

**STAFF SUMMARY AND RECOMMENDATION**  
**SECTION 25137 HEARING**  
**VI&A, INC., INCOME YEAR 1992**

**BACKGROUND**

The taxpayer, VI&A, Inc., reported its business activity as the "service of freight-forwarding" on its original return. As a "freight-forwarder," the taxpayer operates under an Interstate Commerce Commission license as a common carrier. It has the responsibility for the freight, taking title to the goods and issuing bills of lading. VI&A, Inc. is in the business of transporting small package goods, primarily videos, for the major motion picture studios from the duplicators to retail stores and distribution networks. VI&A, Inc. owns very little transportation equipment and uses UPS as a primary carrier.

The taxpayer contracts for the delivery of goods in all of the United States, Puerto Rico and the Canadian provinces. It is the staff's understanding that the taxpayer has property (other than the goods being shipped) and employees in only four states: Illinois, New Jersey, Michigan and California.

The taxpayer's original return was filed using the basic three-factor formula. After an audit and adjustment by the State of Michigan, the taxpayer filed a claim for refund requesting that it be allowed to file under Regulation § 25137-11 as a trucking company. The taxpayer pointed out that the majority of the mobile property and payroll involved were not its own, but rather that of third-parties. Therefore, the taxpayer has requested that it be allowed to use a one-factor formula based upon revenue miles. Claims for refund based upon the Michigan action were also filed with the states of Illinois and New Jersey. The claim apparently was allowed without audit by Illinois.

The Multistate Audit Technique Manual (MATM) provides for a formula for freight-forwarders with respect to the sales factor. Under this formula, sales other than intrastate sales, are allocated 50% to the point of origination and 50% to the point of destination. If the taxpayer is not taxable in one of the states, the sale is assigned to the location where the income-producing activity occurred.

**RECOMMENDATION**

Staff recommends that the taxpayer be treated as a freight-forwarder. It recommends that the taxpayer's request to be classified as a trucking company and its request for an alternative formula to that provided in the trucking company regulation, Reg § 25137-11, be denied.

If the Board accepts the staff's recommendation, the taxpayer's claim for refund will be denied. Additional taxes could be assessed under the freight-forwarder's formula, but the statute of limitations for additional assessments for this year is closed.

## DISCUSSION

### Trucking Company Formula

The trucking company formula, Reg. § 25137-11, has special rules for the assignment of mobile property operating interstate, for the assignment of payroll of employees involved in operating and maintaining mobile property operating interstate, and for the assignment of receipts arising from the interstate transportation of goods.

The taxpayer asserts that it meets the definition of a trucking company, and therefore the regulation should apply. Regulation § 25137-11(b)(1) defines a trucking company as a "motor common carrier, a motor contract carrier, or an express carrier which primarily transports tangible personal property of others by motor vehicle for compensation."

Staff believes that a trucking company must own property and have employees engaged in the transporting of goods. The taxpayer has no mobile property used in interstate movements and has no employees engaged in operating or maintaining such mobile property. All such activities are taken care of by third parties for the taxpayer. The general apportionment formula rules exclude the activities of third parties in the apportionment formula. Use of the activities of others to make an apportionment in the circumstances of this case would be improper.

The taxpayer appears to agree (Letter of August 10, 1998, pg. 2 Section 25137). Because the activities of third-parties are involved, the taxpayer has not submitted any information with respect to the apportionment formula that would arise from use of the trucking company formula.

### Revenue Miles

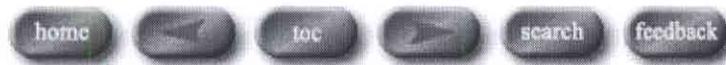
Alternatively, the taxpayer requests that its income be assigned on the basis of a single factor, revenue miles. Revenue miles are determined by multiplying the weight of goods shipped between two locations by a fraction the numerator of which is the miles in California between the two points and the denominator of which is the total miles between the two points. The apportionment percentage is then determined on the basis of total California revenue miles over total revenue miles.

The staff does not believe this approach is proper because 1) it uses a single-factor formula rather than the standard three-factor formula, and 2) it assigns income to states in which the taxpayer has no nexus.

### Comparison of Apportionment Percentages

Apportionment Method	Return as Filed	Freight Forwarder	Revenue Miles
	17.4225%	18.9570%	11.4227215%



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**Freight Forwarding Companies**

Freight forwarding companies arrange for the shipment of goods by air, sea, rail or truck common carriers, and receive fees for their services. In addition, many forwarders will provide their customers with truck trailers that may be transported by independent highway haulers or rail piggyback services.

