BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of	)	
	)	No. 87A-1175-PS
ROCKWELL INTERNATIONAL CORPORATION	)	
	)	

For Appellant: John S. Warren
Attorney at Law

For Respondent: Lazaro L. Bobiles
Counsel

O P I N I O N

This appeal is made pursuant to section 25666 1/ of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Rockwell International Corporation against proposed assessments of additional franchise tax in the amounts of $1,023,527.00 and $239,400.00 for the income years ended September 30, 1972, and September 30, 1973, respectively, and on the protest of Rockwell International Corporation, as successor in interest to Collins Radio Company, against proposed assessments of additional franchise tax in the amounts of $200.00, $70,447.07, and $23,251.89 for the income years ended July 31, 1972, July 31, 1973, and September 30, 1973, respectively.

1/ Unless 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 Rockwell International Corporation

Appellant Rockwell International Corporation (formerly North American Rockwell Corporation) is a large manufacturer of aerospace and electronic products. On July 22, 1971, appellant entered into a stock purchase agreement (agreement) with Collins Radio Company (Collins), a corporation engaged in the manufacture and sale of avionics (airborne communications and navigation equipment) and microwave relay systems. Under the agreement, appellant elected a majority of the board of directors of Collins, and obtained 40-percent voting power with respect to all matters submitted for shareholder approval.

On September 30, 1971, appellant acquired 350,000 shares of a new class of Collins $5 convertible preferred stock (convertible into 1,891,892 shares of a new class of common stock (Class A)) and warrants to purchase an additional 500,000 (first warrant) and 1,121,622 (special warrant) shares of Class A common stock. The conversion rights and first warrant (500,000 shares) were exercisable by appellant at any time, but the special warrant (1,121,622 shares) could only be exercised after the preferred stock was converted in full. Had appellant exercised all of the warrants it acquired, during the relevant years (income years ended September 30, 1972, and September 30, 1973), appellant would have owned approximately 54 percent of the total combined voting power of Collins' voting stock. Even though appellant owned only 40 percent of Collins' voting stock during the relevant years, appellant states that its control over Collins' board of directors gave it effective control over the affairs of Collins. In the latter part of 1971, two of appellant's officers became officers of Collins (one officer was made president and the other executive vice president, finance and administration).

Appellant filed its California franchise tax returns for the relevant years on a unitary basis, including the income and apportionment factors of Collins. Respondent Franchise Tax Board audited appellant's returns and concluded that there was no unity of ownership until November 14, 1973, the date Collins was merged into appellant, and therefore appellant could not file its returns on a unitary basis with Collins. Appellant's protest of respondent's action was denied and this timely appeal followed.

The single issue for resolution is whether there was "unity of ownership" between appellant and Collins so as to require respondent to accept appellant's combined reports for the years in question.

What we have here is a situation where appellant owned less than 50 percent of Collins' voting stock (40-percent ownership), but through a stock purchase agreement obtained the

right to elect, and did elect, a majority of the board of directors of Collins, which appellant believes gave it effective control of Collins. In its briefs, appellant argued that this matter is controlled by our decision in Appeal of Signal Oil and Gas Company, decided by this board on September 14, 1970, because this is a situation where controlling ownership existed in the absence of majority ownership, which appellant believes should satisfy the unity of ownership requirement for combined filing.

In Appeals of Envirocal, Inc., et al., decided by this board on November 15, 1988, however, we overruled our decision in Signal Oil and reiterated the standard we established in Appeal of Douglas Furniture of California, Inc., decided by this board on January 31, 1984, and Appeal of Revere Copper and Brass Incorporated, decided by this board on July 26, 1977, that unity of ownership cannot exist unless controlling ownership of all involved corporations is held by one individual or entity. Thus, even if appellant directly or indirectly controlled most or all of the business activities of Collins (appellant admits that it probably did not have control over all parts of Collins' business (App. Br. at 6)), appellant's argument fails because during the relevant years appellant did not own more than 50 percent of Collins' voting stock.

As we stated in Appeal of Douglas Furniture of California, Inc., supra, the Franchise Tax Board (FTB) for many years interpreted unity of ownership to require more than SO-percent ownership of a subsidiary corporation by a parent corporation. This FTB interpretation established a "bright-line" test for unity of ownership which is consistent with the standards established by the California Supreme Court in Butler Bros. v. McColgan, 17 Cal.2d 664, 667 [111 P.2d 334] (1941), affd., 315 U.S. 501 [86 L.Ed.991] (1942), and Edison California Stores, Inc. v. McColgan, 30 Cal.2d 472, 481 [183 P.2d 161 (1947).) (See also Appeal of Revere Copper and Brass Incorporated, supra.) In keeping with this longstanding interpretation of unity of ownership, the standard we reiterate today is that unity of ownership for purposes of section 25101[2/] requires majority ownership of all involved corporations by one individual or entity. (Appeal of The Tropicana Inn, Inc., Cal. St. Bd. of Equal., Mar. 4, 1986; Appeal of Douglas Furniture of California, Inc., supra; Appeal of Revere Copper and Brass Incorporated, supra.)

