

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
HOUSEHOLD FINANCE CORPORATION)

Appearances:

For Appellant: Burl D. Lack
Attorney at Law

For Respondent: Joseph W. Kegler
Counsel

OPINION

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 Household Finance Corporation against proposed assessments of additional franchise tax in the amounts of \$3,308.40, \$14,597.36, \$6,100.13, \$21,974.13, \$5,500.94, \$17,605.76, \$429.73, \$1,008.75, \$376.85, \$8,150.03, \$4,193.90, \$27,514.45, \$5,815.94 and \$28,459.74 for the taxable years 1956, 1957, 1957, 1958, 1958, 1959, 1960, 1961, 1961, 1962, 1962, 1963, 1963 and 1964, respectively, and pursuant to section 26077 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claims of Household Finance Corporation for refund of franchise tax in the amounts of \$32,000.00, \$33,000.00, \$35,000.00, \$25,000.00 and \$75,000.00 for the taxable years 1957, 1958, 1959, 1963 and 1964, respectively.

Appellant is a Delaware corporation engaged in the small loan business in various states and Canada. During the years 1951 and 1952, it conducted this business through 427 branch offices, 33 of which were in California. In subsequent years appellant expanded its business through the creation of new branch offices and subsidiary corporations. The business activity of a subsidiary was substantially the same as that of a branch office, At the end

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of 1963 appellant was operating through 1,300 branch offices and 485 subsidiaries. Ninety-five of the subsidiaries were doing business in California. Appellant consistently used the separate accounting method in computing the California franchise tax liability of the various branches and subsidiaries located in this state. In December of 1964 the District Court of Appeal decided Household Finance Corp. v. Franchise Tax Board, 230 Cal. App. 2d 926 [41 Cal. Rptr. 5653]. The court there held that appellant's entire operations during the years 1951 and 1952 constituted a unitary business, and consequently appellant's California income should be determined by formula allocation rather than separate accounting.

Consistent with the above court decision, respondent has determined that appellant's business operations, through branch offices and subsidiaries, continued to be unitary during the period 1956 through 1964. After computing the portion of the unitary business net income attributable to California for the above years, respondent further allocated this amount among appellant and each subsidiary doing business in this state. Where appropriate, the commencing corporation provisions of the Revenue and Taxation Code were applied to the subsidiaries. Respondent determined the financial corporation offset separately for each corporation, limiting its use to the franchise tax paid by the corporation which generated the offset, i.e., the corporation which was assessed and which paid the various taxes and fees specified in section 23184 of the Revenue and Taxation Code. In computing the deficiency assessments resulting from the above determinations, respondent computed interest from the date prescribed for the payment of each taxable year's first installment of franchise tax.

Appellant objects to the application of the commencing corporation provisions to the subsidiary corporations which were doing business in California. Both parties to this appeal have submitted information concerning the subsidiaries' initial activities in this state. The information will be presented hereinafter as part of the discussion of this issue.

Appellant objects to the limitation of the use of a financial corporation offset to the franchise tax liability of the corporation which generated the offset. Rather, appellant contends that once a group of corporations is determined to comprise a unitary business, the offsets of the entire group should be added together and subtracted from its total California franchise tax liability.

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Appellant objects to the computation of interest on the deficiencies from the date prescribed for the payment of each taxable year's first installment of franchise tax. Appellant argues that the interest on a deficient second installment of franchise tax should be computed from its own payment due date.

Appellant's three objections raise the sole issues of this case. They will be discussed in the order presented above.

I. Application of the Commencing Corporation Provisions to the Subsidiary Corporations.

Generally, the corporation franchise tax for a certain year is measured by the taxpayer's net income during the preceding year. (See Rev. & Tax. Code, §23183.) However, the franchise tax of a corporation commencing business in California is computed under sections 23221 through 23226 of the Revenue and Taxation Code until that taxpayer has a preceding year of 12 months. The net effect of the application of these commencing corporation provisions is generally that the net income of the taxpayer's first 12-month year is used twice as a measure of franchise tax liability.

In the instant situation appellant first contends that the commencing subsidiaries were not yet a part of the unitary business and evidently did not become a part of it until the commencing corporation provisions were fulfilled. Appellant argues that consequently the subsidiaries' separate accounting must be used to compute their franchise tax liability under the commencing corporation provisions.

Commonly owned corporations are engaged in a unitary business if the operation of the portion of the business within the state is dependent upon or contributes to the operation of the business without the state. (Edison California Stores, Inc, v. McColgan, 30 Cal. 2d 472 [183 P.2d 16]; Appeal of Joyce, Inc., Cal. St. Bd. of Equal., Nov. 23, 1966.) Applying this general principle to the instant situation the issue is whether the subsidiaries, during the time when their franchise tax liability was being computed under the commencing corporation provisions, were dependent upon or contributed to the operation of the unitary business. Respondent's determination that these subsidiaries were part of the unitary business from the time they commenced business in this state is presumptively correct.