When the freight forwarding company does not provide trailers but only arranges transportation by a common carrier, the revenue is generated by the service of making the arrangements. Past experience has shown that the income producing activities of freight forwarders generally take place relatively equally at the points where the shipments originate and terminate. Therefore, in order for the sales factor to clearly reflect the business activities within the state, the department's practice has been to use §25137 to assign 50% of the revenue from freight forwarding services to the point of origination, and 50% to the point of destination. Some freight forwarders may ship to and from states in which they have no employees or activity, and nexus may not exist in those states. In such a situation, the sales should be assigned to the location where the income producing activity occurred.

**Provision of Trailers:**

To the extent that the freight forwarding companies provide their own trailers for transporting customer goods, their revenue is a function of the mileage traveled rather than time spent within and outside the state. In order to clearly reflect the activities within this state, the apportionment rules developed for the trucking, rail, sea or air transportation industries (whichever are applicable) should be applied to the property, payroll and sales related to this activity. Although freight forwarders will not generally fall within the definitions of truck, rail, sea or air transportation companies under the regulations, the general authority of §25137 may be used to permit application of those rules to freight forwarders in cases where necessary to clearly reflect activities within the state.

Unlike trucking and rail companies that will have nexus in all states in which they operate, it is possible that a freight forwarding company's activities within a state may not be sufficient to establish nexus. In such cases, the mileage ratio calculated for freight forwarding companies should exclude miles travelled through states where nexus has not been established.

In *Appeal of John H. Grace Co.*, Cal. St. Bd. of Equal., October 28, 1980, the SBE held that nexus was not established in California when a corporation's only connection with the state was through railroad cars leased by the corporation to industrial companies who in turn arranged for railroad companies to transport their products in those cars. The railroad cars would occasionally pass into or through California. The SBE held that the presence of railroad cars in California, while under the control of the corporation's lessees' bailees, was "too attenuated to satisfy the statutory nexus requirement." As a practical matter, this type of fact pattern will probably not apply to freight forwarders because they make the transportation arrangements and are therefore not as far removed from the movements of their trailers. In order to determine whether a taxpayer has nexus in a particular state, the auditor should refer to the nexus requirements discussed in [MATM 1100](#).

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Reviewed: September 1999



# GALASSO & ASSOCIATES

Rec'd  
9/11/97

September 10, 1997

***Via Federal Express***

Ms Jane R. Raboy, Tax Auditor  
Multistate Tax Audit  
Franchise Tax Board  
9645 Butterfield Way  
Sacramento, California 95812-1468

In re           347:hW:JR  
                  VIA, 1631069,A 20739  
                  1992, \$17,709

Dear Ms Raboy,

The following is a response to your questions:

1. The property originally reported consisted of office furniture and equipment, warehouse equipment and leasehold improvements. See attached. Nothing was reported for rented real property or trucks. *2/16.5 - 2/16.12*
2. See attached list of employees, social security numbers and duties. Other than the president, who was working mostly in Michigan and in the process of moving, the list consists of two salesmen, five or six clerical and the rest are warehouse workers. *2/16.13 - 2/16.14*
3. The reason that the two factors were dropped from the calculation is that it is the only way to apportion fairly given the mix of sub contracting and internal costs. The apportionment should reflect reality, not a mix of unlike numbers. Labor and rolling stock would be apportioned based on the ton/miles within California and total ton/miles of transportation. Please note that line haul and cartage in cost of goods was \$16,000,000. If one assumes this is primarily rental of trucks (80%) and driver labor (20%), these numbers would overwhelm the total property of \$716,855 and labor numbers of \$4,862,961. Further, a significant amount of temporary workers subcontracted is listed in cost of sales (\$1,600,000).

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*2/16. 3*

Again, it is my contention that the net income should be apportioned based upon activity conducted in the state. Ton/miles within to total is the more accurate way to do it.

We fall squarely within the definition of a trucking company under regulation 25137-11(b)1. Via transports tangible personal property of others by major vehicle for compensation. The Regulation does not require ownership of the vehicles and line haul and cartage rental is permitted.

4. Rents should not have been excluded. This was for real property. Se above discussion on rental of trucks.
5. See number 3. Again, the numerical factors would be distorted if the rental of trucks were not allocated on a ton/mile basis. The logic of using the one factor formula to apportion is easily seen to measure the activity percentage in the state.
6. We assigned revenues for ton/mileage into the state from points outside the state and from the state to points outside the state. Every mile. This covers all contact with the state.
7. The missing sales invoices were of a manual nature which could not be retrieved in the system for the ton/mileage calculation. It was assumed that the known percentage was equally applicable to the unknown category.

(A)

If you have any further questions, please call.

