchase 'shares **in the** Putnam funds on an installment basis. It also performs various administrative services for the funds, **such as** mailing reports and letters, keeping records, and answering questions about the funds from fund shareholders. Programs has no separate employees, offices or equipment, but instead uses those of Putnam or PFDI.

Mutual Fund Associates, Inc. (MFA), a California corporation with its headquarters in San Francisco, was a broker-dealer specializing in retail sales of mutual fund shares. Putnam acquired 51 percent of **MFA's** stock early in 1961. **MFA's** president, Mr. Neil Ferguson, **became** a director of Putnam at that time, and two of Putnam's directors became members of **MFA's** eleven-man board of directors. Thereafter, MFA served as an underwriter for the funds managed by Putnam and for the "plan investments" marketed by Programs. It also shared in some of **the** costs of preparing the funds' distribution literature, and occasionally did some printing and mailing for PFDI.

MFA sold shares in unrelated funds as well as in funds managed by Putnam. In 1960, prior to its **acquisition** by Putnam, sales of Putnam fund shares accounted for only 35 percent of **MFA's** total sales. After the acquisition, **MFA's** sales of Putnam fund shares increased to 68 percent of total sales in 1961, 66 percent in 1962, 55 percent in 1963, 47 percent in 1964, 62 percent in 1965, and 59 percent in 1966. MFA received an eight and one-half percent commission (less underwriting costs) on sales of Putnam fund shares and up **to ten** percent on sales of other funds' shares.

At the oral hearing in this **matter**, Mr. Neil Ferguson testified that MFA had agreed to the acquisition by Putnam because of a "feeling **that** we needed to have a close tie with 'a management group like that so if things got really rough we could hopefully look to them for some assistance." Accordingly, soon after the acquisition, MFA secured a written commitment from Putnam to loan **MFA** money "from time to time." In 1962 MFA borrowed \$50,000 under this agreement and also borrowed \$25,000 from its other shareholder. In 1963 Putnam made a short-term loan of **\$100,000** to provide MFA with working capital, and in 1966 it loaned an additional \$500,000 to MFA.

Mr. Ferguson also testified that there was a trend in the mutual **fund** industry **for** management companies

Appeal of Putnam Fund Distributors, Inc., et al.

like Putnam to acquire their own retail sales organizations as a means of increasing share sales. He stated that Putnam, looking toward the future, had followed this trend and acquired MFA as an "experiment" or an "investment". Consistently with this "investment" attitude,, Putnam did not initially play a direct role in MFA's daily operations. Late in 1965, however, Putnam acquired the remaining 49 percent of MFA's stock, and from that time forward Putnam **concededly** exercised direct control over MFA's business.

The final corporation involved in this appeal is Investors Insurance Associates, Inc. (IIA), a general insurance agent for sales of ordinary and term life **insurance**. IIA was a wholly-owned subsidiary of MFA, and the two companies used the same facilities, law and **accounting** firms, insurance company and employee benefit plans. Many of MFA's salesmen also sold insurance for IIA. In fact, it appears that MFA had acquired IIA in order to provide additional business for its sales force; since salesmen often found it difficult to make a living selling only mutual fund shares.

When a taxpayer derives income from sources both within and without California, it is required to 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's business is unitary, its California-source income must be computed by formula apportionment rather than by separate accounting.** (Superior Oil Co. v. Franchise Tax Board, 60 Cal. 2d 406 [34 Cal. Rptr. 565; 386 P. 2d 33] (1963); Honolulu Oil Corp. v. Franchise Tax Board, 60 Cal. 2d 417 [34 Cal. Rptr. 552; 386 P.2d 40] (1963).)

