

Anneal of Universal C.I.T. Credit Corporation

The question presented is whether the Franchise Tax Board has properly used the average notes receivable balance of California debtors as the numerator of the property factor for purposes of the formula used to apportion the unitary net income of the taxpayer-creditors within and without California.

Universal C.I.T. Credit Corporation (hereinafter referred to as appellant) is one of more than fifty subsidiaries of C.I.T. Financial Corporation, a Delaware corporation which does not do business in California. During the years involved in this appeal, appellant and a number of its sister corporations were engaged in a single unitary finance business conducted within and without California, Appellant and respondent have agreed on all aspects of applying the unitary business principle to the group's lending operations, except for the manner of computing the numerator of the property factor of appellant, C.I.T. Corporation (hereinafter referred to as CIT), and Universal C.I.T. Finance Corporation (hereinafter referred to as Finance). Although all of the corporations comprising the unitary group are California taxpayers, the additional assessments here in issue were billed under appellant's name as a matter of convenience.

The business of the unitary companies consists of making secured loans to various types of debtors. These loans are funded exclusively by the borrowings, outside of California, of the parent company, C.I.T. Financial Corporation; the financial subsidiaries themselves are not permitted to borrow money to finance their own operations. Appellant, CIT, and Finance do business in California through small branch and division offices. The operation of these offices is controlled from New York, where the corporate headquarters of the parent company are located. All major decision-making authority is centered in New York, and all advertising and payroll functions are handled there.

Generally speaking, the local branch and division offices make loans pursuant to policies and procedures established in New York governing interest rate charges, criteria for credit reviews, and the general terms and forms of the debt contracts. In a typical transaction occurring in California, a local office will check the credit of a prospective

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borrower and, depending on the amount involved, accept or reject the transaction on its own authority or seek credit approval from the home office. Once a loan is approved, funds are usually advanced to the debtor by a check drawn on the California bank account of the local office involved. The only exception to this procedure consists of the loans made by CIT after mid-1964. Those loans were all made by drafts on funds located in a New York bank.

Normally, the local office keeps copies of the contract, note, and supporting documents arising from a particular transaction but forwards the originals of all these documents to a central location, where they are retained during the life of the debt. In the case of the California offices of both appellant and Finance, this central repository is a Regional Accounting Department (RAD) in Salt Lake City, Utah. CIT's local offices send all their original paper to CIT's home office in New York. The RAD or the home office, as the case may be, reviews and audits the documents and sets up a "notes and accounts receivable" ledger card for each debtor. In connection with appellant's financing of retail installment sales of motor vehicles, the RAD also prepares a coupon payment book for the debtor's use and sends it to him directly, along with his copy of the transaction.

A debtor who has borrowed money from a California office of one of the three unitary companies makes his installment payments directly to that office. The funds are deposited initially in the California bank account of the local office, but, at the end of each business day, any bank balance in excess of a stipulated maximum balance is forwarded to the home offices in New York. As each debtor's payment is received, the local office records it in its own records and then notifies the RAD or home office, which also records the payment on the debtor's "notes and accounts receivable" ledger card. When the RAD or home office receives notification of a debtor's final payment, it verifies full payment of the account and computes the amount of any refund which may be due to the debtor because of prepayment. The original contract documents, marked paid, are then sent to the appropriate local office (along with any refund check) for mailing to the debtor. Should it happen, as it only rarely does, that the debtor defaults and collection proceedings become

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necessary, the local office is responsible for taking the appropriate legal action.

In addition to the activities already described, the RAD or home office performs the following account-service functions:

- (1) Preparation of frequent, periodic accounting and performance reports;
- (2) Preparation of condition reports on the delinquency of accounts receivable; and
- (3) Preparation of appropriate forms, operating manuals, and instructions for use by branch and division offices.

In applying the unitary principle to the financial subsidiaries of C.I.T. Financial Corporation, respondent computed the amount of unitary net income attributable to California by using a three-factor formula composed of interest collected, payroll, and average outstanding balance of accounts receivable. The application of this formula to interstate finance businesses has been repeatedly upheld in this state (see Appeal of Tri-State Livestock Credit Corporation, Cal. St. Bd. of Equal., April 4 1960; Appeal of Beneficial Finance Co. of Alameda and Affiliates, June 6, 1961; Appeal of Interstate Finance Co., Aug. 9, 1961; Household Finance Corp. v. Franchise Tax Board, 230 Cal. App. 2d 926 [41 Cal. Rptr. 565]), and the taxpayers do not challenge it in this case. They do, however, object to respondent's determination that the numerator of the accounts receivable factor should consist of the receivables acquired by the three taxpayers through their California offices.

The taxpayers contend that the accounts receivable factor devised by respondent arbitrarily apportions to California more unitary income than is justified by their activities in California. The theory is that the receivables generated in California should not be assigned to this state for factor purposes because they had a business situs elsewhere. Respondent denies that the receivables had a business situs outside California, and it argues that they were properly attributed to California since the primary and most significant contacts between the taxpayers and their California customers, with respect to the acquisition of

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the receivables and the collection of the income therefrom, occur within this state.