Respectfully,



Joseph P. Galasso, Jr., CPA

/dh

Enc.

pc Michael Beam



## GALASSO & ASSOCIATES

June 11, 1997

Ms Jane R. Raboy  
Tax Audit  
Multistate Corporation Audit  
Franchise Tax Board  
P.O. Box 942867  
Sacramento, California 94267-0041

In re           Vidco Express, Inc.  
                  Corporate No. 1631069  
                  Claim No. A-20739  
                  Tax year: 1992  
                  Claim for Refund Amount: \$17,709

Dear Ms. Raboy:

In response to your request for more information on the referenced matter, scheduled below, by number, are my responses. Should you need more explanation, please do not hesitate to call.

1. Taxpayers are in the business of transporting small packaged goods, primarily videos, for the major studios from the duplicators to the retail stores or to distribution networks. The mode of transportation varies and can be by truck or air. Railroad is used infrequently.

Regulation 25137-11(b)(1) defines a trucking company as one "which primarily transports tangible personal property of others by major vehicle for compensation."

2. It appears that we are subject to the apportionment provisions applicable to trucking companies. Since most of the trucking function is sub-contracted, in lieu of using three factors, (two of which are payroll and property which are significantly reduced by sub-contracting) in the preparation of the amended return, a one factor formula was used which was more representative. That sales factor included ton miles based on any shipments with contact in the State of California (organization, destination or pass through). See page 15 of the report. See Reg. 25137-11(a)3.

3. Attached to the amended return was a schedule indicating contact miles within the state to total miles. Any time goods were shipped into or out of California, miles were added to the California calculation.

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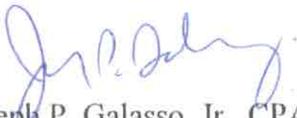
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Attached is the copy of such schedule along with related revenues. Taxpayers mobile fleet in 1992 was small and most items were shipped through the use of independent contractors, e.g. trucks, UPS, airlines.

4. Total California payroll was \$866,871 per the R-1 on the original return. This represents all personnel residing in California and working in California. See schedule R of original return. This was not used in the apportionment calculation as explained in item two.
5. See schedule for California sales.
6. The change will impact years subsequent to 1992. Amended returns will need to be filed. 1993 and 1994 were loss years so this only affects the carryforwards.
7. The ton/mile calculation was taken from a computer run based on shipping points, e.g. origin and destination for each invoice.
8. No reports are required for an independent agency.
9. The State of Michigan has extensively audited the taxpayer's records and its methodologies for the apportionment formula and has held that the company is a transportation company for all but an insignificant part of its business. The State of Illinois has also recognized that the methodology is proper.

Your attention to this matter is appreciated.

Respectfully,



Joseph P. Galasso, Jr., CPA

/dh

Enc.

pc Sal Craparotta  
Mike Beam



## GALASSO & ASSOCIATES

*Certified Mail*

1/13/98

Attn: Jane R. Raboy  
State of California  
Franchise Tax Board  
P.O. Box 1468  
Sacramento, California 95812-1468

Dear Ms Raboy:

In re            Company:            VI&A, Inc.  
                  Corp No.:            1631069  
                  Claim No.:            A-20739  
                  Income Years ended: December 31, 1992  
                  Claim for refund:    \$17,709

In response to your letter of December 2, 1997, a copy of which is attached, please be advised of the following:

1. Any formula for apportionment can produce results with greater than 100% of income being allocated as well as less than 100% of the income being allocated. This occurs because of the different approaches by each state. The fact that other states choose not to tax certain transactions through an income tax, but choose instead to use other sources for revenue e.g. sales, property, gambling, does not mean there is some gap in taxation. As long as California gets its fair share for miles shipped from and to, to the total, California is securing its fair share.
2. Your table assumes that all states need to tax the same way. They do not. Most states use the total mile in the denominator fully recognizing that 100% apportion will not occur by their statutes. If they intend something else, they would have statutorily provided for some type of mechanism to trap "gap" sales as they do on sales of personal property. They do not, fully recognizing that it would be a stretch of the Nexus concepts to tax transportation activities clearly beyond the state.
3. VI&A, Inc. has employees and warehouses for temporary housing of inventory in transit in four states. That is where state tax returns have been filed.
4. Attached are 1992 amended or original returns for Michigan, New Jersey and Illinois. Also, enclosed is the audit report for 1992 for the State of Michigan

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5. Illinois refunded the requested amount through the amended return and has not challenged the method which was used in later years.
6. See above.
7. No Illinois audits were conducted.
8. Attached is the Michigan report.
9. Property information will be submitted under separate cover.
10. See 9.
11. See 9.

Your continuing cooperation in this matter is greatly appreciated.

Respectfully,



Joseph P. Galasso, Jr., CPA

/dh

Enc.



