# STAFF SUMMARY AND RECOMMENDATION
# SECTION 25137 PETITION OF
# SILOG, INC.

## Background

Silog, Inc. ("taxpayer") was a corporation that arranged to transport videos to retail outlets on a national basis using third party carriers. It based its operations at four locations across the United States where it rented warehouses and hired employees to load the videos onto trucks owned by others. One of these centers was in California. Taxpayer had both a warehouse and its headquarters in Michigan. The business was sold for a gain in 1997. This gain is characterized as goodwill and is an intangible. This goodwill was built up through the years by taxpayer's operations across the United States.

## Petition

Taxpayer has filed a petition (see Exhibit A for petition) to vary from the standard apportionment formula by 1) including goodwill in its property factor denominator valued at ninety percent of the sale price allocated to goodwill, and, 2) by including the amount received for goodwill in its sales factor denominator.

In the alternative, taxpayer seeks to have the gain from the sale of the goodwill recharacterized as nonbusiness income and allocated to Michigan.

## Standard UDITPA Rules

The standard UDITPA apportionment formula does not include the value of intangibles in the property factor. Goodwill has no cost basis unless it was purchased from another. It reflects the value another attaches to an operating business above and beyond what is reflected on the balance sheet of the business. It arises from the operation of the business as a whole. Its value is completely subjective and is only verifiable after the fact by what another is willing to pay for it. All of these facts illustrate why an intangible such as goodwill is not included in the property factor. It cannot be accurately valued and it is present wherever the business is located.

The standard UDITPA apportionment formula excludes receipts from occasional substantial sales from the sales factor. The purpose of this exclusion is so that the apportionment formula is based on factors from regular business operations. This avoids the skewing of the apportionment percentage that results when a gain from a single-year substantial sale are assigned to the one state where the sale took place.

Established California precedent supports the conclusion that gains from the sale of goodwill give rise to business income.

## Staff Recommendation

Taxpayer has not met its burden of showing by clear and convincing evidence that the standard apportionment method does not fairly reflect its business operations in California. Since 10.5% of taxpayer's workforce and 28.5% of its real and tangible property are located in California, an 11.5% California apportionment factor fairly reflects taxpayer's business activities in the state. Accordingly, staff recommends that this petition be denied. Please see Exhibit B for a detailed Staff Analysis supporting this recommendation.

**DETAILED STAFF ANALYSIS IN SUPPORT OF RECOMMENDATION**
**SECTION 25137 PETITION**
**SILOG, INC.**

| *Taxable Year* | | *Tax* |
|---|---|---|
| 12/31/97 | | $353,469.00 |
| Totals | | $353,469.00 |

## RECOMMENDATION

Staff recommends that the taxpayer's petition be denied and that the gain on the sale of goodwill be treated as business income subject to the standard apportionment formula as provided for in UDITPA and the regulations adopted thereunder by the department.

## BACKGROUND

This taxpayer has previously petitioned this Board for a variance from the standard UDITPA provisions. In 1998 this Board considered the petition of VI&A (formerly Vidco Express, Inc., currently Silog, Inc.) for the 1992 tax year. That petition asked the Board to find that it was a trucking company under Regulation section 25137-11 and that it may use a single factor formula based on revenue miles. The Board denied that petition. This same issue was raised in the 1997 protest, and was later dropped by the taxpayer when the FTB assigned all of the trucking operation receipts to Michigan based on a cost of performance analysis for a sale of other than tangible personal property. (RTC section 25136.)