The California Supreme Court has stated that a business is unitary if there is unity of ownership, unity of operation as evidenced by central purchasing, advertising, accounting and management, and unity of use in a centralized executive force and general system of operation. (Butler Brothers v. McCollgan, 17 Cal. 2d 664, 678 [111 P.2d 334] (1941). affd. 315 U.S. 3 501 186 L. Ed. 991] (1942).) **The court has also held that a-business is unitary if the business done within this state is dependent upon or contributes to the operation of the business done outside the state.** (Edison California Stores, Inc. v. McCollgan, 30 Cal. 2d 472, 481 [183 P. 2d 16] (1947)). **The California courts have yet to limit the unitary concept, except to state that "[i]t is only**

Appeal of Putnam Fund Distributors, Inc., et al.

if its business within this state is truly separate and distinct from its business without this state, **so** that the segregation of income may be made clearly and **accurately**, that the separate accounting method **may properly** be used." (Butler Brothers v. McColgan, supra, 17 Cal. 2d at 667-668.)

The parties to this appeal agree that the mutual funds managed by Putnam were not part of the alleged unitary business because of a lack of common ownership. **Unity** of ownership is conceded with respect to the other corporations. In addition, **appellants** concede that IIA was unitary with MFA, and that Programs was unitary with Putnam. Therefore the only question remaining is whether Putnam and the two appellant corporations, **MFA** and **PFDI**, were conducting a unitary business.

Although **appellants** contend that Putnam, **MFA** and **PFDI** were not unitary during any of the years in question, they concentrate their **arguments** on the years prior to 1965. In that year Putnam began to share office space with **PFDI** and also began to play a direct role in **MFA's** daily operations, and appellants recognize that these factors make the case **for** unity much stronger. With regard to the earlier years, however, appellants contend that there was no significant unity in either **operation** or use. In their view, Putnam's business of managing mutual funds and their business of selling fund shares were separate and distinct-types of enterprise, **without** any centralized services, common product or inter-company **flow** of goods which would demonstrate "operational or economic interdependence."

We may accept **appellants'** contention that, at least prior to 1965, there was little centralization in the day-to-day business of Putnam, **MFA** and **PFDI**. In previous cases, however, we have consistently held that **such** centralization is **not** necessary to a finding of unity if the operations are otherwise unified to the extent that they depend upon or contribute to one another. (See, e.g., Appeal of I-T-E Circuit Breaker Co., Cal. St. Bd. of Equal., Sept. 23, 1974; Appeal of McCall Corp., Cal. St. Bd. of Equal., June 18, 1963.) For the reasons expressed below, we are persuaded that sufficient interdependence and contribution are present in this case to sustain respondent's determination of unity.

We note, initially, that both **MFA** and **PFDI** shared some common officers and **directors with** Putnam,

Appeal of Putnam Fund Distributors; Inc., et al.

a factor which the courts and this board have considered an important indicator of dependency or contribution. (See Chase Brass & Copper Co. v. Franchise Tax Board, 10 Cal. App. 3d 496 [87 Cal. Rptr. 239], app. dismiss. and cert. den., 400 U. S. 961 [27 L. Ed. 2d 381] (1970); Appeal of T-T-E Circuit Breaker Co., supra.) These interlocking directors provided the means through which Putnam could establish policy for and coordinate the sales efforts of its subsidiaries. Appellants allege that MFA and PFDI competed with one another to some extent in selling mutual fund shares, and such coordination would therefore appear essential to the smooth conduct of their sales operations.

Appellants contend that Putnam treated MFA as an "investment" and did not attempt to control its sales policy. It appears, however, that Putnam had followed an industry trend and acquired MFA in order to promote sales of Putnam fund shares. In fact, MFA's sales of Putnam fund shares increased rapidly and substantially after its acquisition by Putnam, even though MFA could earn higher commissions on sales of other funds' shares. We do not believe that this increase was a mere accident! and there is nothing in the record to show that it was attributable to general market conditions. Rather, it appears that Putnam exerted a significant, though perhaps informal, influence over its subsidiary's sales policy..

Despite appellants' protestations to the contrary, the interlocking directors also facilitated a mutually beneficial exchange of expertise between Putnam and its subsidiaries. At the oral hearing in this matter, Mr. Ferguson testified that the Putnam representatives on MFA's board were "very helpful" in meetings with customers, since they could provide information about investment management and general economic trends that MFA's own staff could not. Mr. Ferguson also stated that Putnam sometimes called upon him to answer questions about the retail sales field. We have no doubt that such information would prove useful to Putnam in deciding whether to establish new mutual funds and in determining what type of fund would be most attractive to investors.