May 26, 1998

## GALASSO & ASSOCIATES

Ms Jane Raboy  
State of California  
Franchise Tax Board  
P.O. Box 1468  
Sacramento, California 95812-1468

In re VI&A, Inc.  
CN:1631069  
Claim: A20739  
Year: 12/31/92  
Amount: \$17,709

Dear Ms Raboy:

Please be advised that the audit by the state of Michigan established the following method:

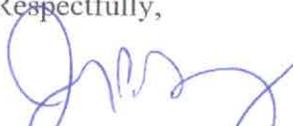
For transportation revenue (approximately 90% of all revenue)  
Michigan revenue miles/ total revenue miles (1 ton,1 mile)  
For services revenue (approximately 10% of all revenue)  
Standard three factor formula

Each would be applied to the respective revenue base 90:10 to arrive at a combined percentage allocable to Michigan. (e.g.  $90\% \times 12\% + 10\% \times 22\% = X$ )

The state recognized that the substantial contracting of trucks and drivers not being in the three factor formula would distort the transportation calculation. With the revenue formula the drivers and trucks would have the same factor as the revenue. This was the result of the 1991-1994 audit.

Please advise if I can provide anything else.

Respectfully,



Joseph P. Galasso, Jr., CPA

/dh

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Accountants and Consultants

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2/23.2



August 4, 1998

In Reply Refer  
347:HW:JR

VI&A, Inc.  
32500 Van Born Road, #100  
Wayne, MI 48184

Corporate Name: VI&A, Inc. (formerly Vidco Express, Inc.)  
Corporate Number: 1631069  
Claim Number A-20739  
Income Year Ended: December 31, 1992  
Claim for Refund Amount: \$ 17,709

We have received and reviewed your correspondence dated June 11, 1997 and September 10, 1997, January 13, 1997, May 26, 1998 and June 19, 1998, and would like to explain our position regarding the claim for refund of VI&A, Inc., hereinafter referred to as "VIA" and formerly known as Vidco Express, Inc.

**ISSUE(S):**

- I. Whether VIA is in the transportation business.
- II. Whether distortion becomes an issue in the use of the revenue-mile formula.

**Basis for Amendment**

Taxpayer asserts that VIA is in the transportation industry. The original return as filed by VIA used the three factor formula in computing their apportionment factor for income year-ended December 31, 1992. VIA indicates that most of its' trucking functions are sub-contracted, and in lieu of using three factors, (two of which are payroll and property which are significantly reduced by sub-contracting), a one factor formula was used to be more representative of its' business activities. The one factor formula, the revenue-mile formula, consisted of the following calculation:

Total CA ton miles	<u>6896.92</u>	=	11.4227%
Total ton miles	60388.71		

VIA further adds that they amended their California return to reflect the revenue-mile formula due to an audit adjustment proposed by the State of Michigan. The State of Michigan, however, used a hybrid method in calculating VIA's apportionment factors. For example, for transportation (92% of revenue), Michigan used the revenue miles formula and for services (8% of revenue), the standard three factor formula was used. The State of Illinois accepted without audit VIA's amended return.

**Business Operations**

VIA reported its' business activity as a "service of freight-forwarding" on Form 1120. A freight forwarder performs the same function as a shipper's agent, but has operating authority from the ICC as a common carrier. As a common carrier, they assume the responsibility for the freight by taking title to the goods and issuing their own bill of lading. Other services which can be offered to the shipper include cartage, warehousing, transloading of goods, deconsolidating shipments as the break-bulk agent, and clearing customs as the customhouse broker.

When the freight forwarding company does not provide trailers but only arranges transportation by a common carrier, the revenue is generated by the service of making the arrangements.

**I. *TRANSPORTATION BUSINESS AND REVENUE MILE FORMULA***

The salient points from the taxpayer's representative are outlined below and were obtained during the scope of our inquiry from correspondence specifically dated June 11, 1997, September 10, 1997, May 26, 1998, and June 19, 1998:

- VIA is in the business of transporting small packaged goods, primarily videos, for the major studios from the duplicators to the retail stores or to distribution networks.
- Since most of the trucking function is subcontract, in lieu of using three factors, (two of which are payroll and property which are significantly reduced by subcontracting) a one factor formula was used which was more representative.
- VIA falls squarely within the definition of a trucking company under California Regulation 25137-11(b) 1.
- The audit by the State of Michigan established that the substantial contracting of trucks and drivers not being in the three factor formula would distort the transportation calculation.

**Law & Analysis**

Currently, California Regulation 25137-11(c) provides for the apportionment of business income of trucking companies. The apportionment factors are determined by obtaining the following:

1. mobile property located in more than one state during the year,
2. compensation paid to personnel which operate and maintain mobile property for services performed in more than one state, and
3. receipts from all shipments which originates and terminates within this state.