Silog, Inc. ("Silog" formerly VI&A, Inc.) was formed in 1987 as a Michigan corporation and expanded into California by renting a warehouse. Michigan was the headquarters and corporate domicile. The company's primary business was the delivery of videos for first time stocking from duplicators to retailers. Silog rented real estate and transportation was predominantly arranged with the hiring of third party transporters.[1] Taxpayer provided the labor for packaging at the point of origination and arranged to transport the videos, but never took title. Silog had warehouses in four locations (Michigan, Illinois, New Jersey, and California) across the United States located near duplicator plants. The warehouses received the goods in bulk and then its employees would break them down into smaller packages and use either independent contractors or UPS for final delivery. Silog would distribute nationally for a given contract and there were separate contracts for each title distributed. The duplicators would pay for transportation to the warehouses. There were Silog employees at the warehouses who would load the videos onto trucks that would then deliver the videos to large retailers who would handle the unloading. Hence, Silog's costs were only at the point of origination, not at the point of destination, plus administrative costs. One of the warehouses was located in Carson City, California, where Silog had four salaried employees and thirty part-time hourly employees. In addition, Silog had one or two sales people in Los Angeles who solicited business.

[1] Taxpayer states that it rented trucks and contracted for labor; however it appears that taxpayer "arranged for transportation," using "national air freight and trucking companies" as well as "UPS, Federal Express, Airborne, Etc." and " thousands of local and regional carriers who perform the local deliveries direct to the retail stores." (May 31, 2005, taxpayer correspondence, page 1.)

The taxpayer's original return divided its income into three categories: transportation income; other income (from display assembly); and capital gain from sale of good will. It used a different apportionment formula for each category. For the transportation income, taxpayer used a single sales factor revenue/mile formula. For the display assembly income, taxpayer applied a three-factor formula, assigning receipts based on where the displays were assembled. For the capital gain, taxpayer concluded that it was nonbusiness income and sourced 100% of the gain to Michigan.

The department audited Silog's returns for the tax year ending December 31, 1997 (the protest year). The auditor reclassified the capital gain as business income apportionable to California and applied the standard three-factor formula to compute California taxable income. A Notice of Proposed Assessment was issued on June 25, 2003. A protest hearing was held on June 13, 2005 via telephone conference.

A determination letter on the protest was sent on February 1, 2006 denying taxpayer's protest in part and finding as follows:

> the capital gain on the sale of goodwill is apportionable business income and the gain should be excluded from the sales factor under Regulation sections 25137(c)(1)(A) or 25137(c)(1)(C);
>
> taxpayer does not qualify as a trucking company under Regulation section 25137-11 so the interstate ratio of that regulation does not apply;
>
> the property factor was corrected to exclude transportation expenses from rent; taxpayer was not allowed to use a modified revenue/mile formula under RTC section 25137;
>
> taxpayer does not qualify as a freight forwarder;
>
> transportation services income was to be apportioned using the standard three factor formula under a RTC section 25136 cost of performance methodology;
>
> the taxpayer was allowed to assign income from display assembly based on the location of the warehouse where the service was provided.
>
> The overall apportionment factor was determined to be **11.5004%.**

## THE PETITION

Taxpayer asserts the following adjustments to the standard apportionment formula:

- include goodwill in the denominator of the property factor, valuing it at ninety percent of the sale price of the goodwill;
- include the $27.5 million gain from the sale of good will in the sales factor denominator, with none apportioned to California in the numerator;
- in the alternative, find the capital gain from sale of goodwill to be nonbusiness income under RTC section 25125 and allocate the gain to Michigan.

## ANALYSIS

***Property Factor:***

Taxpayer seeks to include goodwill, an intangible, in the property factor, valuing it at ninety percent of the sale price ($24.8 million). Taxpayer argues that the goodwill should be included in the property factor and be assigned solely to Michigan based upon the cost of creating it.

The taxpayer, however, provides no analysis or evidence showing that the standard apportionment method does not fairly reflect the extent of taxpayer 's business in California. As the party seeking to deviate from the standard method, taxpayer has the burden under Revenue & Taxation Code ("RTC") section 25137 to show by clear and convincing evidence that the standard formula does not fairly reflect taxpayer's business activities in California. Taxpayer has not carried this burden, and on that basis staff recommends that this petition on this issue be denied.

Both as a matter of statute and theory the taxpayer's requested variance is not supportable.

