

CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 241

October 28, 1959

ALLOCATION: FORMULA – UNITARY BUSINESS

Syllabus:

(1) The Franchise Tax Board has the right to apply an allocation formula to combined corporate income, (a) in the case of a multi-corporate unitary business pursuant to Sections 25101 and 24631 et seq. of the Bank and Corporation Tax Law and (b) under the circumstances prescribed in Sections 25102, 25103, and 25104 of the Bank and Corporation Tax Law.

(2) In the case of a unitary business the formula is more accurate than separate accounting.

(3) In the present instance a unitary business exists.

X Corporation (parent) conducts a unitary business engaged in the mining, processing and smelting of metal products. X Corporation mines the ore. B Corporation (a subsidiary of X Corporation) purchases the ore mined by X Corporation and refines it. B Corporation also refines the ore mined by other companies on a toll basis. The subsidiary sells the refined metal on the open market. B Corporation is X Corporation's largest customer, purchasing over one-half of the parent's production. At times the parent has not been able to supply enough ore to the subsidiary, then B corporation has supplied the remainder of its needs from other sources.

The present state of the law may be summarized as follows: There are two purposes for which a combined report may be required by the Franchise Tax Board. The first of these purposes is to determine the California income of those members of a multi corporate unitary business which are doing business in California. The second purpose is to adjust the intercompany transactions or transactions between corporations and stockholders and to prevent the avoidance of taxes by shifting of income and deductions.

Since there is common ownership plus interdependency and integration of the operations of the corporations, they should be treated as a single unitary business. The Legislature by enacting the allocation and accounting sections, mentioned above, and the courts recognize that the separate accounting method is appropriate to determine the true income of a separate business; but that when the business is not separate, and is an integral part of a larger and unitary system, the separate accounting is inadequate and unsatisfactory in ascertaining the true result of the activities and values attributable to that business.