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(Appeal of John Deere Plow Co. of Moline, Cal. St. Bd. of Equal., Dec. 13, 1961; Appeal of Dohrmann Commercial Co., Cal. St. Bd. of Equal., Feb. 29, 1956.) Appellant has the burden of overcoming this presumption.

Respondent has stated that each subsidiary from the time it commenced business in California put to immediate use unitary business procedures, assets and benefits such as loan procedures, central accounting procedures, operating manuals, trained personnel, funds from appellant, central purchasing and national advertising, and good will from appellant's name. Respondent has also stated that 19 of the subsidiaries which were doing business in California had time lags of from 6 months to 7 years between their dates of incorporation and their dates of commencing business in this state. Respondent argues that these time lags indicate advance planning by appellant for proper and immediate integration of the subsidiaries into the unitary business.

Appellant's only evidence relating to this contention is that 16 of these corporations had first taxable years of $2\frac{1}{2}$ months or less, and 22 others had first taxable years varying from 3 to 5 months. It is argued that these short years indicate the inappropriateness and inequity of including these corporations in the unitary business. Appellant has not contended that above fact statements made by respondent are erroneous. Under the circumstances we do not think that appellant has carried its burden. Therefore respondent's determination that the subsidiaries were part of the unitary business from the time they commenced business in this state must be upheld.

Appellant next argues that the theory of the commencing corporation provisions is based upon a recognition of the separate entities of the new corporations, and contends that once a business is determined to be unitary, the separate corporate existence of the subsidiaries should be disregarded and the business taxed as one entity. Under this line of reasoning the commencing corporation provisions would only have application when the business first commenced in corporate form in this state. In appellant's situation, therefore, these provisions would already have been satisfied, as Household Finance Corporation fulfilled them when it commenced business here .

Appellant's contention is inconsistent with the concept of a unitary business and the consequent formula allocation of unitary income. The function of this concept is not to disregard the various taxable entities involved

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and combine them as one unit. (Edison California Stores, Inc. v. McColgan, 30 Cal. 2d 472 [183 P.2d 167, Appeal of Max Factor & Co., Cal. St. Bd. of Equal., Apr. 24, 1967.) Rather its function is merely to ascertain the true income of the business attributable to sources within California.. (Edison California Stores, Inc. v. McColgan, supra.) When two or more corporate entities each conduct a portion of the unitary business in this state, their separate entities are respected and a further allocation is made among them to determine the true income of each.' (Appeal of Joyce, Inc., Cal. St. Bd. of Equal., Nov. 23, 1966; See Altman and Keesling, Allocation of Income in State Taxation (2d ed. 1950) p. 176-7.) This board has upheld the intrastate allocation of the California portion of a business' unitary income in various situations. In each of these, such allocation had a significant effect upon the amount or burden of franchise tax liability. (See Appeals of Kaiser-Frazer Sales Corp. and Kaiser Motors Corp., Cal. St. Bd. of Equal., Nov. 7, 1958; Appeal of Joyce, Inc., supra; Oakland Aircraft Engine Service, Inc., Cal. St. Bd. of Equal., Oct. 5, 1965.) Therefore, we can find no merit in appellant's contention that application of the commencing corporation provisions to its subsidiaries is inconsistent with the concept of a unitary business.

Appellant next seems to contend that section 25102 Of the Revenue and Taxation Code and its applicable regulation, regulation 24303-24304, title 18, California Administrative Code, provide authority for Household Finance Corporation and its subsidiaries to submit a combined report for discretionary acceptance or rejection by the Franchise Tax Board. This contention is based upon the, assumption that such a report would limit application of the commencing corporation provisions to the commencement of the unitary business itself in this state, as suggested in appellant's immediately preceding contention. We do not reach the question of the accuracy of this assumption because in Appeals of Pacific Coast Properties, Inc., et al., decided this day, we held that section 25102 does not authorize corporations to submit a combined report. Rather, the Franchise Tax Board is given discretionary authority to permit the submission of a combined report if one is offered, or to require such a submission, if the board determines that a combined report is necessary in order to reflect the proper income of the corporations. A taxpayer cannot compel the Franchise Tax Board to act; that is, to permit or require submission of a combined report. If the board does not act, then under section 25102 there is no reviewable exercise of discretion.

Alternatively, appellant suggests a method of filing analogous to the option given affiliated railroad

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corporations under sections 23361 through 23364-a of the Revenue and Taxation Code. These sections allow the specified type of corporate group to file a consolidated return. However, new corporations file separately until the commencing corporation provisions are fulfilled. We can find no authority for such treatment of appellant and its subsidiaries. Affiliated railroad corporations enjoy a special privilege under sections 23361 through 23364a which is not available to other types of corporations.

