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1. *1982 Cal. Tax LEXIS 222*

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1982 Cal. Tax LEXIS 222

State Board of Equalization of the State of California

June 29, 1982

Reporter
1982 Cal. Tax LEXIS 222 *

In the Matter *of* the *Appeal of DRESSER* INDUSTRIES, INC.

Core Terms

pump, foreign country, net income tax, subsidiary, foreign commerce, do business, franchise tax, interstate, shipment, throw

Counsel

For Appellant: Frank M. Keesling, Attorney at Law

For Respondent: Bruce W. Walker, Chief Counsel

Kendall Kinyon, Counsel

Panel: Before the State Board *of* Equalization

Opinion By: Per Curiam

Opinion

OPINION

This ***appeal*** is made pursuant to section 26075, subdivision (a), ***of*** the Revenue and Taxation Code from the action ***of*** the Franchise Tax Board in denying the claims ***of Dresser*** Industries, Inc., for refund ***of*** franchise tax in the amounts ***of*** $346.23, $11,715.37, $12,549.52, and $5,929.68 for the income years ended October 31, 1968, 1969, 1970, and 1971, respectively.

The question presented is whether, in computing the sales factor ***of*** appellant's apportionment formula, respondent properly applied the "throw-back" rule to various sales ***of*** products which were manufactured in California and sold and shipped to customers located in foreign countries.

Appellant and its subsidiaries are engaged in a multinational unitary business which is one ***of*** the world's leading suppliers ***of*** high technology products and services to energy, natural resources, and industrial markets. Through its Pacific Pumps Division, appellant operates a plant in Huntington Park, California, which manufactures process, turbo, and boiler-feed **[*2]** pumps. During the years in question, some ***of*** these pumps were sold by appellant in foreign countries in which it did business, and some were sold in other foreign countries by appellant's wholly owned sales subsidiaries operating on a commission basis. Appellant's agreements with these subsidiaries provided that they would act as the exclusive sales representative for appellant's products in their respective territories, but the record does not reveal whether these corporations also acted as sales representatives for other principals. All export sales ***of*** pumps, whether made directly by appellant or through its sales subsidiaries, were consummated by the direct shipment ***of*** pumps from California to the foreign customers.

Respondent's application ***of*** the "throw back" rule in this case involves three different factual situations:

1. Appellant did business and filed income tax returns in some foreign jurisdictions. The "throw back" rule has not been applied to the sales ***of*** pumps to custmers in these jurisdictions.

2. In certain other countries where appellant itself did not do business, one or the other ***of*** its sales subsidiaries did do business in those countries, and had substantial **[*3]** payroll and property investments there. In addition to soliciting orders, the subsidiaries delivered pumps, serviced them, made repairs, and engaged in other activities in connection with the sale ***of*** pumps and other products manufactured by appellant. Respondent has applied the "throw back" rule to pump shipments to these countries, on the grounds that appellant itself was not subject to income tax in these countries under United States jurisdictional standards.

3. In still other countries where appellant did not do business, one or more ***of*** appellant's unitary nonsales subsidiaries actively did business, but the activities ***of*** the sales subsidiaries were limited to the taking ***of*** orders by salesmen, and these orders were filled by the shipment ***of*** pumps from California. These pump sales have likewise been "thrown back" to California, on the theory that if P.L. 86-272 were applicable to foreign commerce, these countries would not have jurisdiction to tax appellant's income.

As a result ***of*** the application ***of*** the "throw back" rule to the second and third situations described above, respondent increased the numerator ***of*** appellant's sales factor by the amount ***of*** pump sales "thrown **[*4]** back" to California, causing a greater shareof appellant's unitary business income to be apportioned to California. Appellant paid the additional tax resulting from respondent's action, filed timely claims for refund, and has ***appealed*** from respondent's denial ***of*** its claims.

A taxpayer who derives income from sources both within and without California is required to measure its franchise tax liability by its net income derived from or attributable to California sources in accordance with the Uniform Division ***of*** Income for Tax Purposes Act (UDITPA) contained in *Revenue and Taxation Code sections 25120-25139*. (*Rev. & Tax. Code, § 25101*.) As required by section 25128, a taxpayer's business income must be apportioned to this state by means ***of*** an equally-weighted three-factor formula composed ***of*** the property factor, the payroll factor, and the sales factor.

