

Appeal of Kelsey-Hayes Company

Appellant is a Delaware corporation with its principal office in Romulus, Michigan. Appellant is organized into several divisions located in **various** states throughout the United States. Appellant is also the majority **stockholder** of a Canadian subsidiary. **Appellant's** various **operating divisions** manufacture and sell automobile and other vehicular parts, aerospace components, and various specialty parts.

Prior to January 1, 1968, appellant did not own or lease any property, solicit any sales or employ any personnel in California. However, both before and after that date, appellant made substantial California destination sales to California locations. These sales were made pursuant to orders placed by customers at appellant's main office in Michigan.

On January 1, 1968, appellant acquired substantially all the assets of a Nevada corporation which had its principal office and facilities in California. This corporation became appellant's Fabco Division which continued to operate in California. The entire operation of the Fabco Division continued basically unaltered after the acquisition.

The acquisition of the Fabco Division was of relatively minor significance when compared to appellant's overall operations. For example, **during** the-1969 fiscal year, **the total sales and payroll of the Fabco Division** were approximately .7 percent of appellant's total sales and payroll. For the same period the property of the Fabco Division amounted to approximately .5 percent of appellant's total property. During the appeal years, appellant's only employees in California were employed by and worked exclusively on Fabco operations. No property other than that used by Fabco was **owned or** leased by appellant in California during the years in issue.

It is conceded that prior to January 1, 1968, **appellant** was not subject to tax-because the unsolicited California destination sales presented an insufficient nexus for California to assert taxing jurisdiction. It is also conceded that during the appeal years the Fabco Division was not unitary with appellant's other divisions. Furthermore, there is no-dispute that during the years in issue appellant was subject to tax with respect to its Fabco.Division, and that, since Fabco did business both within and without California, the tax was to be determined on the basis of a separate apportionment formula which considered only the Fabco operations. (See

Appeal of Kelsey-Hayes Company

Rev. & Tax. Code, § 25101.) However, respondent. **also** determined that, after January 1, 1968, appellant **was** subject to tax with respect to its other divisions, and that such tax was to be computed by a separate apportionment **formula** which. excluded the operations of the Fabco Division. 1/ It is the propriety of this determination that presents the issue for resolution.

It is well settled that a foreign corporation engaged in interstate and foreign commerce as well as conducting intrastate business in California may be subjected to a properly apportioned tax by this state for the privilege of engaging in intrastate commerce. (Matson Navigation Co. v. State Board of Equalization, 3 Cal. 2d 1 [43 P 2d 8051 (1935)], affd., 297 U.S. 441 [80 L. Ed. 7911 (1936)] ; see also Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 [51 L. Ed. 2d 3261 (1977)].) Accordingly, section 23151 of the Revenue and Taxation Code imposes a franchise tax measured by net income on every nonexempt corporation doing business within California. When the income of a corporate taxpayer is derived from or attributable to sources both within and without this state, the tax shall be measured by the net income derived from or attributable to sources within this state. (Rev. & Tax. Code, § 25101.) For the years in issue, business income was to be apportioned by the three-factor formula of property, payroll and sales contained in the Uniform Division of Income for Tax Purposes Act (UDITPA). (Rev. & Tax. Code, §§ 25120-25139.) Formula apportionment **is** required where a corporate taxpayer generates business income in California and in 'one or more other states. (See Rev. & Tax. Code, § 25121; Cal. Admin. Code, tit. 18, reg. 25121, **subd.** (a), art. 2; see also Cal. Admin. Code, tit. 18, reg. 25101, **subd.** (f).)

1/ Since appellant's other divisions were not **subject** to tax in California until the acquisition of **Fabco** on January 1, 1968, the numerator of the sales factor of the apportionment formula for **the income** year ended August 31, 1968, included only the California destination sales made from January 1, 1968, through August 31, 1968. For both appeal years the numerator of the apportionment formula consisted only of the sales factor; the property and payroll factors were zero since there was no California payroll or property for the non-California divisions. The denominator, of course, was three. (See Rev. & Tax. Code, §§ 25128, 25129, 25131 & 25134.)

Appeal of Kelsey-Hayes Company

Although appellant does not deny that the activities of its Fabco Division subject it to California tax, it does challenge respondent's determination that it was subject to additional tax with respect to its other divisions. It is appellant's position that since the Fabco Division is not unitary with its other operations, the only income subject to tax is the income associated with the Fabco Division. Since all other operations are separate and distinct from the California operations of its Fabco Division, appellant argues that such operations cannot be considered business activities in California and are not subject to California tax. Furthermore, appellant continues, the only activities engaged in by its non-California divisions are exempt from taxation under Public Law No. 86-272 (73 Stat. 555 (1959), 15 U.S.C. § 381 j .

Initially, appellant's argument confuses two separate and distinct concepts, jurisdiction to tax and the unitary business concept. As presented by this appeal, jurisdiction to tax is concerned with the existence or nonexistence of sufficient contacts, or nexus, to satisfy the due process requirements for the valid imposition of a state tax on or measured by the corporate net income of a foreign corporation. (See generally Lohr-Schmidt, Developing 'Jurisdictional Standards for State Taxation of Multistate Corporate Net Income, 22 Hastings L. J. 1035 (1971).) On the other hand, the unitary business concept requires that, where a corporation or group of corporations exhibit certain unitary characteristics, they must compute the measure of their tax by means of a combined report. (See generally Butler Bros. v. McColgan, 17 Cal. 2d 664 [111 P.2d 334] (1941), affd., 315 U.S. 501 [86 L. Ed. 991] (1942); Edison California Stores, Inc. v. McColgan, 30 Cal. 2d 472 [183 P.2d 16] (1947).)