In addition to interlocking directors, substantial intercompany financing has also been recognized as an important indicator of dependency or contribution. (See Appeal of Beecham, Inc., Cal. St. Bd. of Equal., March 2, 1977.) Here Putnam agreed to loan money to MFA

Appeal of Putnam Fund Distributors, Inc., et al.

"from time to **time**," apparently' whenever MFA needed funds, and in fact it did **loan** substantial amounts during the **appeal years**. Since one reason MFA became affiliated with Putnam was to obtain financial backing, we cannot accept appellants' suggestion that these loans were insignificant, **even** though MFA at times also borrowed money from other sources.

Several other factors deserve to be mentioned. For example, PFDI and Putnam shared a common trade name, used the same law and accounting firms, and had joint employee benefit plans. There were also numerous personnel transfers between those two companies. As underwriters, both MFA and PFDI helped defray the costs of preparing and distributing sales literature for the funds managed by Putnam. In addition, MFA did some printing and mailing for PFDI. Admittedly, some of these factors are less significant than others. Taken together, however, they tend to show mutual dependency and contribution between Putnam and its subsidiaries. (See Appeal of F. W. Woolworth Co., Cal. St. Bd. of Equal., July 31, 1972; Appeals of Servomation Corp., et al., Cal. St. Bd. of Equal., July 7, 1967,)

Finally, the unique economic relationship between Putnam and its subsidiaries also indicates interdependency and contribution. MFA and PFDI **earned commission** income from sales of mutual fund shares, and Putnam **provided** its subsidiaries with a product to sell by **creating** and **efficiently** managing mutual funds. Appellants concede that they owed their status as underwriters of the Putnam funds to their connections with Putnam. **Moreover**, Putnam's income from managing mutual funds was computed as a percentage of each fund's net asset **value**. Therefore, to the extent that **MFA's** and **PFDI's** selling **activities** increased the funds' net asset values, those **activities** also contributed directly to Putnam's income. The selling activities may also have indirectly contributed to Putnam's income by increasing the **opportunities** to earn reciprocity. In short, although the activities of Putnam and its subsidiaries may conceptually be thought of as distinct types of enterprise, they were in fact economically **related** activities that both depended upon and contributed to one another.

Appellants rely on Hamilton Management Corp. v. State Tax Commission, 253 Or. 602 [457 P. 2d 4861 (1969)]. That case involved a taxpayer which managed a

Appeal of Putnam Fund Distributors, Inc., et al.

mutual fund in Colorado and which sold fund shares. in Oregon and other states. While recognizing that some unitary features connected the taxpayer's managing, and selling activities, the court held that the business was not unitary under Oregon law. The case was decided under regulation 4.280 (1)- (B) of the Oregon Tax Commission; which provided, in part:

The term 'unitary business' means that the taxpayer to which it is applied is carrying on a business, the component parts of which are too closely connected and necessary to each other to justify division or separate consideration as independent units.

The court also concluded that the managing and selling activities did not depend on or contribute to one another, even though the taxpayer's sales were used as a measure of its management fee. In reaching this conclusion, the court stated that there was no "nexus" for taxation, as required by the due process clause of the Fourteenth Amendment to the United States Constitution, because Oregon had conferred no "opportunities or protection" on the management aspects of the business.

We do not regard the Oregon court's conclusions regarding "nexus" as controlling on this appeal. Respondent does not assert that California has jurisdiction to tax Putnam's management business in Boston. It seeks only to compute and to tax the income of MFA, PFDI and IIA which is reasonably attributable to California sources. An apportionment formula which is fairly calculated to reach this result does not offend the due process clause of the Fourteenth Amendment. (Butler Brothers v. McCollgan, supra, 335 U.S. at 506-507.) More importantly, the Oregon regulation quoted above differs from California law. In California, the test for a unitary business is not whether the component parts "are too closely connected and necessary to each other to justify division," but whether the business done within the state is dependent upon or contributes to the overall operations. (Superior Oil Co. v. Franchise Tax Board, supra, 60 Cal. 2d at 413-414.) For these reasons, we respectfully decline to follow the Oregon court's decision.