2/ During the relevant periods section 25101 provided in part that:

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Having decided that unity of ownership is not present in the instant matter, we could conclude our decision at this point. However, we are aware of a recent California appellate court decision, Hugo Neu-Proler Internat. Sales Corp. v. Franchise Tax Bd., 195 Cal.App.3d 326 [240 Cal.Rptr. 6351 (1987) which appears to take the view that the unitary concept arises from section 25102,3/ and which affirmed the trial court's finding that the statutory standard for unity of ownership in a multiple entity business is found in section 25105.4/ In allowing the taxpayer in Hugo Neu-Proler to invoke sections 25102 and 25105 against the FTB, the appellate court analogized section 25105 to section 482 of the Internal Revenue Code,5/ as interpreted in B. Forman Co., Inc. v.

2/ (continued)

> When the income of a taxpayer subject to the tax imposed under this part is derived from or attributable to sources both within and without the state the tax shall be measured by the net income derived from or attributable to sources within this state in accordance with the provisions of Article 2 (commencing with section 25120 ....

Section 25101, added by Statutes 1955, page 1649, in effect June 6, 1955, began as section 10 of the Bank and Corporation Franchise Tax Act of 1929 (Act), and was reenacted without change as section 24301 when the Act was repealed and reenacted in 1949 and amended on July 1, 1951, as the Bank and Corporation Tax Law. The language of section 25101 is substantially the same as section 10 of the Act, except for the reference to the apportionment formula contained in the Uniform Division of Income for Tax Purposes Act (UDITPA), section 25120, et seq. (See also fn. 8, supra.)

3/ During the relevant periods section 25102 provided that:

> In the case of two or more persons, as defined in section 19 of this code, owned or controlled directly or indirectly by the same interests, the Franchise Tax Board may permit or require the filing of a combined report and such other information as it deems necessary and is authorized to impose the tax due under this part as though the combined entire net income was that of one

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Commissioner, 453 F.2d 1144 (2d Cir. 1972), a case affirming the government's use of section 482 against the taxpayer.6/

In our view, the analysis in Hugo Neu-Proler is inconsistent with a number of previous California Supreme Court and court of appeal decisions, including Edison California Stores, Inc. v. McColgan, supra, Superior Oil Co. v. Franchise Tax Board, 60 Cal.2d 406 [34 Cal.Rptr. 545] (1963), and Handlery v. Franchise Tax Board, 26 Cal.App.3d 970 [103 Cal.Rptr. 465] (1972). Edison Stores stands for the proposition that the statutory provisions now contained in

3/ (continued)

> person, or to distribute, apportion, or allocate the gross income or deductions between or among such persons, if it determines that such consolidation, distribution, apportionment, or allocation is necessary in order to reflect the proper income of any such persons. (Emphasis added.)

4/ During the relevant periods section 25105 provided that:

> Direct or indirect ownership or control of more than 50 percent of the voting stock of the taxpayer shall constitute ownership or control for the purpose of this article.

5/ During the relevant periods IRC section 482 provided that:

> In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests. the Secretary-or-his delegate may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necesary in order to prevent evasion of taxes or clearly to reflect the income of any such organizations, trades, or businesses. (Emphasis added.)

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section 25101 are the authority for applying unitary apportionment principles to a multicorporate business. Superior Oil (and its companion case, Honolulu Oil Co. v. Franchise Tax Board, 60 Cal.2d 417 [34 Cal.Rptr. 552] (1963)) holds that taxpayers may rely on the statutory provisions of section 25101 to force the FTB to allow formula apportionment in appropriate cases. Handlery, on the other hand, holds that section 25102 confers no rights on a taxpayer to compel the FTB to accept a combined report: it merely authorizes the FTB, in its discretion, to permit or require such a report when it believes one is necessary to protect the state's revenue. (See also fn. 3, supra.)

In earlier appeals to this board, (see Appeal of Revere Copper and Brass, Incorporated, supra; Appeal of Douglas Furniture of California, Inc., supra; and Appeals of Envirocal, Inc., et al., supra), we discussed these cases at some length, along with the legislative history of section 25101 and of section 25102 and its related sections (section 24725 and IRC section 482). Although we will not repeat those discussions here, we will point out that section 25105, like section 25102, had its genesis in section 14 7/ of the Bank and Corporation Franchise Tax Act of 1929. Section 14 of the Act, as amended by Statutes 1943, page 189, provided that direct or indirect ownership or control of more than 50 percent of the voting stock of the bank or corporation shall constitute "ownership or control" for the purposes of that section. No mention was made of section 10 8/ of the Act, the predecessor of current

5/ (continued)
Section 24725 of the Revenue and Taxation Code is substantially similar to IRC section 482.

