BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of	)	
	)	No. 87N-1645-PS
THE NUTRASWEET COMPANY	)	

For Appellant: W.J. Novello
Assistant Treasurer

For Respondent: A. Kent Summers
Counsel

O P I N I O N

This appeal is made pursuant to section 25666[1/] of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of The NutraSweet Company against proposed assessments of additional franchise tax in the amounts of $8,468 and $16,823 for the income years 1974 and 1976, respectively, and pursuant to section 26075, subdivision (a), from the action of the Franchise Tax Board in denying the claims of The NutraSweet Company for refund of franchise tax in the amounts of $51,853.55, $52,935.35, $44,877.27, and $41,299.67, for the income years 1974, 1975, 1976, and 1977, 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.

The question presented in this case is whether the California-destination sales made by appellant's wholly owned unitary subsidiary operating in the Commonwealth of Puerto Rico are attributable to California for purposes of computing the sales factor of the apportionment formula for appellant's unitary corporate group.

During the years in issue, appellant The NutraSweet Company (formerly G. D. Searle & Co.) and a number of its subsidiaries were engaged in a world-wide unitary business involving the invention, development, manufacture, marketing, and sale of ethical and proprietary pharmaceutical products. Part of this business was conducted in California. Appellant's wholly owned subsidiary, Searle & Co. (SCO), had its principal place of business in Caguas, Puerto Rico, and was engaged in the manufacture and sale of ethical pharmaceutical products. In 1970, appellant and SCO entered into a marketing and sales agreement (agreement), which provided in part that appellant would provide marketing and sales promotion services such as sales administration, professional education, market promotion planning, and advertising on behalf of SCO in the United States and elsewhere. To perform its obligations under the agreement, appellant maintained a marketing, sales administration, and customer-service staff in Skokie, Illinois, as well as a field sales force operating throughout the United States.

Appellant's principal method of marketing SCO's products was the direct contact, or "detailing," method: sales representatives called on health-care professionals to discuss or give details about the products and to urge them to either prescribe, recommend, or utilize the products. During 1974 and 1975, approximately 97 percent of SCO's sales were to independent drug wholesalers, who were also customers of appellant. All orders for SCO products were on SCO's order forms, filled from SCO's inventory in Puerto Rico, and shipped by SCO via air carrier directly to the customer which placed the order. SCO customers were billed directly by SCO and were directed to render payment to SCO in Puerto Rico. For its marketing services, appellant was paid the greater of 25 percent of SCO's net sales in the United States, or appellant's cost of performance.

For the income years 1974 through 1977, appellant filed combined reports which treated SCO's sales from Puerto Rico to this state as California sales for purposes of the unitary group's sales factor. Appellant subsequently concluded that SCO was protected from taxation by virtue of Public Law No. 86-272, and filed amended returns which treated SCO's sales from Puerto Rico to this state as non-California sales for sales factor purposes. The amended returns resulted in refund claims. Respondent audited appellant's tax returns and refund claims and concluded that the California-destination sales from Puerto Rico were properly attributable to California. Respondent, therefore, denied appellant's refund claims and affirmed the proposed additional assessments set forth above. Appellant then filed this timely appeal.

Appellant's position in this case is based on our decision in the Appeal of Joyce, Inc., which was decided by this board on November 23, 1966, but overruled, with respect to the issue now before us, on January 24, 1990, by our Opinion on Petition for Rehearing in the Appeal of Finnigan Corporation, 88-SBE-022-A. In Joyce, we had held that California-destination sales made by a member of a unitary corporate group, another of whose members was taxable in California, could not be attributed to California for sales factor purposes because the seller itself was exempt from taxation in

California by virtue of Public Law No. 86-272. Our opinion in Finnigan overturned this apportionment rule in a case involving a different, but closely related, issue. We there held that non-California-destination sales made by a California corporation should be attributed to the destination states, rather than "thrown back" to California, for sales factor purposes, since a unitary affiliate of the seller was taxable in all of those states even though the seller itself was not. The case now before us presents the same issue and fact pattern that appeared in Joyce (assuming, without deciding, that SCO is protected from taxation in California by Public Law No. 86-272). Since Joyce was overruled in Finnigan, it is obvious that appellant's position in this appeal must be rejected.

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

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 The NutraSweet Company against proposed assessments of additional franchise tax in the amounts of $8,468 and $16,823 for the income years 1974 and 1976, respectively, and, pursuant to section 26077, that the action of the Franchise Tax Board in denying the claims of The NutraSweet Company for refund of franchise tax in the amounts of $51,853.55, $52,935.35, $44,877.27, and $41,299.67 for the income years 1974, 1975, 1976, and 1977, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 29th day of October, 1992, by the State Board of Equalization, with Board Members Mr. Sherman, Mr. Dronenburg, Mr. Fong, and Ms. Scott present.

Brad Sherman, Chairman

Ernest J. Dronenburg, Jr., Member

Matthew K. Fong, Member

Windie Scott*, Member

_____, Member

*For Gray Davis,per Government Code section 7.9

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