



BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of }  
SIGNAL COMPANIES, INC. } No. 85A-203-MW

For Appellant: B. David Freundlich  
Vice President - Taxes

Pierre H. Canu  
Tax Counsel

For Respondent: Brian W. Toman  
Counsel

O P I N I O N

This appeal is made pursuant to section 25666<sup>1/</sup> of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Signal. Companies, Inc., against proposed assessments of additional franchise tax in the amounts of \$252,546, \$1,137,868, \$235,905, and \$125,820 for the income years 1970, 1971, 1972, and 1973, respectively.

1/ Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as in effect for the income years in issue.

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Two questions are presented by this appeal: 1) Whether the Franchise Tax Board's (FTB) method of computing appellant's California taxable income was proper; and 2) whether the basis of Space Petroleum, Inc. (Space), a wholly owned foreign subsidiary of appellant, should have been adjusted to reflect income allocated from Space to appellant.

Appellant's unitary group filed their franchise tax returns on the basis of a combined report and formula apportionment. Appellant incurred nonbusiness losses which were apparently used to offset some of the unitary group's combined business income. Although it is not explicitly stated in the record, appellant apparently computed the total business income of the group attributable to California and the total nonbusiness income or loss specifically allocable to California, netted these two totals, and figured the total California tax for all the corporations doing business in California on the basis of this net figure. Appellant reported and paid the total California tax for the group. The FTB recomputed appellant's income for each of the appeal years as follows:

1. Appellant's unitary group business income was recomputed under the provisions of Sections 25120 et seq.
2. Each California taxpayer's apportionment percentage was calculated based on their respective factors of property, payroll and sales within this state and everywhere.
3. Each California taxpayer's share of the unitary group business income attributable to California sources was calculated by multiplying each California taxpayer's California apportionment percentage by the unitary group business income (intrastate apportionment of income).
4. Each California taxpayer's non-business income and losses were computed and added to each California taxpayer's business income attributable to California sources.

(Resp. Br. at 1-2.)

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The FTB's recomputation offset appellant's individual nonbusiness loss attributable to California against appellant's individual apportioned California business income, resulting in negative taxable income for appellant individually because its nonbusiness losses exceeded its apportioned business income. Thus, the unitary group lost the tax benefits of offsetting appellant's nonbusiness losses against the unitary group's combined apportionable business income.

Section 25101 provides, in relevant part,

When the income of a taxpayer subject to the tax imposed under this part is derived from or attributable to sources both within and without the state the tax shall be measured by the net income derived from or attributable to sources within this state in accordance with the provisions of Article 2 (commencing with Section 25120)....

Appellant states that it is not arguing that business and nonbusiness income or loss should be added together before applying the apportionment formula, its argument is that section 25101 "imposes California tax on the 'net income' of a combined group derived from or attributable to California" (App. Reply Br. at 3) and that "'net income' means the total of apportioned business income or loss and allocated non-business income or loss of the combined group." (App. Reply Br. at 4.)

Appellant is correct in asserting that net income is to be used in computing the tax and that net income encompasses both business and nonbusiness income or loss. What appellant overlooks is that it is the taxpayer's net income, including the taxpayer's business and nonbusiness income or loss, upon which the tax computation is based. It is the individual corporate entity which is the taxpayer, not the unitary group.

Appellant's argument appears to turn on the theory that all of the corporations engaged in a unitary business are combined as one unit for purposes of taxation. Appellant is mistaken. The various taxable entities involved are not disregarded. "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 Household

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Finance Corporation, Cal. st. Bd. of Equal., Nov. 20, 1968.)

The requirement of net income, including business and nonbusiness income or Loss, and the unitary business concept are both fully **respected** by the method used by the FTB. The **business** income of the unitary **group** is combined and **then** apportioned to each taxpayer by formula. **T**hen the nonbusiness income or loss of each taxpayer is added to **the** apportioned business income of the taxpayer, resulting **in** a net income figure. **T**he tax is then computed for each taxpayer on the basis of this net income figure. **T**hus, each taxpayer pays tax on its fair share of the **business** income, which is generated by the operations of the unitary business as a whole, and on its own nonbusiness income, which is not connected with the unitary business, but arises out of the activities of **the** individual corporate entity. Therefore, **the** FTB properly computed appellant's tax for the appeal years.

The second issue, regarding the FTB's refusal to adjust appellant's basis in Space, is identical to the issue raised in the Appeal of Signal Companies, Inc. (Signal I), for income-years 1963 through 1968, decided this day. In that appeal, we reversed the action of the FTB. On the basis of the opinion in Signal I, we must decide **this issue** adversely to **the** FTB in the **present** appeal.

For the reasons stated above, we conclude that the action of the FTB must be reversed with **regard to** the basis adjustment issue and sustained with regard to the **method of computing** appellant's tax liability.

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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 Signal Companies, Inc., against *proposed* assessments of additional franchise tax in the amounts of \$252,546, ~~\$1,137,863~~, \$235,905, and \$125,820 for the income years 1970, 1971, 1972, and 1973, respectively, be modified in accordance with the foregoing opinion.

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>	, <b>Member</b>
<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