6/ That IRC section 482 cannot be used against the government is made plain by the federal regulations: "Section 482 grants no right to a controlled taxpayer to apply its provisions at will, nor does it grant any right to compel the district director to apply such provisions." (Treas. Reg. § 1.482-1(b)(3).)

7/ When enacted, section 14 provided that:

> In the case of two or more corporations or banks or of one or more banks and one or more corporations owned or controlled directly or indirectly by the same interests, the commissioner is authorized to

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section 25101.9/ When the Bank and Corporation Franchise Tax Act was repealed and reenacted as the Bank and Corporation Tax Law, (enacted Statutes 1949, effective, as amended, July 1, 19511, section 14 became sections 24303, 24303a, 24303b and 24303c, which in 1955 were adopted without change as sections 25102, 25103, 25104 and 25105, respectively.

We are persuaded by the legislative history of sections 25102 and 25105 that the definition of "ownership and

7/ (continued)

> distribute, apportion, or allocate gross income or deductions between or among such corporations or banks, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any such corporations or banks. (Emphasis added.)

Statutes 1951, page 279, in effect September 22, 1951, substituted "Franchise Tax Board" for "Commissioner".

8/ When enacted, section 10 provided in part that:

> If the entire business of the bank or corporation is done within this state, the tax shall be according to or measured by its entire net income; and if the entire business of such bank or corporation is not done within this state, the tax shall be according to or measured by that portion thereof which is derived from business done within this state. The portion of net income derived from business done within this state, shall be determined by an allocation upon the basis of sales, purchases, expenses of manufacturer, payroll, value and situs of tangible property, or by reference to these or other factors, or by such other method of allocation as is fairly calculated to assign to the state the portion of net income reasonably attributable to the business done within this state and to avoid subjecting the taxpayer to double taxation ....

9/ It is well settled that when a statute, although new in form, reenacts an older statute without substantial change, even

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control" contained in section 25105 applies to section 25102 and not to section 25101. Furthermore, we remain convinced that a taxpayer's "right" to file a combined report arises exclusively under section 25101, (see Container Corporation of America v. Franchise Tax Board, 117 Cal.App.3d 988, 994 [173 Cal.Rptr. 1211 (1981), affd., 463 U.S. 159 [77 L.Ed.2d 5451 (1983); Anaconda Company v. Franchise Tax Board, 130 Cal.App.3d 15, 24 [181 Cal.Rptr. 6401 (1982)), and that, for the reasons set forth in Appeal of Douglas Furniture of California, Inc., supra, the standard for unity of ownership under section 25101 is majority ownership of all involved corporations by a single individual or entity. Since we firmly believe that this view is well supported by longstanding decisions of California's highest courts, we intend to adhere to it until a different interpretation is mandated either by the California Supreme Court or by the overwhelming weight of published decisions by the courts of appeal.

Since appellant did not own more than 50 percent of Collins' voting stock during the relevant years, there was no unity of ownership, and appellant and Collins were not entitled to file a combined report without respondent's consent. Respondent's action must, therefore, be sustained.

9/ (continued)
though it repeals an older statute, the new statute is but a continuation of the old, and there is no break in continuous operation of the old statute and no abatement of any of the legal consequences of acts done under the old statute, and such rule applies especially to consolidation, revision or modification of statutes, whether the subject is civil or criminal law. (Sobey v. Molony, 40 Cal.App.2d 381 [104 P.2d 8681 (1940).)

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 Rockwell International Corporation against proposed assessments of additional franchise tax in the amounts of $1,023,527.00 and $239,400.00 for the income years ended September 30, 1972, and September 30, 1973, respectively, and on the protest of Rockwell International Corporation, as successor in interest to Collins Radio Company, against proposed assessments of additional franchise tax in the amounts of $200.00, $70,447.07, and $23,251.89 for the income years ended July 31, 1972, July 31, 1973, and September 30, 1973, be and the same is hereby sustained.

Done at Sacramento, California, this 27th day of November, 1990, by the State Board of Equalization, with Board Members Mr. Collis, Mr. Dronenburg, Mr. Bennett, and Mr. Davies present.

Conway H. Collis, Chairman

Ernest J. Dronenburg, Jr., Member

William M. Bennett, Member

John Davies* Member

_____, Member

*For Gray Davis, per Government Code section 7.9