To sum up, the California Supreme Court has., stated that a business is "clearly unitary" if there is "any evidence" that the taxpayer's operations in this state contribute to the earning of income outside this

Appeal of Putnam Fund Distributors, Inc., et al.

state. (Butler Brothers v. McColgan, supra, 17 Cal, 2d at 668.) Measured by this standard, the evidence in this case amply supports respondent's determination of unity. We therefore conclude that both MFA and PFDI were unitary with Putnam during the years in question.

II

Appellants contend that the following items should be excluded from their unitary income subject to formula apportionment: (1) commissions earned from insurance sales by IIA; (2) commiss ions earned by MFA on sales of shares in mutual funds which were not managed by Putnam; (3) Putnam's management fees to the extent they are attributable to assets acquired by the Putnam funds prior to 1960; and (4) Putnam's management fees to the extent they are attributable to assets acquired by certain mutual funds before those funds became clients of Putnam. In support of their position, appellants argue that the activities which produced such income were not part of the unitary business.

We first address the commissions earned by, IIA. As indicated in the first portion of this appeal, appellants have conceded that IIA was unitary with MFA, and the record supports this concession.. MFA acquired IIA in order to provide additional business for its own sales organization. Moreover, since the two companies shared the same facilities and sales personnel., IIA's earnings presumably helped to defray the costs of maintaining the organization. (See RKO Teleradio Pictures, Inc. v. Franchise Tax Board, 246 Cal. App. 2d 812, 817 [55 Cal. Rptr. 299] (1966).) It therefore appears that IIA contributed to MFA's business of selling mutual fund shares in that it enabled MFA to have a larger and more efficient sales organization than would otherwise have been possible.

While appellants recognize these considerations, they contend that IIA's insurance. sales were incidental to the unitary business conducted by Putnam and MFA. They argue that insurance sales had no direct connection with Putnam's business of managing mutual funds. We have consistently held, however, that direct links between each and every segment of a business are not a prerequisite to a finding of unity. (See Appe'al of Monsanto Co., Cal. St. Bd. of Equal., Nov. 6, 1970; Appeal of Grolier Society, Inc., Cal. St. Bd. of Equal., Aug. 19, 1975; Appeal of Arkla Industries, Inc., Cal. St. Bd. of Equal., Aug. 16, 1977.) All that need be shown is that each segment forms

Appeal of Putnam Fund Distributors, Inc., et al.

an inseparable part of the unitary business wherever conducted. (Appeal of Monsanto Co., supra.) Here IIA formed an inseparable part of the unitary business because it depended upon and contributed to **MFA's** mutual fund sales. Its income from insurance sales is therefore includable in unitary income.

Similar reasoning leads us to reject appellant's other contentions. MFA used the same facilities **and** personnel to sell shares both in the Putnam funds and in other funds. Putnam used the same facilities and personnel to manage all the funds with which it had contracts, regardless of when or how the funds acquired **their assets**. Accordingly, each of these activities was an inseparable part of the unitary business, and the income therefrom is includable in unitary income. (See RKO Teleradio Pictures, Inc. v. Franchise Tax Board, supra.)

In support of their position that these activities were not part of the unitary business, appellants rely on the cryptic holding in Chase Brass & Copper Co. v. Franchise Tax Board, supra, that sales of certain metal by-products were not part of the taxpayer's unitary business. We considered an analagous argument in the Appeal of Arkla Industries, Inc., supra. For the reasons expressed **in** that opinion, we do not believe Chase Brass supports appellants' position on this point. (See also Appeals of The Anaconda Co., et al., Cal. St. Bd. of Equal., May 11, 1972.)

III

In apportioning appellants' unitary income to California, respondent used a two-factor formula composed of revenue and payroll. Appellants contend that the formula should include a property factor to reflect the assets of the funds managed by Putnam.