We conclude that appellant's California subsidiaries were part of the unitary business from the time they commenced business in this state, and that they were subject to the commencing corporation provisions of the Revenue and Taxation Code. The application of these provisions is not in conflict with the concept of a unitary business, and appellant's suggested methods for the filing of a combined or consolidated return are without authority in the instant situation. Appellant made a voluntary decision to use subsidiary corporations in the expansion of its business. Doubtless this was done in order to obtain the various legal benefits which accompany the corporate form. Appellant must also bear the concomitant tax disadvantages which resulted from this decision. (Moline Properties, Inc. v. Commissioner, 319 U.S. 436 [87 L. Ed. 1499]; Burnet v. Commonwealth Improvement Co., 287 U.S. 415 [77 L. Ed. 399].)

II. Limitation of the Financial Corporation Offset.

Section 23184 allows financial corporations to offset against the franchise tax the amounts paid to the state or its political subdivisions as certain specified taxes and fees, including personal property taxes and personal property broker license fees. In some instances a corporation's offset may be larger than its franchise tax liability. Consequently the excess of the offset will be unused.

Appellant first contends, as it did above, that once a business is determined to be unitary, the separate corporate existence of the subsidiaries should be disregarded and the business taxed as one entity. Consequently appellant argues that the total financial corporation offsets of the business should be subtracted from its total franchise tax liability. We have already answered this contention in part I of this opinion. The argument has no more merit in regard to the financial corporation offset than it did with reference to the commencing corporation provisions.

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Appellant next contends that the financial corporation offsets are part of the unitary net income computation. Thus, like deductions, the offsets should be totaled and subtracted from unitary income. However, this argument misconstrues the mechanics of the offset. It is not a deduction; rather it is an offset against franchise tax. The offset is applied only after a portion of the unitary income has been allocated to California, this amount has been further allocated among the corporations doing business in this state, and the franchise tax of the entity generating the offset has been computed.

We conclude that respondent was correct in limiting the use of each financial corporation offset to the corporation which generated it.

III. Date of Interest Computation.

Section 25901b of the Revenue and Taxation Code provides:

Interest upon the amount determined as a deficiency shall be assessed, collected and paid in the same manner as the tax at the rate of 6 percent per year from the date prescribed for the payment of the tax or, if the tax is paid in installments, from the date prescribed for the payment of the first installment, until the date the tax is paid.... (Emphasis' added.)

Appellant and its subsidiaries are financial corporations and as such pay their franchise tax in two installments. (Rev. & Tax. Code, §§25552, 25552a.) The assessments involved in the instant appeal are deficiency assessments issued by respondent under section 25662 of the above code. For each of the years in question, respondent has computed the interest due on the deficiencies from the date prescribed for the payment of the first installment.

Appellant contends that interest on the amounts which were deficient from each taxable year's second installment should be computed from the due date of that installment. Appellant argues that this computation is a more equitable method, and is supported by the Franchise Tax Board's Legal Ruling 253, October 30, 1959. However Legal Ruling 253, supra, is distinguishable from the instant issue. The ruling held that when there was a delinquent payment of the second installment of franchise tax by a financial corporation, interest on the delinquent amount should be computed from the due date of that installment. This

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holding is not in conflict with section 25901b which is only operative when there is an "amount determined as a deficiency." The instant issue involves deficiencies, not delinquent amounts.

We conclude that section 25901b directly and unambiguously covers the present situation and, accordingly, that respondent's computation was correct.

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 Household Finance Corporation against proposed assessments of additional franchise tax in the amounts of \$3,308.40, \$14,597.36, \$6,198.43, \$21,974.12, \$5,580.94, \$17,700.00, \$12,439.73, \$1,008.75, \$376.85, \$8,150.03, \$4,193.90, \$27,514.45, \$5,815.94 and \$28,459.74 for the taxable years 1956, 1957, 1957, 1958, 1958, 1959, 1960, 1961, 1961, 1962, 1962, 1963, 1963 and 1964, respectively, and pursuant to section 26077 of the Revenue and Taxation Code that the action of the Franchise Tax Board in denying the claims of Household Finance Corporation for refund of franchise tax in the amounts of \$32,000.00, \$33,000.00, \$35,000.00, \$25,000.00 and \$75,000.00 for the taxable years 1957, 1958, 1959, 1963 and 1964, respectively, be and the same are hereby sustained.

Done at Sacramento, California, this 20th day of November, 1968, by the State Board of Equalization.

, Chairman
 , Member
 , Member
 , Member
_____, Member

ATTEST: , Secretary