The jurisdictional nexus which is sufficient for California to impose a tax upon appellant is based upon appellant's substantial presence in California through the business activities of its Fabco Division. Fabco is not a separate corporation. It is merely a division, an integral and indivisible part of appellant, a single corporation. Once appellant is subject to California's taxing jurisdiction because of the presence of its Fabco Division, all of its income properly apportioned to reflect only California's portion, may be taxed. (See Matson Navigation Co. v. State Board of Equalization, supra.) The fact that Fabco is not unitary with appellant's other divisions is of no significance when considering whether California has jurisdiction to impose a

Appeal of Kelsey-Hayes Company

properly apportioned tax upon appellant. That one division of a multidivisional single corporation is not unitary with the remaining divisions does not alter the fact that the single corporate taxpayer remains a single corporation. If Fabco had been unitary with appellant's other business activities during the appeal years, the application of a single apportionment formula to all of appellant's unitary business activities would have formed the basis for an appropriate apportionment Of appellant's California source income. However, since Fabco was not unitary with appellant's other business activities, the application of two separate apportionment formulas was required to properly apportion appellant's California source income. (Cal. Admin. Code, tit. 18, reg. 25120, subd. (b), art. 2.)

We believe that appellant's reliance on Public Law No. 86-272 is also misplaced. For purposes of this appeal, Public Law No. 86-272 provides that no state may impose a tax on net income, or a tax measured by net income, on income derived within the state by a company (whether it be an individual proprietorship, partnership or corporation) from interstate commerce if the only business activities within the state by or on behalf of such company are the solicitation of orders within the state for tangible personal property where such orders are sent outside the state for approval or rejection and, if approved, are filled by shipment or delivery from a point outside the state. Appellant's reliance on Public Law No. 86-272 ignores the fact that its Fabco Division, which has established a substantial physical presence in California, is an integral part of appellant, a single corporation. When the activities of Fabco are considered within the parameters of Public Law No. 86-272, as they must since Fabco is an integral and inseparable component of appellant's corporate structure, it is evident that appellant's California activities extend far beyond those protected by the federal law. It is inappropriate, as suggested by appellant, to ignore Fabco's substantial presence in California simply because it is not unitary with appellant's other activities when testing appellant's California activities by the jurisdictional standards of Public Law No. 86-272. Since appellant is a single corporation, although not engaged in a unitary business with its Fabco Division during the appeal years, the jurisdictional standards of Public Law No. 86-272 must be tested by the totality of appellant's business activities in California.

Finally, appellant argues that even if it is subject to tax with respect to its non-California

Appeal of Kelsev-Haves Company

divisions, it should be entitled to a special formula pursuant to section 25137 of the Revenue and **Taxation** Code on the basis that the formula applied does not "fairly represent the extent of the taxpayer's business activities in this state." In order to insure that UDITPA is applied as uniformly as possible, the party seeking **relief** under section 25137 bears the burden of proving that exceptional circumstances are present.

(Appeal of Borden, Inc., Cal. St. Bd. of Equal., Feb. 3, 1977; Appeal of Donald M. Drake Co., Cal. St. Bd. Of Equal., Feb. 3, 1977, mod. March 2, 1977.) We do not believe that appellant has carried this burden. The only reason that the sales factor alone appeared in the numerator of the apportionment formula was because appellant's other divisions had no California property or payroll. As we have previously indicated, the denominator remained three. Had anything been included in the numerator for property or payroll, the effect would have been to increase the amount of income apportioned to California. There is nothing unique about appellant's business operations. Basically, it is a manufacturing and selling enterprise which is readily amenable to the standard three-factor apportionment formula. (See Appeal of Texaco, Inc., Cal. St. Bd. of Equal., Jan. 11, 1978.)

In accordance with the views expressed above, we conclude that respondent's action in this matter must be sustained.


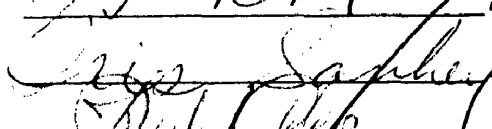
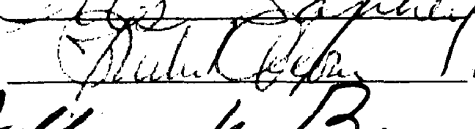
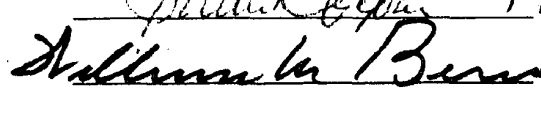
Appeal of Kelsey-Hayes Company

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 Kelsey-Hayes Company against **proposed assessments** of additional franchise tax in the amounts of **\$17,218.11 and \$24,914.61** for the income years ended August 31, 1968, and August 31, 1969, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 18th day of October, 1978, by the State Board of Equalization.

 , Chairman
 , Member
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_____, Member