Former section 25101 of the Revenue and Taxation Code gave respondent wide discretion in choosing an appropriate apportionment formula. (El Dorado Oil Works v. McColgan, 34 Cal. 2d 731 [215 P.2d 4] app. diss., 340 U. S. 11 [95 L. Ed. 589] (1950).) Under this section respondent's choice would not be set aside unless the taxpayer established by clear and cogent evidence that

Appeal of Putnam Fund Distributors, Inc., et al.

the formula was manifestly unreasonable or that it ~~29-~~ resulted in the taxation of extraterritorial values. 29- (Pacific Fruit Express Co. v. McColgan, 67 Cal. App. 2d 93 [153 P.2d 607] (1944).)

As a general rule, the property factor includes all property held for use or actually used in the taxpayer's unitary business. (See Wahrhaftig, Allocation Factors in Use in California, 12 Hastings L.J. 65, 79-81 (August 1960).) If property is an essential element responsible for the earning of unitary income, it must be reflected in a property factor even if it is merely leased and not owned by the taxpayer. (McDonnell Douglas Corp. v. Franchise Tax Board, 69 Cal. 2d 506 [72 Cal. Rptr. 465; 446 P. 2d 313] (1968).) Property may be excluded from the factor, however, and indeed a property factor may be omitted entirely, if property is not a material income-producing component of the taxpayer's unitary business. (Appeal of John Blair & Co., Cal. St. Bd. of Equal., March 4, 1965.)

Respondent contends that the assets of the mutual funds were not used in the business to produce unitary income. It points out that since the assets were owned by the mutual funds, they produced dividend, interest, and capital appreciation income only for the funds and their shareholders, and the funds were not part of the unitary business. Appellants, on the other hand, rely on the fact that the fund assets were used as a measure of unitary income from Putnam's management fees. If this measuring feature is not reflected in a property factor, they argue, a disproportionate amount of the management fees would be apportioned to this state because of MFA's large California payroll.

2/ The Uniform Division of Income for Tax Purposes Act, Revenue and Taxation Code sections 25120 through 25139, now limits respondent's discretion in these matters. (Appeal of Donald M. Drake Co., Cal. St. Bd. of Equal., Feb. 3, 1977, mod., March 2, 1977.) However, the Uniform Act is applicable only to income or taxable years beginning after December 31, 1966 (Stats. 1966; p. 181), and is accordingly not involved in this appeal.

Appeal of Putnam Fund Distributors, Inc., et al.

We believe that respondent has the better of this argument. Putnam's management fees were produced by the services it performed for the funds, not directly by the assets which it managed. Since the income yielded by the fund assets was not unitary income subject to formula apportionment, we see no reason why the formula must contain a property factor to account for those assets. There is nothing to the contrary in McDonnell Douglas Corp. v. Franchise Tax Board, supra, since the property **there** in question did produce unitary income for the taxpayer. Moreover, appellants' argument ignores the fact that respondent's formula contains a revenue factor as a counterbalance to the payroll factor. The management fees were placed entirely in the denominator of the revenue factor and excluded from the numerator. Even without a **property** factor, therefore, the formula adequately recognizes that the management fees were attributable to services rendered outside this state.

In a further attempt to show that respondent's formula is arbitrary, appellants compare the percentage of Putnam fund shareholders who were California residents with the percentage of unitary income assigned to this state. Since the percentages differ, they argue, the formula must be distortive. This argument assumes that the unitary business consisted exclusively of managing and selling shares in the Putnam funds. As indicated previously, however, the unitary business also included insurance sales and sales of shares in unrelated mutual funds. Since some of the unitary income from these activities was apportionable to California, the mere **fact that** the percentages cited by appellants are unequal does not prove that the formula is distortive.

No error has been shown in respondent's failure to include a property factor and, accordingly, we sustain respondent's action on this point.

IV

Respondent included **100** percent of the commissions which PFDI earned on sales through California brokers in the numerator of the revenue factor used in apportioning appellants' unitary income for the income years 1960 through 1966. The revenue factor used in apportioning **PFDI's** income for the years 1955 through 1959 was also computed in this manner. Appellants contend that **PFDI's** commissions should be excluded from the revenue factor.