The Regulation also applies to companies which are not predominantly trucking, but which do conduct some trucking activities. Secondly, California Regulation 25137-11(c) provides that when a taxpayer, other than a trucking company conducts trucking activities and the apportionment factors directly related to such activities are separately identified, such factor shall be assigned to the apportionment factor.

**Conclusion**

It is our position that VIA is not in the transportation business and does not fall within the terms of California Regulation 25137-11. VIA is providing a service by making arrangements for trucking companies, rather than performing the actual trucking activity. Further, property schedules remitted to our office for review support our argument that VIA did not own *any* delivery equipment or trucks as assets. Based on this information it would appear that VIA's actual income producing activity was for the

Corporate No.: 1631069

"service of subcontracting" to independent third parties for the delivery of goods. Representative confirmed by phone on June 23, 1997, that VIA did not have a fleet and used UPS as a primary carrier.

Accordingly, since most of the trucking activity is subcontracted by an independent third party the use of freight miles would not reflect VIA's business activity within California. Instead, the use of freight miles would actually use an independent third party's economic activity in an attempt to measure VIA's economic activity within CA. California law and regulations §§ 25120-25137 require that the taxpayer's apportionment factors be used to reflect their business activity within this state rather than someone else's.

### I. *DISTORTION*

It is also our position that the use of the revenue-mile formula, as requested by the taxpayer results per se in distortion. A summary of the "Ton/Miles Analysis" schedule, as submitted for our review, provided for \$8,298,211 in sales resulting in "no where income." See the table below for details:

<u>State (Nexus established)</u>	<u>Amount</u>	<u>Apportionment %</u>
Illinois	\$ 4,659,746	19.9957
New Jersey	\$ 77,561	.3328
Michigan	\$ 13,421,666	57.5944
California	\$ 5,144,791	22.0771
	\$ 23,303,764	100.0000
Sales for IYE 12/92	\$ 31,601,975	
Difference	\$ 8,298,211	

The taxpayer asserts that the above table assumes that all states need to tax the same way, which they do not. Secondly, the taxpayer also asserts that most states use the total mile in the denominator fully recognizing that 100% of the apportionment will not occur by their statues. However, in our analysis of sales originating from California, see Exhibit A, VIA's revenue-mile formula results in income being assigned to a state that does not have the right to tax the income. This treatment of the sales factor is inconsistent with the full accountability concept of UDITPA under the throwback sales concept.

Lastly, VIA relies on R&TC §25137, which authorizes discretionary adjustments to the apportionment provisions of the Uniform Act if those provisions "do not fairly represent the extent of the taxpayer's business activity in this state." However, the party who seeks to invoke Section 25137 bears the burden of showing that *exceptional* circumstances exist to justify deviating from the regular apportionment provisions. It is our position that the percentage change as determined by VIA is not enough to show distortion under R&TC §25137.

If you decide to pursue the Section 25137 distortion petition, your file will be routed to the Section 25137 Petition Coordinator in the Legal Division for review and possible action by the three member FTB.

Please review and indicate your position below:

\_\_\_\_ Yes, I agree. I understand that our claim for refund will be withdrawn. Please close our claim for refund for income year ended 12/31/92.

Corporate No.: 1631069

\_\_\_\_\_ No, I do not agree with the proposed adjustment to the claim for refund for income year ending 12/31/92. I would like to pursue a Section 25137 distortion petition.

\_\_\_\_\_  
Date\_\_\_\_\_  
Signature of Officer & Title

Please reply by **August 14, 1998**. If a reply is not received by that date, we will assume that you are in agreement with our position, and your claim for refund with will be closed accordingly.

Jane R. Raboy, CPA  
Associate Tax Auditor  
Multistate Corporation Audit  
Telephone (916) 845-5718  
Fax (916) 843-2237

cc: ATTN J Galasso Jr CPA  
Galasso & Associates CPA PLC  
100 N Crooks STE 114  
Clawson, Michigan 48017

