



BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )  
JOY WORLD CORPORATION )

For Appellant: James H. Sakoda  
Attorney at Law

For Respondent: John R. Akin  
Counsel

O P I N I O N

This appeal is made pursuant to section 25666 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Joy World Corporation against proposed assessments of additional franchise tax in the amounts of \$19,006.00, \$15,176.00, and \$18,540.00 for the income years 1973, 1974, and 1975, respectively.

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Appellant, a California corporation, is a wholly-owned subsidiary of Toyoshima & Company, Limited, a Japanese corporation. During the income years in issue, appellant was principally involved in the purchase of raw cotton in this country, Mexico, and Guatemala for subsequent export to Japan and other Asian nations; approximately 90 percent of the cotton it purchased was later sold to **its parent**. In addition to this business activity, appellant was also involved in the import and export of certain items of recreational equipment. The principal activity of appellant's parent consisted of the import, export, manufacture, and distribution of textiles.

In the latter part of 1977; respondent audited appellant's returns for the income years in issue. While it did not receive all of the information requested during the course of this audit, respondent was, nevertheless, able to determine from the available data that appellant, its parent, and the latter's other subsidiaries (hereinafter collectively referred to as "the affiliated group") constituted a single unitary business. Respondent also concluded, on the basis of the available information, that the gain derived from the sale of certain of the affiliated group's securities and fixed assets constituted business income subject to apportionment by formula under California's combined reporting procedures. The amount of such gain for the first two of the three income years on appeal was determined by reference to **financial statements** supplied by appellant. Respondent estimated the gain from such sales for the 1975 income year **when appellant failed to provide the data needed to precisely ascertain that amount. Notices of proposed assessment were subsequently issued reflecting respondent's determination of appellant's increased franchise tax liability.**

Appellant protested respondent's proposed assessments and, in the protest proceedings which ensued, **provided** additional information pertaining to the unitary character of the affiliated group. Despite repeated requests that it do so, however, appellant failed to furnish additional data regarding the nature of the income realized from the affiliated group's aforementioned **sales of securities and fixed assets**. After consideration of appellant's protest, respondent adjusted its previous determinations of appellant's increased tax liability and issued the subject assessments, thereby resulting in this appeal.

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Appellant has not challenged respondent's determination that the affiliated group is engaged in a single unitary business. Accordingly, the central issue presented by this appeal is whether appellant has established as erroneous respondent's determination that the gain realized by the affiliated group from the sale of the previously mentioned securities and fixed assets constituted apportionable business income.

The Uniform Division of Income for Tax Purposes Act (UDITPA) was adopted by California, effective for years beginning after December 31, 1966. (Rev. & Tax. Code, §§ 25120-25139.) Section 25120 of the Revenue and Taxation Code defines the terms "business income" and "nonbusiness income" as follows:

(a) "Business income" means income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.

\* \* \*

(d) "Nonbusiness income" means all income other than business income.

Respondent's regulation interpreting the above quoted section provides, in pertinent part:

Section 25120 defines "business income" as income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations. In essence, all income which arises from the conduct of trade or business operations of a taxpayer is business income. For purposes of administration of Sections 25120 to 25139 inclusive, the income of the taxpayer is business income unless clearly classifiable as nonbusiness income.

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. . . [T]he critical element in determining whether income is "business income" or "non-business income" is the identification of the transactions and activity which are the elements of a particular trade or business.

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Gain or loss from the sale, exchange or other disposition of real or tangible or intangible personal property constitutes business income if the property while owned by the taxpayer was used in the taxpayer's trade or business. However, if such property was utilized for the production of nonbusiness income or otherwise was removed from the property factor before its sale, exchange or other disposition, the gain or loss will constitute nonbusiness income. (Cal. Admin. Code, tit. 18, reg. 25120, subds. (a) and (c)(2) (Art. 2.5).) (Emphasis added.)

The relevant inquiry presented here is, therefore, a factual one, i.e., whether the income under consideration arose in the course of the affiliated group's regular trade or business. (See Appeal of General Dynamics Corporation, Cal; St. Bd. of Equal., June 3, 1975.)

Appellant maintains that the gain from the affiliated group's sale of the relevant securities and fixed assets constituted nonbusiness income under Revenue and Taxation Code section 25120 and the regulations promulgated pursuant thereto. Specifically, appellant asserts that those securities and fixed assets were held for investment and were not used in, or incidental to, the affiliated group's trade or business. Furthermore, appellant claims that income earned from the sale of securities and fixed assets for investment constitutes nonbusiness income under Japanese accounting principles.

It is well established that a presumption of correctness attends respondent's determinations as to issues of fact and that appellant has the burden of proving such determinations erroneous. (See, e.g., Todd v. McColgan, 89 Cal.App.2d 509 [201 P.2d 414] (1949); Appeal of Robert L. Webber, Cal. St. Bd. of Equal., Oct. 6, 1976; Appeal of the Diners' Club, Inc., Cal. St. Bd. of Equal., Sept. 1, 1967.) In a previous appeal in which an identical issue was presented for our determination, we specifically held that the taxpayer had the

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burden of establishing the facts necessary to support its position that certain income was derived from an event extraneous to its unitary business. (Appeal of Universal Services, Inc., of Texas, Cal. St. Bd. of Equal., Feb. 8, 1966.) To overcome the presumed correctness of respondent's findings as to the relevant factual issue presented here, appellant must introduce credible evidence to support its assertions. If we find that it has failed to do so, respondent's action in this matter must be upheld. (W. M. Buchanan, 20 B.T.A. 210 (1930); Appeal of James C. and Monablanche A. Walshe, Cal. St. Bd. of Equal., Oct. 0, 1975.)

In the instant appeal, appellant has completely failed to offer any evidence as to the relevant issue. Instead, it has limited itself to unsupported assertions as to the ultimate factual question presented here, namely, that the affiliated group's sale of the subject securities and fixed assets was unrelated, or incidental to, its regular trade or business. As noted above, assertions of this nature are not sufficient to overcome the presumption of correctness arising from respondent's determination. Furthermore, we find as irrelevant appellant's assertion that the income under discussion constitutes nonbusiness income under Japanese accounting principles. For purposes of this appeal, the nature of the subject income is to be ascertained pursuant to the statutory and regulatory authority cited above.

We also believe that respondent's estimation of the affiliated group's gain from the sale of such securities and fixed assets for the 1975 income year by reference to financial data supplied by appellant for the previous two years was reasonable. Appellant failed to provide the relevant information despite respondent's repeated requests that it do so. When a taxpayer refuses to cooperate in the ascertainment of its income, respondent may use reasonable estimates to establish that income. (See, e.g., Joseph F. Giddio, 54 T.C. 1530 (1970); Norman Thomas, 80,359 P-H Memo. T.C. (1980).) In the absence of appellant's records, respondent was statutorily authorized to compute the amount of such gain apportionable to appellant by whatever method would, in its judgment, clearly reflect that income. (Rev. & Tax. Code, § 24651, subd. (b).) Since it has failed to provide any evidence establishing that respondent's determination in this regard was excessive or without foundation, we must conclude that appellant has also failed to carry its burden of proof as to this issue.

For the reasons set forth above, respondent's action in this matter will be sustained.

