



87-SBE-069

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
OSCAR ENTERPRISES, L.T.D.) No. 86R-1118-DB

For Appellant: Duncan MacCorkindale
Laventhol & Horwath

For Respondent: Paul J. Petrozzi
Counsel

O P I N I O N

This appeal is made pursuant to section 26075, subdivision (a),¹ of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claim of Oscar Enterprises, L.T.D., for refund of franchise tax in the amount of \$4,107.66 for the income year ended May 31, 1985.

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

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The question presented is whether respondent properly applied a two-factor apportionment formula to apportion appellant's income.

Appellant is a United Kingdom corporation which does business in both the United Kingdom and California. It is conceded that appellant conducted a single unitary business within and without California during the year in question. In its franchise tax return for that year, appellant apportioned its net income by means of the standard, three-factor **apportionment formula**, using a sales factor of 83.19 percent, a payroll factor of 100 percent, and a property factor of 0 percent. Upon inquiring into the reason why appellant reported a zero property factor, respondent learned that appellant did not own or rent any real or tangible personal property anywhere, either within or without California. **Consequently**, respondent excluded the property factor entirely from the apportionment formula and required appellant to apportion its income on the basis of the average of its sales and payroll factors.

The general rule for apportioning a **multijurisdictional** taxpayer's income is contained in section 25128, which provides for the use of a formula which apportions income on the basis of the arithmetic average of the taxpayer's property, payroll, and sales in California, as compared to its property, payroll, and sales everywhere. Section 25137 provides, **however**, that, if the standard allocation and apportionment **rules** do not fairly represent the extent of the taxpayer's business activity in California, the taxpayer **may** request or the Franchise Tax Board may require the use of some other equitable method of apportionment, including the exclusion of any one or more of the normal apportionment factors. In the present **case**, respondent invoked this statutory authority and excluded the property factor from the standard formula.

Respondent acknowledges that it bears the burden of proving that the normal statutory apportionment provisions do not fairly reflect appellant's activities in this state and that the use of section **25137's** special relief provisions is, therefore, permissible. (Appeal of Donald M. Drake Company, Cal. St. Bd. of Equal., Feb. 3, 1977; Appeal of New York Football Giants, Inc., Cal. St. Bd. of Equal., Feb. 3, 1977.) In respondent's view, its burden is met because, as a matter of law, the use of a formula factor which does not reflect the taxpayer's economic activity in California seriously distorts the

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apportionment of the taxpayer's income. We agree. Using a zero property factor in the formula has the effect of reducing the amount of income apportioned to California, based upon the assumption that the taxpayer uses all of its property outside of California to help generate income from its out-of-state business activities. That assumption is **manifestly** false in this **case**. Here, the taxpayer has no tangible property anywhere which is used in the production of its income. Under such circumstances, the property factor cannot possibly aid in the determination of how much of the taxpayer's income is earned in California and in each of the other taxing jurisdictions in which it conducts its business. A fair representation of the taxpayer's business activities in this state requires the use of factors which are causally related to the production of the taxpayer's income (see State of Georgia v. Coca Cola Bottling Co., 212 Ga. 630 [94 S.E.2d 7081 (1956)], and section 25137 plainly authorizes the exclusion of a standard formula factor, where that factor has no tendency in reason to reflect the taxpayer's business activities in California and elsewhere. (See also Appeal of Putnam Fund Distributors, Inc., et al., Cal. St. Bd. of Equal., Dec. 6, 1977 (exclusion of property factor).)

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

