



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
PRATT & WHITNEY COMPANY, INCORPORATED)

Appearances:

For Appellant: Valentine Brookes, Attorney at Law;
G. B. Ellis, Jr., Certified Public
Accountant

For Respondent: Crawford H. Thomas, Associate Tax Counsel

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O P I N I O N

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 Pratt & Whitney Company, Incorporated, to proposed assessments of additional franchise tax in the amounts of \$11,230.14, \$13,707.41 and \$5,363.37 for the income years 1952, 1953 and 1954, respectively.

Appellant is engaged principally in the business of manufacturing and selling machine tools, cutting tools and gages. All manufacturing is performed outside California. It has several branch sales offices including one in San Francisco.

Appellant's salesmen are technically trained. Each has a territory. The salesmen are paid commissions on all sales to customers in their territories. About two-thirds of the value of all sales are of special order items. The "specialness" of the special order sales ranges from a customer order for a style of gage carried in stock but of a nonstock size to an order for a giant machine designed and engineered to the customer's unique needs. All items sold on special order are shipped to the customer from outside California.

A special order sale has its beginning when the salesman makes one of his regular calls on a customer or when a customer asks him to call. The customer's engineers will state their needs to the salesman. The salesman will send the information to the headquarters office in Hartford, Connecticut. The design engineers in Hartford will then design the machinery and supply the specifications and price. The specifications will usually be checked by the Appellant's engineers in Hartford with the customer's engineers. There may be subsequent modifications before a definite purchase order is issued. Sometimes the customer will approach the headquarters office directly rather than deal through a salesman.

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Appellant's business is unitary in nature and Respondent therefore determined the income from California by applying an allocation formula composed of the factors of property, payroll and sales. Respondent has included as California sales in the sales factor of the formula 100% of the sales to California customers. Appellant contends that the activities of its design department in Hartford constitute sales activities which should be recognized in the sales factor. To accomplish this, Appellant suggests that only 50% of its sales to California customers be attributed to California for purposes of the sales factor.

Regulation 24301, Title 18, California Administrative Code, provides in part as follows:

The sales or gross receipts factor generally shall be apportioned in accordance with employee sales activity of the taxpayer within and without the State. This factor is computed on the basis of gross sales or receipts, less returns and allowances. The same rule applies to repeat or mail order sales resulting from prior employee solicitation. Sales which are made through brokers or factors shall be explained in detail in schedules attached to the return. Promotional activities of an employee are given some weight in the sales factor.

In Appeal of Avco Manufacturing Corporation, Cal. St. Bd. of Equal., Dec. 16, 1955 (2 CCH Cal. Tax Cas., Par. 201-438), (2 P-H State & Local Tax Serv., Cal., Par. 13,214), we said:

The purpose of the sales factor in the allocation formula has been described by eminent authorities as being to serve as a balance against the other factors of property and payroll and to give recognition to the efforts of the taxpayer in obtaining customers and markets.

In order to give effect to the purpose of the sales factor and to make feasible its use as a distinct factor the selling activities which are taken into consideration must be a relatively restricted group of activities and cannot include everything which might conceivably influence the making of a sale. Appellant does not have a product to sell until the design department has designed it and priced it. These functions undoubtedly influence sales. The activities of the design department, however, are reflected in the payroll factor and, together with the manufacturing plants which are reflected in