Appeal of Putnam Fund Distributors, Inc., et al.

Throughout the years in question PFDI employed two regional representatives in this state, one in Los Angeles and the other in San Francisco. Their job was to visit the offices of independent brokers to maintain friendly relations and to help solve problems encountered in selling Putnam fund shares. They also regularly gave lectures to groups of prospective investors about the benefits and advantages of owning Putnam fund shares.

Although the regional representatives **occasionally** transmitted purchase orders to **PFDI's** Boston office, for approval, they did not themselves solicit or process such orders. Sales of Putnam fund shares were made directly from **PFDI's** Boston office to independent brokers who then resold the shares to investors. Insofar as we can tell from the record, however, personnel in the Boston headquarters engaged in no activities of a promotional or solicitational nature.

During the appeal years the Revenue and **Taxation Code contained no** specific definition of the sales or revenue factor. ^{3/} Respondent's regulations provided, however: "The sales or gross receipts factor **generally** shall be apportioned in accordance with employee sales activity of the taxpayer within and without the State. ... Promotional activities of an employee are given some weight in the sales factor." (Cal. Admin. Code, tit. 18, reg. 25101, subd. (a).) Appellants appear to contend that **PFDI's** commissions should be entirely excluded from the revenue factor because its regional representatives were not engaged in "employee sales activity" within the meaning of this regulation. We disagree.

The purpose of the revenue factor is to **serve** as a balance against the other apportionment factors 'and "sales should, so far as possible, be apportioned to the

^{3/} Such a definition is now presented in Revenue and **Taxation** Code section 25134, which is part of the Uniform Division of Income for Tax Purposes Act. As indicated in footnote 2, *supra*, the Uniform Act does not apply to the years under consideration.

Appeal of Putnam Fund Distributors, Inc., et al.

state where the markets are found, from which the business is received, or where the customers are located." (Altman & Keesling, Allocation of Income in State Taxation (2d ed. 1950), pp. 126, 128; Appeal of Fourco Glass Co., Cal. St. Bd. of Equal., April 20, 1960.) We have therefore liberally construed the term "employee sales activity" to include not only direct solicitation of purchase orders, but also promotional activities directed at the taxpayer's principal markets. (See Appeal of Pfizer Inc., etc., Cal. St. Bd. of Equal., May 8, 1973.) Here **PFDI's** business was to sell fund shares to independent brokers for resale to investors. Its regional representatives accordingly aimed their promotional efforts both at brokers and at prospective investors. We conclude that those efforts were "employee sales activity" for purposes of the revenue factor.

Appellants contend, in the alternative, that only 25 percent of **PFDI's** California commissions should be included in the numerator of the revenue factor. In support of this position they rely on the Appeal of the United States Shoe Corporation, decided by this board on December 16, 1959, and the Appeal of Hammond Organ Company, decided by this board on May 17, 1962. In each of those cases, however, the taxpayer's California sales were attributable to promotional or solicitational activities outside California as well as to promotion within this state. The record in this case reveals no such out-of-state activities. Accordingly, we believe respondent properly included 100 percent of **PFDI's** California commissions in the numerator of the revenue factor. (See Appeal of Pfizer, Inc., etc., supra.)

The Appeal of Avco Manufacturing Corporation, decided by this board on December 16, 1959, is not to the contrary. Although the facts of that case arguably would have justified inclusion of all the taxpayer's California sales in the numerator of its sales factor, respondent chose to include only a lesser percentage. We held that this action was not an abuse of respondent's discretion. The taxpayer did not contend, and we did not hold or imply, that inclusion of all California sales in the numerator of the sales factor would have been improper.

V

The next question is whether PFDI was subject to either the franchise or corporate income tax.

Appeal of Putnam Fund Distributors, Inc., et al.