Corporate No.: 1631069

Exhibit A

origin	CA
Sum of sales	
Destination	Total
0	\$ 11,600
AB	\$ 101
AK	\$ 18,243
AL	\$ 43,501
AR	\$ 40,214
AZ	\$ 107,208
BC	\$ 927
CA	\$ 900,817
CO	\$ 277,001
CT	\$ 6,838
DC	\$ 191
DE	\$ 8,551
FL	\$ 103,169
GA	\$ 137,486
HI	\$ 179,349
IA	\$ 66,552
ID	\$ 15,431
IL	\$ 328,303
IN	\$ 64,816
KS	\$ 35,033
KY	\$ 81,443
LA	\$ 31,378
MA	\$ 61,467
MB	\$ 683
MD	\$ 77,333
ME	\$ 1,025
MI	\$ 262,566
MN	\$ 119,798
MO	\$ 48,549
MS	\$ 18,224
MT	\$ 13,886
NC	\$ 57,908
NE	\$ 2,692
NH	\$ 1,957
NJ	\$ 180,387
NM	\$ 31,025
NS	\$ 721
NV	\$ 22,525
NY	\$ 116,813
OH	\$ 174,844
OK	\$ 33,662
ON	\$ 178,718
OR	\$ 153,141
PA	\$ 167,578
PQ	\$ 4,030
PR	\$ 3,509
RI	\$ 1,203
SC	\$ 14,495
SD	\$ 1,600
TN	\$ 136,766
TX	\$ 274,958
UT	\$ 236,251
VA	\$ 39,557
VT	\$ 2,884
WA	\$ 216,613
WI	\$ 12,196
WV	\$ 4,125
WY	\$ 12,950
Grand Total	\$ 5,144,791
IL	\$ (328,303)
MI	\$ (262,566)
NJ	\$ (180,387)
CA	\$ (900,817)
	\$ (1,672,074)

Corporate No.: 1631069

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Sales to be throwback to                    \$           3,472,717  
CA - based on cost of  
performance.



## GALASSO & ASSOCIATES

August 10, 1998

8.12.98

*Via Federal Express*

Ms Jane R. Raboy, CPA  
Associate Tax Auditor  
Multistate Corporation Audit  
State of California  
Franchise Tax Board  
P.O. Box 1468  
Sacramento, California 95812-1468

In re VI&A, Inc.  
CN:1631069  
Claim: A20739  
Year: 12/31/92  
Amount: \$17,709

Dear Ms Raboy:

I received your correspondence dated August 4, 1998 and disagree with your disallowance of the requested refund and reasons presented therein. A copy of your correspondence is attached.

Therefore, I must protest and appeal your decision. further, I would like to pursue a Section 25137 Distortion Petition.

Although your memo is a fine summary, I must disagree with the conclusion for the following reasons:

### Transportation

The argument that a freight forwarder is in the service business and not a transportation company is superficial. Black's Law Dictionary, Fourth Edition, page 1670 defines transportation to be: "The removal of goods or persons from one place to another by a carrier". This what VI&A does. For that matter, so does your concept of a traditional trucking company or airline.

- The nature of our business, large inconsistent volumes permits ownership of only a small number of trucks, principally in New Jersey. This in no way should diminish our characterization just because the most efficient and cost effective way is to subcontract.
- You noted that we have operating authority from the ICC, indeed are required to, just like your concept of a traditional trucking company or airline for that matter.
- We have the risk of loss of goods just like a traditional trucking company. We are not in the "Service of subcontracting" to our customers. They pay us to move goods and accept the risk of loss if the goods do not make their destination. We are in the service business, that is the removal of goods from one place to another.

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2/27.1

- No where does the California Regulations contemplate that a whole fleet must be owned. Indeed, most of your concept of traditional trucking company may lease vehicles or subcontract for peak periods.

### Distortion

You have made a quantum jump with the conclusion that transportation service originating in California results in other states not having the right to tax the income. Each jurisdiction has a right to tax companies based upon their statutes and right to tax services. Please remember that PL 86-272 applies to the apportionment on the sale of goods not services. Each state, therefore, has a right to tax services based upon presence in each state.

For example, I submit that the State of California taxes professional athletes based upon time in California. The fact that other states may not tax transportation services probably is a reflection of receiving tax revenue from other sources, e.g. gasoline tax, license fees, etc. Some states such as Nevada gets revenue from other unrelated sources and have chosen not to tax transportation companies. They certainly have a right; they have just chosen not to exercise it.

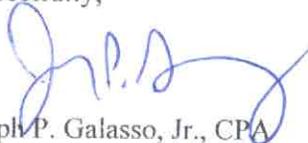
### 25137

The burden of showing that traditional apportionment provisions "do not fairly represent the extent of the taxpayers' business activity in the state" has been met. Your letter correctly states that subcontracting distorts the payroll and property factors significantly and the one factor more properly reflects activity with California. (A roll-up of the other two factors would produce the same result.)

### Conclusion

Ms Raboy, Please process this letter as my appeal request and 25137 distortion petition. Your cooperation and professionalism in this matter and throughout the review process has been most appreciated.

