BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
) 85A-623-DB
FINNIGAN CORPORATION)

Appearances:

For Appellant: Ronald B. Schrotenboer
Attorney at Law

For Respondent: Paul Petrozzi
Counsel

Prentiss Wilson, Jr., and Walter Hellerstein, Attorneys at Law, filed an amicus letter brief urging that the Joyce case be overruled.

OPINION ON PETITION FOR REHEARING

On August 25, 1988, we modified the action of the Franchise Tax Board on the protest of Finnigan Corporation against proposed assessments of additional franchise tax in the amounts of $18,957 and $14,537 for the income years 1977 and 1978, respectively. On September 13, 1988, respondent filed a timely petition for rehearing pursuant to section 25667 of the Revenue and Taxation Code.

The question presented in this appeal is whether respondent Franchise Tax Board, for purposes of calculating the sales factor of the apportionment formula, properly applied the "throw-back" rule to the non-California-destination sales made by appellant's unitary subsidiary, Disc Instruments (Disc). In our original decision, we held that these sales should not be thrown back to California even though Disc, as a separate corporate entity, was not taxable in those states, since

another member of the unitary group - namely, appellant - was taxable in the states into which Disc's sales were made.

Respondent's assessments against appellant were based, in substantial part at least, on the decision in the Appeal of Joyce, Inc., decided by this board on November 23, 1966. That case involved a multicorporate unitary business two of whose members had income *from* California sales but only one of which was subject to tax in California. The other was insulated from California's taxing jurisdiction because of. Public Law No. 86-272. Joyce held that Public Law No. 86-272 prohibited respondent from apportioning all of the unitary group's California-source income to the corporation taxable in California, and required that the portion of that income attributable to the exempt corporation's activities (sales) in California had to be computed and then excluded from the measure of the franchise tax.

Controversial almost from its inception, the Joyce case in recent years has been the subject of particularly pointed scholarly criticism. (See J. Hellerstein and W. Hellerstein, 1988 Cumulative Supplement to J. Hellerstein, State Taxation I: Corporate Income and Franchise Taxes (1983), ¶ 9.17 [1][b][iii]; Corrigan, "Finnigan's Wake or Joyce's? The Application of the Unitary Principle to Combined Groups," 1 J. Cal. Tax. 5(1989).) To those well versed in unitary matters, Joyce undeniably contravenes fundamental unitary theory in two important respects. First, by forbidding the assignment of sales to the state of destination in situations where at least one member of the unitary group is taxable in that state, but the actual seller is not, the Joyce rule defeats the basic purpose of the sales factor, which is to reflect the markets for the unitary business's goods and. services. (See Altman and Keesling, Allocation of Income in State Taxation (2d ed. 1950), pp. 126-128; Appeals of Pacific Telephone and Telegraph Company, Cal. St. Bd. of Equal., Hay 4, 1978.) Second, by focusing on the state's jurisdiction to tax the seller as a separate corporate entity, the rule elevates form over substance by yielding a different apportionment result dependent solely on whether the unitary business is conducted by several corporations or only by one. The teaching of Edison California Stores v. McColgan, 30 Cal.2d 472 [183 P.2d 161 (1947), however, is that application of the unitary concept does not depend on the number of corporations which make up the business, at least in the absence of some compelling, consideration requiring a difference in treatment.

Clearly, when the board decided Joyce in 1966, it believed that Public Law No. 86-272 constituted that sort of compelling consideration. This was not an unreasonable position to take at that time. The federal statute had been enacted only a few years earlier, in 1959, and the exact scope of its limitations on states' powers to tax interstate businesses was far from clear. Evidently, the board believed that the courts were likely to take a dim view of a state tax administrative policy that, while not directly contrary to the federal statute, might be regarded as an attempt to evade it. For that reason, the board refused to sanction a method of apportionment which assigned all of the unitary group's California-source income to the only member of the group taxable in California, when some of that income was clearly attributable to the California activities carried on by an affiliate exempted from California's franchise tax by Public Law No. 86-272.

In our original opinion in the present case, Joyce was not overruled because, strictly speaking, it involved a different set of facts and a different problem. There is little question, however, that our decision in this case is analytically and philosophically incompatible with Joyce. We are also inclined to agree with those who have argued that leaving Joyce untouched creates undesirable uncertainty for taxpayers and respondent alike. While any appellate body should hesitate to overturn a longstanding precedent, there unquestionably are situations where reason, common sense, and the integrity of a body of law require such action. This is one of those cases. Joyce established an unsound rule of apportionment out of fear that the courts would give an expansive interpretation to Public Law No. 86-272 and thereby seriously restrict the application of unitary apportionment principles to multicorporate businesses. Intervening years have shown, however, that this fear was unfounded. Just as significantly, they have also shown that the unitary concept has become firmly established in the courts, especially in the U.S. Supreme Court, and that a state has considerable latitude in selecting a method of fairly apportioning the income of a unitary business. (Container Corp. v. Franchise Tax Bd., 463 U.S. 159, 169-171 [77 L.Ed.2d 545] (1983).) Based on all of these considerations, we have concluded that the apportionment rule announced in Joyce should be overruled.

In reaching this result, we wish to emphasize that it is only an apportionment rule which has been changed. Notwithstanding the repeated protestations of respondent's counsel to the contrary, nothing we have said in this case alters or affects in any way the existing rules concerning a state's jurisdiction to tax a particular corporation.

Our original decision in this case was correctly decided. Respondent's petition will, therefore, be denied.

ORDER

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 2566.7 .of the Revenue and Taxation Code, that the petition of the Franchise Tax Board for rehearing of the appeal of Finnigan Corporation from the action of the Franchise Tax Board on its protest against proposed assessments of additional franchise tax in the amounts of $18,957 and $14,537 for the income years 1977 and 1978, respectively, be and the same is hereby denied, and that our order of August 25, 1988, be and the same is hereby affirmed.

Done at Sacramento, California, this 24th day of January, 1990, by the State Board o-f Equalization, with Board Members Mr. Collis, Mr. Carpenter, and Mr. Davies present.

Conway H. Collis, Chairman

Paul Carpenter, Member

John Davies*, **, Member

_____, Member

_____, Member

*Abstained

**For Gray Davis, per Government Code section 7.9