Section 25134 defines the sales factor as "a fraction, the numerator ***of*** which is the total sales ***of*** the taxpayer in this state during the income year, and the denominator ***of*** which is the total sales ***of*** the taxpayer everywhere during the income year." For purposes ***of*** determining whether sales ***of*** tangible personal property are in **[*5]** this state, section 25135 sets forth the following rules:

Sales ***of*** tangible personal property are in this state if:

(a) The property is delivered or shipped to a purchaser, other than the United States government, within this state regardless ***of*** the f.o.b. point or other conditions ***of*** the sale; or

(b) The property is shipped from an office, store, warehouse, factory, or other place ***of*** storage in this state and (1) the purchaser is the United States government or (2) the taxpayer is not taxable in the state ***of*** the purchaser. (Emphasis added.)

The underscored language in subdivision (b) contains the "throw back" rule whose application is at issue in this case. Respondent has invoked the rule on the theory that appellant itself was not "taxable in the state[s] ***of*** the purchaser[s]" ***of*** its pumps. It appears that respondent's only reason for reaching this conclusion is its view that uniformity in the interpretation ***of*** UDITPA's statutes and regulations requires the application ***of*** P.L. 86-272's jurisdictional limitations to the taxation ***of*** income from both interstate and foreign commerce. At least, that is the only argument respondent has offered in defense ***of*** its determination **[*6]** in this case. Thus, if we conclude that P.L. 86-272 need not be considered in determining whether appellant was taxable in the foreign countries in question, respondent's action cannot be sustained.

UDITPA defines the term "state" to include not only a state ***of*** the United States but also any foreign country. (*Rev. & Tax. Code, § 25120*, subd. (f).) For purposes ***of*** allocating and apportioning income under UDITPA, a taxpayer is "taxable" in another "state" if

(a) in that state it is subject to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege ***of*** doing business, or a corporate stock tax, or (b) that state has jurisdiction to subject the taxpayer to a net income tax regardless ***of*** whether, in fact, the state does or does not. (*Rev. & Tax. Code, § 25122*.) (Emphasis added.)

Since appellant does not contend that it was actually subject to any ***of*** these taxes in the foreign countries in question, our sole concern is whether any ***of*** those countries had jurisdiction to subject appellant to a net income tax.

For the years in question, respondent's regulation 25122, subdivision (c), sets forth the following rules for detemining jurisdiction **[*7]** to tax net incoem:

The second test in Section 25122(b) applies if the taxpayer's business activities are sufficient to give the state jurisdiction to impose a net income tax under the Constitution and statutes ***of*** the United States. Jurisdiction to tax is not present where the state is prohibited from imposing the tax by reason ***of*** the provisions ***of*** Public Law 86-272, *15 U.S.C.A. §§ 381*-385. In the case ***of*** any "state," as defined in Section 25120 (f), other than a state ***of*** the United States or political subdivision ***of*** such state, the determination ***of*** whether such "state" has jurisdiction to subject the taxpayer to a net income tax shall be made as though the jurisdictional standards applicable to a state ***of*** the United States applied in that state… (Cal. Admin. Code, tit. 18, reg. 25122, subd. (c) (art.2).)

Both parties agree that United States jurisdictional standards should be used to determine whether a foreign country has jurisdiction to tax the appellant." (Contra, *Scott & Williams, Inc. v. Bd. **of** Taxation, 372 A.2d 1305 (N.H. 1977).)* They disagree, however, on whether P.L. 86-272 has any application to the facts ***of*** this case. Appellant argues that it does not, **[*8]** because P.L. 86-272 does not apply to foreign commerce. Although respondent recognizes that the Congress limited the immunity ***of*** P.L. 86-272 to interstate commerce, * it contends that subdivision (c) ***of*** regulation 25122 requires not only that the same uniform standards be applied to determine both a sister state's and a foreign country's jurisdiction to tax, but also that the jurisdiction limitations ***of*** P.L. 86-272 be

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* P.L. 86-272 provides, in pertinent part:

No State, or political subdivision thereof, shall have power to impose,… a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf ***of*** such person… are either, or both, ***of*** the following:

(1) the solicitation ***of*** orders by such person, or his representative, in such State for sales ***of*** tangible personal property, which orders, are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State;… (Pub. L. No. 86-272, 73 Stat. 555 (1959), *15 U.S.C. § 381*.) (Emphasis added.)

applied regardless ***of*** whether the taxpayer's business activities are in interstate or foreign commerce. We believe respondent has misconstrued the regulation.