Respectfully,



Joseph P. Galasso, Jr., CPA

/dh

Enc.

pc Irene Correia  
Sal Craparotta



STATE OF CALIFORNIA  
**FRANCHISE TAX BOARD**  
P.O. Box 1468  
Sacramento CA 95812-1468

August 4, 1998

In Reply Refer  
347:HW:JR

VI&A, Inc.  
32500 Van Born Road, #100  
Wayne, MI 48184

Corporate Name: VI&A, Inc. (formerly Vidco Express, Inc.)  
Corporate Number: 1631069  
Claim Number: A-20739  
Income Year Ended: December 31, 1992  
Claim for Refund Amount: \$ 17,709

We have received and reviewed your correspondence dated June 11, 1997 and September 10, 1997, January 13, 1997, May 26, 1998 and June 19, 1998, and would like to explain our position regarding the claim for refund of VI&A, Inc., hereinafter referred to as "VIA" and formerly known as Vidco Express, Inc.

**ISSUE(S):**

- I. Whether VIA is in the transportation business.
- II. Whether distortion becomes an issue in the use of the revenue-mile formula.

**Basis for Amendment**

Taxpayer asserts that VIA is in the transportation industry. The original return as filed by VIA used the three factor formula in computing their apportionment factor for income year-ended December 31, 1992. VIA indicates that most of its' trucking functions are sub-contracted, and in lieu of using three factors, (two of which are payroll and property which are significantly reduced by sub-contracting), a one factor formula was used to be more representative of its' business activities. The one factor formula, the revenue-mile formula, consisted of the following calculation:

Total CA ton miles	<u>6896.92</u>	=	11.4227%
Total ton miles	60388.71		

VIA further adds that they amended their California return to reflect the revenue-mile formula due to an audit adjustment proposed by the State of Michigan. The State of Michigan, however, used a hybrid method in calculating VIA's apportionment factors. For example, for transportation (92% of revenue), Michigan used the revenue miles formula and for services (8% of revenue), the standard three factor formula was used. The State of Illinois accepted without audit VIA's amended return.

2/21.3

### **Business Operations**

VIA reported its' business activity as a "service of freight-forwarding" on Form 1120. A freight forwarder performs the same function as a shipper's agent, but has operating authority from the ICC as a common carrier. As a common carrier, they assume the responsibility for the freight by taking title to the goods and issuing their own bill of lading. Other services which can be offered to the shipper include cartage, warehousing, transloading of goods, deconsolidating shipments as the break-bulk agent, and clearing customs as the customhouse broker.

When the freight forwarding company does not provide trailers but only arranges transportation by a common carrier, the revenue is generated by the service of making the arrangements.

### ***I. TRANSPORTATION BUSINESS AND REVENUE MILE FORMULA***

The salient points from the taxpayer's representative are outlined below and were obtained during the scope of our inquiry from correspondence specifically dated June 11, 1997, September 10, 1997, May 26, 1998, and June 19, 1998:

- VIA is in the business of transporting small packaged goods, primarily videos, for the major studios from the duplicators to the retail stores or to distribution networks.
- Since most of the trucking function is subcontract, in lieu of using three factors, (two of which are payroll and property which are significantly reduced by subcontracting) a one factor formula was used which was more representative.
- VIA falls squarely within the definition of a trucking company under California Regulation 25137-11(b) 1.
- The audit by the State of Michigan established that the substantial contracting of trucks and drivers not being in the three factor formula would distort the transportation calculation.

### **Law & Analysis**

Currently, California Regulation 25137-11(c) provides for the apportionment of business income of trucking companies. The apportionment factors are determined by obtaining the following:

1. mobile property located in more than one state during the year,
2. compensation paid to personnel which operate and maintain mobile property for services performed in more than one state, and
3. receipts from all shipments which originates and terminates within this state.

The Regulation also applies to companies which are not predominantly trucking, but which do conduct some trucking activities. Secondly, California Regulation 25137-11(c) provides that when a taxpayer, other than a trucking company conducts trucking activities and the apportionment factors directly related to such activities are separately identified, such factor shall be assigned to the apportionment factor.

### **Conclusion**

It is our position that VIA is not in the transportation business and does not fall within the terms of California Regulation 25137-11. VIA is providing a service by making arrangements for trucking companies, rather than performing the actual trucking activity. Further, property schedules remitted to our office for review support our argument that VIA did not own *any* delivery equipment or trucks as assets. Based on this information it would appear that VIA's actual income producing activity was for the "service of subcontracting" to independent third parties for the delivery of goods. Representative confirmed by phone on June 23, 1997, that VIA did not have a fleet and used UPS as a primary carrier.

Accordingly, since most of the trucking activity is subcontracted by an independent third party the use of freight miles would not reflect VIA's business activity within California. Instead, the use of freight miles

Corporate No.: 1631069

would actually use an independent third party's economic activity in an attempt to measure VIA's economic activity within CA. California law and regulations §§ 25120-25137 require that the taxpayer's apportionment factors be used to reflect their business activity within this state rather than someone else's.