The Franchise Tax Board has been given broad discretion to devise a formula for the apportionment of unitary income. (El Dorado Oil Works v. McColgan, 34 Cal. 2d 731 [215 P.2d 4], appeal dismissed, 340 U.S. 801 [95 L. Ed. 589]; Pacific Fruit Express Co. v. McColgan, 67 Cal. App. 2d 93 [153 P.2d 607].) Where, as here, a taxpayer contends that the formula selected is arbitrary and produces an unreasonable result, he must prove it by clear and convincing evidence. (Butler Bros. v. McColgan, 17 Cal. 2d 664 [111 P.2d 334]; aff'd, 315 U.S. 501 [86 L. Ed. 991]; McDonnell Douglas Corp. v. Franchise Tax Board, 69 Cal. 2d 506 [72 Cal. Rptr. 465, 446 P.2d 313].) In our opinion, the evidence produced by the taxpayers falls well short of meeting that standard.

The taxpayers' principal argument, that the receivables originated in California had a business situs outside this state, is not supported by the facts in the record or by any authority that has been cited. Indeed, insofar as we can determine, the receivables in question did not clearly have a business situs anywhere under any of the generally recognized methods of acquiring such situs. For example, the receivables were not pledged to secure funds to conduct the unitary business, although the original loan documents were held in central locations so that they could have been used for that purpose. The unitary business was financed entirely by the unsecured borrowings of the parent corporation.

In addition to contending that the receivables had a business situs outside California, the taxpayers also argue that the receivables had insufficient connections with California to justify putting all of them in the numerator of the factor. To support this contention, the taxpayers rely primarily on cases suggesting that California could not properly levy an ad valorem property tax on these receivables. We believe that the answer to this argument is provided by Montgomery Ward & Co. v. Franchise Tax Board, 6 Cal. App. 3d 149 [85 Cal. Rptr. 890], appeal dismissed, 400 U.S. 913 [27 L. Ed. 2d 152]. In disposing of a question concerning the tangible property factor of the standard apportionment formula, the court there held that

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property assigned to California for factor purposes need not have situs in California for ad valorem property tax purposes because the factor does not attempt to tax property. Rather, like the other formula factors, it merely seeks to measure the portion of the taxpayers' business emanating from California. (Id., 6 Cal. App. 3d at 156.) Although the appeal now before us involves intangible rather than tangible property, we believe the same principles apply to both types of property.

Finally, the taxpayers say that exclusion of the California receivables from the numerator of the factor is compelled by our decisions in Appeal of Interstate Finance Co., decided August 9, 1961, and Appeal of Tri-State Livestock Credit Corporation, decided April 4, 1960. In Interstate we held that all of the appellant's installment obligations not sold to a bank were assignable to California for factor purposes because the taxpayer had its commercial domicile in this state and the intangibles had not acquired a business situs elsewhere. In Tri-State we held that all of the appellant's loans were assignable to California because they were serviced here and because the debt instruments were pledged to a bank here in order to obtain funds to make further loans. Since the facts now before us are allegedly the opposite of the facts in those cases, the taxpayers contend that the result here should be the opposite.

Neither case requires the result urged by the taxpayers. The fact that all of the taxpayers' receivables could not be attributed to California under the decisions in Interstate and Tri-State does not mean that none of them can. The instant appeal raises the question of which intangibles can be included in the numerator of the receivables factor when the intangibles have not been pledged in California and when the commercial domiciles of the taxpayers are not in California. Neither Interstate nor Tri-State involved that issue; consequently, neither case controls our decision in this appeal.

The controlling question is the general one of whether the formula respondent has applied is, arbitrary or produces an unreasonable result. On this record, we cannot say that the formula is defective in either respect. It seems eminently reasonable to us for the receivables generated through the taxpayers' California offices to be assigned to this state for purposes of the receivables factor. The

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receivables were acquired here and the income from them was collected here. It is true that the loan solicitation and income-collecting activities carried on in California are already reflected to some extent in the payroll and interest factors, but that in itself does not mean that putting the California receivables in the numerator of the third factor impermissibly overloads the formula in favor of California. The out-of-California activities, which the taxpayers contend are underrepresented in the formula, are reflected in the payroll factor. We cannot find the receivables factor here to be arbitrary or unreasonable when it has the practical effect of measuring the amount of the taxpayers' loan capital which is deployed in California.

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 26077 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claims of Universal C.I.T. Credit Corporation for refund of franchise tax in the amounts of \$14,449.07 and \$3,901.14 for the income years 1956 and 1966, respectively, and pursuant to section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Universal C.I.T. Credit Corporation against proposed assessments of additional franchise tax in the amounts and for the years as follows:

<u>Income Year</u>	<u>Taxable Year</u>	<u>Proposed Assessments</u>
1957	1958	\$ 60,446.77
1958	1959	16,935.70
1959	1959	236.34
1959	1960	42,966.15
1960	1961	60,130.42
1961	1962	128,053.69
1962	1963	158,387.58
1963	1964	86,348.90
1964	1965	66,040.83
1965	1966	11,084.93

be and the same are hereby sustained.