Throughout the years at issue PFDI maintained one permanent office in Los Angeles and another in San Francisco. PFDI placed its name on the doors of these offices and in the directories of the buildings where the offices were located. It also listed its name in the yellow pages of California telephone books.

As indicated in the preceding section of this appeal, PFDI employed a regional representative in each of its California offices. The representatives not only maintained contacts with independent brokers, but also regularly gave promotional lectures to groups of prospective investors. Except for a clerk employed from 1959 on, the two representatives were **PFDI's** only employees in this state.

Corporations doing business in California are generally subject to the franchise tax. (Rev. & Tax. Code, § 23151.) "Doing business" is defined as "actively engaging in any transaction for the purpose of financial or pecuniary gain or profit." (Rev. & Tax. Code, § 23101.) Respondent's regulations provide, however, that foreign corporations engaged wholly in interstate commerce will not be considered as "doing business" in California. (Cal. Admin. Code, tit. 18, reg. 23101; but see Complete Auto Transit, Inc. v. Brady, U.S. [51 L. Ed. 2d 326] (1977).) PFDI contends that it was engaged solely in interstate commerce, that is, promoting sales from its Boston office to California brokers, and therefore was not "doing business" in California.

In Cheney Bros. Co. v. Massachusetts, 246 U.S. 147 [62 L. Ed. 632] (1918) one question before the Court was whether the Northwest Consolidated Milling Company was doing local business in Massachusetts. The Court held that it was for the following reasons:

This company was incorporated under the laws of Minnesota, operates flour mills there, and sells the flour to wholesale dealers throughout the country. It has an office in Massachusetts where it employs several salesmen for the purpose of inducing local tradesmen to carry and deal in its flour. These salesmen solicit and take orders from retail dealers and turn the same over to the nearest wholesale dealer, who fills the order and is paid by the retailer. Thus the salesman, although not in the employ of the wholesaler, is selling flour for him.

Appeal of Putnam Fund Distributors, Inc., et al.

Of course this is a domestic business,--inducing one local merchant to buy a particular class of goods from another, --and may be taxed by the **state**, regardless of the motive with which it is conducted. (62 L. Ed. at 637.)

Similarly, PFDI was clearly "doing business" in this state. Its representatives **gave** promotional lectures; to induce California investors to purchase fund shares from California brokers. The fact that these lectures were promotional and did not include systematic solicitation of orders goes only to the nature of PFDI's local business and not to whether it **was** carrying on a local business. (Lilly & Co. v. Sav-On-Drugs, Inc., 366 U.S. 276, 282 [6 L. Ed. 2d 2881, **reh'g. den.**, 366 U.S. 978 [6 L. Ed. 2d 1268] (1961).) **Accordingly**, we hold that PFDI was subject to the franchise tax during the years in question. In view of this decision, it is unnecessary to determine whether PFDI may have been liable for corporate income tax.

VI

PFDI did not file California franchise or income tax returns for any of the appeal years. Respondent accordingly imposed failure-to-file penalties pursuant to Revenue and Taxation Code section 25931, which requires such penalties **"unless it is shown that the failure is due to reasonable cause and not due to willful neglect"**

Several federal cases indicate that a taxpayer's good faith but mistaken belief that it owes no tax may constitute reasonable cause for failure to file a return, if the law regarding taxability is unclear and there is reasonable doubt as to how the legal issues will ultimately be resolved. (See, **e.g.**, J. T. Wurtsbaugh, Transferree, 13 T.C. 1059 (1949); Henry Yeckes, ¶ 66,178 P-H Memo. T. C. (1966).) Relying on these **e cases**, PFDI contends that there was substantial doubt as to whether it was "doing business" in California, and that it **reasonably** and in good faith believed that it owed **no franchise tax** to this state.

Although what constitutes "doing business" in California is not entirely clear, we do not believe that the ambiguity in the law is so great as to justify, in itself, PFDI's failure to file **returns**. Soliciting intrastate sales has been considered "doing business" within a state at least since 1918, when the Supreme

Appeal of Putnam Fund Distributors, Inc., et al.

