



88-SBE-022

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
PINNIGAN CORPORATION) No. 85A-623-LB
)

Appearances:

For Appellant: Ronald B. Schrottenboer
Attorney at Law

For Respondent: Paul J. Petrozzi
Counsel

O P I N I O N

This appeal is made pursuant to section 25666¹/ of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Pinnigan Corporation against proposed assessments of additional franchise tax in the amounts of \$18,957 and \$14,537 for the income years 1977 and 1978, respectively. Appellant received refunds for 1976 and 1979 and would be entitled to larger refunds for those years if it prevails. The Franchise Tax Board has agreed to make the appropriate adjustments if necessary.

¹/ & less otherwise specified, all section references are to sections of the Revenue and Taxation Code as in effect for the income years in issue.

Appeal of Finnigan Corporation

The issue for determination is whether, in computing the sales factor of the apportionment formula, the Franchise **Tax Board (FTB)** properly applied the 'throw **back**' rule, thereby treating sales by appellant's wholly-owned subsidiary, Disc Instruments (Disc).. to customers located outside of California as California **sales.**^{2/}

Appellant, a California corporation, is engaged in a unitary business that manufactures and sells scientific instruments. Appellant conducts its unitary business through various subsidiaries, including Disc, in California, other states, and foreign countries.

During the appeal years Disc, also a California corporation, manufactured and sold a line of sophisticated scientific instruments somewhat different from those of appellant to customers inside and outside of California. Disc maintained its own sales staff and had its own customers. Disc was not taxable in any of those states outside of California into which it made sales although appellant, itself, was taxable in those states.

In computing the sales factor of the apportionment formula, sales of tangible personal property are ordinarily assigned to the state of the destination of the goods (the destination rule). (Rev. & Tax. Code, § 25135, subd. (a).) However, such sales are assigned, or "thrown back," to California if the property is shipped from this state and the "taxpayer is not taxable in the state of the purchaser" (the "throw back" rule). (Rev. & Tax. Code, § 25135, subd. (b).)

In computing the sales factor appellant treated Disc's out-of-state sales as non-California sales and applied the destination rule. In order for the destination rule to apply, it must be shown that the taxpayer is actually taxable in the state to which the goods were shipped, or the states to which the goods were shipped had 'jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact; the state does or does not.' (Rev. & Tax. Code, § 25122, subd. (b).) The FTB, however, determined that Disc could not show that it was taxable in those states even though appellant, itself, was taxable in those states. Therefore, the FTB concluded that the "throw back" rule was applicable and treated the sales as California sales, thereby including them in the numerator of the sales factor.

^{2/} A second issue, whether the Franchise Tax Board properly applied the "throw back" rule to sales made by appellant, itself, in foreign countries, has been conceded by appellant.-

Appeal of Finnigan Corporation

The FTB views this case as one simply involving the burden of proof: Appellant agrees that Disc Las not actually taxed in any of the states to which sales were made; therefore, appellant must show that Disc was subject to a net income tax in those states even though no such tax was imposed. Since appellant cannot satisfy its burden of-proof by making such a showing, the FTB concludes that it must prevail.

Although appellant makes several arguments in support of its position, we need to consider only one. Appellant argues that the FTB interprets the word "taxpayer" in the "throw back" rule (Rev. & Tax. Code, § 25135, subd. (b)(2)) differently than it does for all other applicable sections of the Uniform Division of Income For Tax Purposes Act (UDITPA). In effect, appellant argues that the FTB applies the "throw back" rule on a separate corporation basis by interpreting the word "taxpayer. in that context to mean each corporation considered separately, while interpreting "taxpayer" in all other UDITPA provisions to mean all corporations in the unitary group. Appellant's conclusion is that the "throw back" rule should also be applied on a combined group basis..

While we find appellant's argument somewhat **overbroad**, it is, **nevertheless**, persuasive.

The **FTB's** response to appellant's argument is that it is bound to follow the definition given in Revenue and Taxation Code **section 23037**:

Taxpayer means any person or bank subject to the tax imposed under [the Bank and Corporation Tax **Law**].

Section 23037 is one of several definitional statutes which are all prefaced by section 23030 which provides: **"Except where -the context otherwise requires,** the definitions given in this chapter [which **includes** section 23037) govern the construction of this part." (Emphasis added.) When exploring the thrust of the phrase **"[e]xcept where the context otherwise requires,"** it is instructive to consider the **FTB's** regulations under UDITPA.

Section 25121, subdivision (a)(1), of the **FTB's** regulations provides that **"[t]he word 'taxpayer' as used in these regulations is the same as defined in section 23037 and the regulations thereunder."** (Cal. Admin. Code, tit. 18, § 25121, subd. (a)(1).) However, the same regulation contains the following phrase: **"Any taxpayer subject to the taxing jurisdiction of this state:** (Cal. Admin. Code, tit. 18, § 25121, subd. (d).) This phrase strongly suggests that the word 'taxpayer. is used in, at least, two senses; one in which

Appeal of Finnigan Corporation

the "taxpayer" is taxable in California, and another in which the 'taxpayer. is not taxable in this state. An analysis of the various sections of UDITPA bears this out. Thus, it is apparent that the **FTB's** regulations have adopted the gloss of section 23030.

It is apparent that 'in all UDITPA provisions dealing with formula apportionment except section 25135, the FTB interprets the term "taxpayer" to mean all of the corporations within the combined unitary group. (See, e.g., Rev. & Tax. Code, §§ 25129, 25130, 25131, and 25134: see also § 25120, subd. (a).) Any other interpretation would violate basic unitary theory since. only separate corporations taxable by this state would be included within the **ambit** of the apportionment statutes. (See Edison California Stores, Inc. v. McColgan, 30 **Cal.2d** 472 [183 P.2d 161 (1947)].) On the other **hand**, those UDITPA statutes dealing with specific allocation tend to use the term "**taxpayer**" to mean the specific corporate entity in question. (See, e.g., Rev. & Tax. Code, §§ 25124-25129; see also Rev. & Tax. Code, § 25137 where "**taxpayer**" is used three times in three lines with two distinct meanings;) Thus, it is apparent that the term "**taxpayer**" as used in UDITPA is multifaceted.

It, therefore, remains for us to determine how the term is used in section 25135, subdivision (b)(2). We believe that basic unitary theory requires us to conclude that, as used in section 25135, subdivision (b)(2), "**taxpayer**" means all corporations within the combined unitary group. **To hold** otherwise would result in an apportionment formula which produced a different tax effect where the unitary business was conducted by the divisions of a single corporation than where it was conducted by multiple corporations. **No difference in** principle is discernible in the two situations. The California Supreme Court has told us that as far as unitary theory is concerned the same rule should apply whether the integral parts of the unitary business are or are not separately **incorporated**. (Edison California Stores, Inc. v. McColgan, supra, 30 **Cal.2d** at 473, 480.)

Accordingly, since appellant, a member of the unitary group, was taxable in the foreign states at issue, Disc's sales to those states were improperly thrown back to California. Therefore, the determination of the FTB on this issue must be reversed and its action modified.

