

## CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 119

May 8, 1958

### ALLOCATION

#### Syllabus:

The fact that a parent and subsidiary, the latter having no activity outside of California, are not combined under Section 25102, does not destroy the basic unitary nature of their operations. In such cases there may be an allocation of the subsidiary's income within and without this State based on factors which would have been recognized had they been combined.

Taxpayer is wholly owned by X Co. whose principal activity is the purchase and sale of cotton in Arizona and California. Taxpayer was formed in order to comply with certain Federal requirements to obtain loans from a Federal Intermediate Farm Loan Bank in California. Its only function is to loan money to farmers and gin operators. The money for these loans is obtained by pledging its notes receivable to the Federal Intermediate Farm Loan Bank. Taxpayer has no employees. Its entire functions are performed by employees of X Co., which charges taxpayer a flat charge per year for the services. Taxpayer loans money to the parent from which it receives interest income. Further, by the subsidiary's method of operation, X Co. insures itself a supply of cotton for its own activities. Advice is requested whether taxpayer who has no activities of its own outside California is entitled to any allocation of income outside this State.

The operations of X Co. and taxpayer are basically unitary in nature. Each company uses the same employees. Taxpayer's activities further X Co's operation. In absence of Federal restrictions the entire operation would have been conducted by X Co. However, because of formula differences between general and financial corporations, it is not feasible to combine both companies under Section 25102. The fact that the operations cannot be combined, however, does not destroy the basic unitary nature of the operations of the two companies. Since we would, in a combined report, recognize the solicitation effort of the parent's employees in determining the out-of-state sales factor, it will also be recognized when the operations are not combined.

In view of the integrated services performed here by the parent's employees, an agency relationship is established within the meaning of Reg. 23040(b). Since a large part of taxpayer's income results from X Co's activities in Arizona, that effort should be recognized in the formula. In the absence of wage payments, the formula would consist of two factors, property and sales. The usual property factor would be replaced by the average value of notes and

accounts receivable which would be apportioned to California since all loans are executed here. The income factor would be segregated between Arizona and California depending on where the solicitation of the borrower was begun. In most cases this will be at the borrower's location.

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