

Appeal of Photo-Marker Corporation
of California

Organized in 1966, Photo-Marker Corporation of California (hereinafter "appellant") is a California corporation engaged in the business of selling paper; machinery, and color analysis services to manufacturers in the garment industry. Its stock is wholly owned by Photo-Marker Corporation Located in New York. The parents corporation has two subsidiaries in Florida and Texas as well as a New York affiliate involved in international operations.

The chairman of the board of directors for Photo-Marker Corporation is Leon M. Stern who also performs the duties of chief executive officer for that company. The treasurer and chief financial officer of the parent company is Walter Witrock. During the income years under review, Mr. Stern and Mr. Witrock were apparently officers or employees of appellant corporation. The record does not reflect what their positions or duties were with the California subsidiary. We observe, however, that Mr. Witrock is appellant's current president and that appellant does not contest the treatment of the two officers as employees of appellant. Both officers filed California resident personal income tax returns for all three income years under appeal.

On its franchise tax returns for said income years, appellant reported its income on a separate accounting basis. After conducting an audit, the Franchise Tax Board determined that appellant was part of a single unitary business with its parent company and three other subsidiaries. Consequently, respondent redetermined appellant's California income by formula apportionment of the combined incomes of all of the Photo-Marker entities and then issued the proposed assessments of additional tax in October 1981. Following respondent's denial of its protest against the deficiency assessments, appellant filed a timely appeal with this board.

First, in its initial appeal letter, appellant objected to the combination of its income and the application of formula apportionment procedures to the resultant combined report. When the income of a taxpayer is derived from sources both within and without this state, its franchise tax liability will be measured by its net income derived from or attributable to sources within this state.. (Rev. & Tax. Code, § 25101.) If the taxpayer is engaged in a single unitary business with affiliated corporations, the income attributable to California sources must be determined by applying-an

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apportionment formula to the total income derived from the combined unitary operations of the affiliated companies. (Edison California Stores, Inc. v. McColgan, 30 Cal.2d 472 [183 P.2d 16] (1947).)

Respondent's determination that appellant is engaged in a single unitary business with its parent and other affiliated companies is presumptively correct, and the burden is on appellant to show that the determination is erroneous. (Appeal of John Deere Plow Co. of Moline, Cal. St. Bd. of Equal., Dec. 13, 1961; Appeal of Kikkoman International, Inc., Cal. St. Bd. of Equal., June 29, 1982.) Appellant must prove by a preponderance of the evidence that, in the aggregate, the unitary connections relied on by respondent are so lacking in substance as to compel the conclusion that a single integrated economic enterprise did not exist. (Appeal of Saga Corporation, Cal. St. Bd. of Equal., June 29, 1982.) Here, appellant has implicitly disputed the finding of unity but subsequently failed to present any evidence on this issue. Its unsupported statements simply denying respondent's finding of a unitary business are insufficient to overcome the presumption of correctness attached to respondent's determination. (Appeal of New Home Sewing Machine Company, Cal. St. Bd. of Equal., Aug. 17, 1982; Appeal of Shachihata, Inc., U.S.A., Cal. St. Bd. of Equal., Jan. 9, 1979.)

Second, at the hearing on this matter, appellant argued that, if the determination of unity was upheld, then in the alternative, it contested the correctness of respondent's computation of its payroll factor. Specifically, appellant asserted that the salaries of Mr. Stern and Mr. Witrock were improperly attributable to this state.

Since appellant was engaged in a single unitary business, it was subject to the apportionment and allocation provisions of the Uniform Division of Income for Tax Purposes Act (UDITPA), found in sections 25120 through 25139, in determining its income attributable to and taxable by California. (Rev. & Tax. Code, § 25101; Cal. Admin. Code, tit. 18, reg. 25101, subd. (f).) Under UDITPA, a taxpayer's income attributable to this state is determined by multiplying its business income by a fraction (commonly called the apportionment formula), the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three. (Rev. & Tax. Code, § 25128.) The property, payroll, and sales factors are fractions, the

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denominators or' which are composed ,of the taxpayer's worldwide property values, payroll, and sales, respectively, and the numerators of which are composed of the taxpayer's California property values, payroll, and sales, respectively. (Rev. & Tax. Code, §§ 25129, 25132, 25134.)

Respondent's regulation further explains that section 25133 sets forth five tests, each of which must be passed before compensation is considered not paid in California:

Compensation is paid in this state if any one of the following tests, applied consecutively, are met:

(1) The employee's service is performed entirely within the state.