### I. ***DISTORTION***

It is also our position that the use of the revenue-mile formula, as requested by the taxpayer results per se in distortion. A summary of the "Ton/Miles Analysis" schedule, as submitted for our review, provided for \$8,298,211 in sales resulting in "no where income." See the table below for details:

<u>State (Nexus established)</u>	<u>Amount</u>	<u>Apportionment</u>
		<u>%</u>
Illinois	\$ 4,659,746	19.9957
New Jersey	\$ 77,561	.3328
Michigan	\$ 13,421,666	57.5944
California	\$ 5,144,791	22.0771
	\$ 23,303,764	100.0000
Sales for IYE 12/92	\$ 31,601,975	
Difference	\$ 8,298,211	

The taxpayer asserts that the above table assumes that all states need to tax the same way, which they do not. Secondly, the taxpayer also asserts that most states use the total mile in the denominator fully recognizing that 100% of the apportionment will not occur by their statues. However, in our analysis of sales originating from California, see Exhibit A, VIA's revenue-mile formula results in income being assigned to a state that does not have the right to tax the income. This treatment of the sales factor is inconsistent with the full accountability concept of UDITPA under the throwback sales concept.

Lastly, VIA relies on R&TC §25137, which authorizes discretionary adjustments to the apportionment provisions of the Uniform Act if those provisions "do not fairly represent the extent of the taxpayer's business activity in this state." However, the party who seeks to invoke Section 25137 bears the burden of showing that *exceptional* circumstances exist to justify deviating from the regular apportionment provisions. It is our position that the percentage change as determined by VIA is not enough to show distortion under *R&TC §25137*.

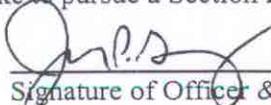
If you decide to pursue the Section 25137 distortion petition, your file will be routed to the Section 25137 Petition Coordinator in the Legal Division for review and possible action by the three member FTB.

Please review and indicate your position below:

Yes, I agree. I understand that our claim for refund will be withdrawn. Please close our claim for refund for income year ended 12/31/92.

No, I do not agree with the proposed adjustment to the claim for refund for income year ending 12/31/92. I would like to pursue a Section 25137 distortion petition.

8-10-98  
Date

  
Signature of Officer & Title

Corporate No.: 1631069

Please reply by **August 14, 1998**. If a reply is not received by that date, we will assume that you are in agreement with our position, and your claim for refund with will be closed accordingly.

Jane R. Raboy, CPA  
Associate Tax Auditor  
Multistate Corporation Audit  
Telephone (916) 845-5718  
Fax (916) 843-2237

cc: ATTN J Galasso Jr CPA  
Galasso & Associates CPA PLC  
100 N Crooks STE 114  
Clawson, Michigan 48017

2/27/6

Corporate No.: 1631069

Exhibit A

origin	CA
Sum of sales	
Destination	Total
0	\$ 11,600
AB	\$ 101
AK	\$ 18,243
AL	\$ 43,501
AR	\$ 40,214
AZ	\$ 107,208
BC	\$ 927
CA	\$ 900,817
CO	\$ 277,001
CT	\$ 6,838
DC	\$ 191
DE	\$ 8,551
FL	\$ 103,169
GA	\$ 137,486
HI	\$ 179,349
IA	\$ 66,552
ID	\$ 15,431
IL	\$ 328,303
IN	\$ 64,816
KS	\$ 35,033
KY	\$ 81,443
LA	\$ 31,378
MA	\$ 61,467
MB	\$ 683
MD	\$ 77,333
ME	\$ 1,025
MI	\$ 262,566
MN	\$ 119,798
MO	\$ 48,549
MS	\$ 18,224
MT	\$ 13,886
NC	\$ 57,908
NE	\$ 2,692
NH	\$ 1,957
NJ	\$ 180,387
NM	\$ 31,025
NS	\$ 721
NV	\$ 22,525
NY	\$ 116,813
OH	\$ 174,844
OK	\$ 33,662
ON	\$ 178,718
OR	\$ 153,141
PA	\$ 167,578
PQ	\$ 4,030
PR	\$ 3,509
RI	\$ 1,203
SC	\$ 14,495
SD	\$ 1,600
TN	\$ 136,766
TX	\$ 274,958
UT	\$ 236,251
VA	\$ 39,557
VT	\$ 2,884
WA	\$ 216,613
WI	\$ 12,196
WV	\$ 4,125
WY	\$ 12,950
Grand Total	\$ 5,144,791
IL	\$ (328,303)
MI	\$ (262,566)
NJ	\$ (180,387)
CA	\$ (900,817)
	\$ (1,672,074)

2/27.7

Sales to be throwback to  
CA - based on cost of  
performance.

\$ 3,472,717

2/27.8