Court decided Cheney Bros. Co. v. Massachusetts, supra. Despite this holding, PFDI apparently made no attempt to discover whether its activities' in California--promoting intrastate sales--might also be considered "doing business." Insofar as we can tell from the record, PFDI did not seek legal advice on this point or request a ruling from the Franchise Tax Board. It chose instead to rely on its speculative and unfounded belief that its **activities** were entirely in interstate commerce. We hold that PFDI has failed to establish reasonable cause for failing to file returns. (See Appeal of Estate of Marilyn Monroe, Deceased, Cal. St. Bd. of Equal., April 22, 1975.)

VII

The final issue in this appeal is whether the proposed assessment for the income year 1965 was timely.

In 1965 MFA transferred all its assets to a newly formed corporation, MFA Incorporating Company (Incorporating), in exchange for all of Incorporating's stock. MFA then changed its name to MFA Liquidating Company (Liquidating) and merged with Putnam. Incorporating changed its name to Mutual Fund Associates Incorporated (Mutual) and continued **MFA's** business.

In order to obtain a tax clearance certificate for MFA (see Corp. Code, **§ 1905**), a vice president of Incorporating executed respondent's Assumption of Tax Liability form. Therein Incorporating agreed to "file or cause to be filed with the Franchise Tax Board such returns and data that may be required of" MFA, and also "to pay in full, without reservation or restriction, all accrued or accruing franchise taxes and delinquent charges thereon **of**" MFA.

Subsequently respondent obtained a written waiver of the statute of limitations on behalf of Incorporating. The waiver provides that "any deficiency in taxes or penalties, including interest thereon, due under any return(s) made by or on behalf of [Incorporating] may be proposed to be assessed at any time on or before" September 15, 1971. Within the waiver period, but after the statute of limitations would otherwise have run, respondent issued the proposed assessment in question to Mutual as successor in interest to Liquidating?

Appellants do not contest the timeliness or validity of Incorporating's waiver of the statute of

Appeal of Putnam Fund Distributors, Inc., et al.

limitations. They also concede that Mutual is a transferee of Incorporating and that the proposed assessment was correctly addressed. They contend, however, that Incorporating's waiver applies only to taxes owed by Incorporating in its own right, and that it does not extend the limitations period for any taxes which **Incorporating** may owe as a transferee of MFA.

We find no merit in this argument. **Incorporating** expressly agreed to file such returns as might be required of MFA, and also waived the limitations period for taxes due under **"any return(s)"** made by it for the year in question. Clearly this waiver applies not only to Incorporating's own returns, but also to any return it filed or caused to be filed on **behalf of** MFA.

The cases cited by appellants (Carnation Milk Products Co., 15 B.T.A. 556 (1929); Moore Investment Co., ¶ 61,261 P-H Memo. T.C. (1961)) are distinguishable on their facts. In neither of those cases had the transferee expressly assumed the transferor's tax liability. Accordingly, we hold that the proposed assessment in question was timely.

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,

Appeal of Putnam Fund Distributors, Inc., et al.

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 protests against proposed assessments of additional franchise tax and penalties in the amounts and for the years as follows:

<u>Appellant</u>	<u>Income Year</u>	<u>Franchise Tax</u>	<u>Penalty</u>
Putnam Fund Distributors, Inc.	1955	\$ 43.48	\$ 10.87
	1955	43.48	10.87
	1956	25.00	6.25
	1957	25.00	6.25
	1958	37.76	9.44
	1959	318.23	79.56
	1960	1,859.00	464.75
	1961	7,388.04	1,847.01
	1962	3,237.85	809.46
	1963	1,747.52	436.88
	1964	2,342.40	585.60
Mutual Fund Associates, Inc., Successor in Interest to MFA Liquidating Co.	1965	25,344.00	
Mutual Fund Associates, Inc.	i966	25,314.00	

be and the same is hereby modified in accordance with respondent's concession regarding the payroll factor. In all other respects, the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this **6th** day of December , 1977, by the State Board of Equalization.

William L. Burns, Chairman
Richard O'Brien, Member
Robert Perry, Member
Irene Sanchez, Member
_____, Member