(2) The employee's service is performed both within and without the state, but the service performed without the state is incidental to the employee's service within the state. The word "incidental" means any service which is temporary or transitory in nature, or which is rendered in connection with an isolated transaction.

(3) If the employee's services are performed both within and without: this state, the employee's compensation will be attributed to this state::

(A) if the employee's base of operations is in this state; or

(B) if there is no base of operations in any state in which some part of the service is performed, but the place from which the service is directed or controlled is in this state; or

(C) if the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed but the employee's residence is in this state.

The term "base of operations" is the place of more or less permanent nature from which the employee starts his work and to which he

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customarily returns in order to receive instructions from the taxpayer or communications from his customers or other persons or to replenish stock or other materials, repair equipment, or perform any other functions necessary to the exercise of his trade or profession at some other point or points. The term "place from which the service is directed or controlled" refers to the place from which the power to direct or control is exercised by the taxpayer.

(Cal, Admin. Code, tit. 18, reg. 25133.)

In the present matter, appellant contends that Messrs. Stern and Witrock performed services in New York as well as California. As directors and officers of the parent company, appellant argues that their executive duties in New York were more important and permanent than their jobs in California. Even though they might have spent more time in this state during the appeal years, appellant notes that the officers frequently travelled to New York. Because its California subsidiary operations were small in **comparison to** those of the parent company, appellant adds that the base of operations for these two officers was logically in New York, the site of corporate headquarters. **Moreover**, appellant takes the position that the parent company always controlled and directed the services of the two officers inasmuch as they were elected by its board of directors to their positions and **answerable** to said board under their employment contracts. Appellant thus concludes that salaries of the two officers were not paid in this state but in New York and excludable from the numerator of its payroll factor. We cannot agree for the following **reasons**.

Applying the first test under regulation 25133, subdivision (1), **we note that** the Franchise Tax Board concedes that the two officers conducted business in both California and New York and thus there is no dispute that they performed services not entirely within this state. Respondent argues though that the second test under subdivision (2) does **apply because** the small amount of time spent in New York by the officers shows that the services performed there for the parent company were incidental to their corporate duties in California. In our view, however, the services provided by Messrs. Stern and Witrock to Photo-Marker Corporation in New York cannot have been merely temporary or transitory in nature if rendered in connection with their ongoing and

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permanent positions as directors and officer; for the parent company. Respondent has so much as stated that it "does not question the importance of the duties performed in New York." (Resp. Br. at 4.)

Whereas it is clear that these officers' services were furnished both within and without California, the third test under regulation 25133, subdivision (3)(A), states that their compensation will be considered to have been paid here if their base of operations was in this state. Appellant has contended that the base of operations for Messrs. Stern and Witrock during the appeal period was not in California, but we believe that the record supports a finding that it was. even though the corporate headquarters of the parent company may have been in New York, appellant has revealed that the parent company had plans during the appeal period to establish manufacturing operations in this state and to relocate its headquarters to this state. Appellant has admitted that Mr. Stern moved to California to supervise development of the new manufacturing facilities and he returned to New York after the appeal period in 1980 when the company dropped its relocation plans. In Mr. Witrock's case, based on his current title, we must assume that he was permanently assigned to manage the California subsidiary. Appellant has not provided any evidence to otherwise explain his long-term presence here. While both officers had continuing responsibilities to oversee the affairs of the New York parent company, they were able to discharge these obligations by making short-term, albeit regular, business trips to New York to attend meetings and prepare periodic reports. In other words, it appears from the record that the base of operations for both officers during the income years in question was located in California. Respondent's determination that the executive compensation for these officers was paid in this state will be sustained.--/

2/ Since we have found that the base of operations for these employees was in this state, it is not necessary to discuss the applicability of the remaining two compensation tests under regulation 25133, subdivision (3).

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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 Photo-Marker Corporation of California against proposed assessments of additional franchise tax in the amounts of \$3,577, \$8,513, and \$14,246 for the income years ended June 30, 1977, June 30, 1978, and June 30, 1979, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 19th day Of November, 1986, by the State Board of Equalization, with Board Members Mr. Nevins, Mr. Collis, Mr. Bennett, Mr. Dronenburg and Mr. Harvey present.

<u>Richard Nevins</u>	, Chairman
<u>Conway H. Collis</u>	, Member
<u>William M. Bennett</u>	, Member
<u>Ernest J. Dronenburg, Jr.</u>	, Member
<u>Walter Harvey*</u>	, Member

*For Kenneth Cory, per Government Code section 7.9