[*9]

The notion that regulation 25122 eliminates the basic distinction between interstate and foreign commerce is supported neither by the language ***of*** the regulation nor by the principle ***of*** uniformity, upon which respondent so heavily relies. The regulation states simply that jurisdiction to tax is not present when a state is "prohibited" by P.L. 86-272 from imposing a net income tax. No such prohibition exists, however, when the income sought to be taxed is derived from foreign commerce. If, for example, appellant were a Canadian corporation which had sales representatives in California who merely solicited orders for pumps from California customers, and the orders were approved in Canada and filled by shipments from a Canadian factory, P.L. 86-272 would not prevent California from levying a net income tax on the appellant. Nothing in subdivision (c) ***of*** regultion 25122 requires the conclusion that California's jurisdiction to tax should be limited by P.L. 86-272 in such a case. Indeed, if such a limitation were read into the regulation, it would appear to be in conflict with the rule that the reach ***of*** the California franchise tax is coextensive with the state's constitutional power **[*10]** to tax. (See *Butler Bros. v. McColgan, 17 Cal.2d 664 [111 P.2d 334]* (1941), affd., *315 U.S. 501 [86 L.Ed. 991]* (1942); *Matson Navigation Co. v. State Board **of** Equalization, 3 Cal.2d 1 [43 P.2d 805]* (1935), affd., *297 U.S. 441 [80 L.Ed. 791]* (1936); *Luckenback S.S. Co. v. Franchise Tax Board, 219 Cal.App.2d 710 [33 Cal.Rptr. 544]* (1963).)

Respondent fares no better with its reliance on the principle ***of*** uniformity. There is no lack ***of*** uniformity simply because different jurisdictional standards are applied to different classes ***of*** commence, so long as those 9 standards are applied consistently to both foreign and domestic "states." Furthermore, although respondent has suggested that its interpretation ***of*** regulation 25122 must be followed in order for California to be in conformity with the other UDITPA states which have adopted the same reguation, it has cited no authority from such states in support ***of*** its interpretation.

Since subdivision (c) ***of*** regulation 25122 does not authorize the application ***of*** P.L. 86-272 to foreign commerce with a California destination, both logic and uniformity compel the same result where, as here, the stream ***of*** commerce flows **[*11]** in the opposite direction. Accordingly, we hold that respondent erred in ruling that the jurisdictional limitations ***of*** P.L. 86-272 must be considered in determining whether the foreign countries in questin had jurisdiction to tax the appellant under United States jurisdictional standards. Since respondent has not argued that these countries lacked jurisdiction to tax the appellant for any other reason, we conclude that appellant was "taxable" in those countries. Appellant's foreign pump sales, therefore, should not have been "thrown back" to California for sales factor purposes, but should, instead, have been assigned to their respective foreign destinations under the general rule ***of*** *Revenue and Taxation Code section 25135*, subdivision (a).

In light ***of*** our disposition ***of*** the jurisdictional issue, it is unnecessary to consider appellant's other major argument that, even if the foreign countries lacked jurisdiction to tax appellant itself, the sales in question should nevertheless have been assigned to their destinations, since other members ***of*** appellant's combined report group were taxable in those countries. Accordingly, we express no opinion on the continuing validity ***of*** our **[*12]** decision in the ***Appeal of*** Joyce, Inc., decided by this board on November 23, 1966.

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 26077 **of** the Revenue and Taxation Code*, that the action ***of*** the Franchise Tax Board in denying the claims ***of*** ***Dresser*** Industries, Inc., for refund ***of*** franchise tax in the amounts ***of*** $346.23, $11,715.37, $12,549.52 and $5,929.68 for the income years ended October 31, 1968, 1969, 1970 and 1971, be and the same is hereby reversed.

Done at Sacramento, California, this 29th day ***of*** June, 1982, by the State Board ***of*** Equalization, with Board Members Mr. Bennett, Mr. Dronenburg and Mr. Nevins present.

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