The property factor under the standard apportionment method is set forth in RTC section 25129 which states [emphasis added],

> The property factor is a fraction, the numerator of which is the average value of the taxpayer's *real and tangible personal property* owned or rented and used in this state during the taxable year and the denominator of which is the average value of all the taxpayer's *real and tangible personal property* owned or rented and used during the taxable year.

"Intangible property is not specifically included in the property factor." (RTC § 25129; *Appeal of Retail Marketing Services, Inc*., 1991-SBE-003, August 1, 1991. p. 2.) The parties agree that goodwill is intangible. Intangible property may only be included in the property factor if the statutory formula does not fairly represent taxpayer's activities in California. (*Id*. at p. 4.) Taxpayer's argument for including the intangible in the property factor is that by failing to include the goodwill, the "warehouse activity alone is represented in this formula which clearly does not fairly apportion the income." (May 10, 2006 taxpayer correspondence, page 2.) Taxpayer relies on a list of five "drivers of the business and the related costs of performance" that it states were all located in Michigan. Finally, taxpayer seeks to change the law based on statements made in secondary sources.

While it may be that the majority of the costsof taxpayer's business were in Michigan, and that there was only one warehouse in California, this is not a sufficient showing. "What must be shown is that the statutory formula distorts the extent of the taxpayer's business activities in this state." (*Appeal of Retail Marketing Services, Inc*., supra, p. 4.) Only then is a departure from the standard formula warranted.

Goodwill, unless purchased from another, has no cost basis. It reflects the value another attaches to an operating business above and beyond what is reflected on the balance sheet of the business. It arises from the operation of the business as a whole. Its value is completely subjective and is verifiable only after the fact by what another is willing to pay for it. All of these facts illustrate why an intangible such as goodwill is not included in the property factor. It cannot be accurately valued and it is present wherever the business is located. The taxpayer has not established the need to include goodwill in the property factor and its assignment of the value it proposed to a single jurisdiction does not reflect the fact that it is a value that attaches to the business wherever it is conducted. It should also be noted that the taxpayer has never previously attempted to include goodwill in its property factor.

The overall California apportionment factor based on regular business operations is **11.5%.** (See Exhibit A.) This includes a sales factor of **3.5%** that assigns all transportation receipts to Michigan under RTC section 25136, even though 6.4% of the revenue miles traveled were within California. The parties agree that **10.5%** of the workforce of Silog, Inc. is located in California, which is a good indicator of the amount of business in this state. In addition, **28.5%** of the tangible and real property used in running the business operation of taxpayer is located in California, another good indicator of California business activity. All of these items contribute to the creation of the business's goodwill. Hence, 11.5% is a fair representation of taxpayer's business activities in the state with 10.5% of the workforce and 28.5% of real and tangible property in this state and a fair representation of where its goodwill exists. Taxpayer has made no contrary showing of how the 11.5% factor is distortive. Since taxpayer has not shown how the standard method (excluding the intangible goodwill from the property factor) with an 11.5% factor unfairly reflects taxpayer's business activities in California, the petition must be denied on this issue.

***Sales Factor:***

Taxpayer seeks to place the $27.5 million gain from the sale of good will into its sales factor denominator with a zero California numerator. The asserted basis of this is that "none of the payments received for the goodwill were from California activities or from capital located nor associated with California. The costs of performance in creating the assets were all in Michigan." (May 10, 2006 taxpayer correspondence, p. 3.)

This approach disregards current law that mandates that the gain should be excluded from the sales factor entirely under either Regulation section 25137, subsection (c)(1)(A) [substantial receipts from occasional sale], or Regulation section 25137, subsection (c)(1)(C) [no identifiable income producing activity]; consequently, the gain should be taxed based on the apportionment factor from regular business operations. It also ignores the fact that the goodwill inherent in a business attaches to wherever the business operates and it cannot be isolated to a single jurisdiction.

- **Substantial Receipts from Occasional Sales are Excluded under Regulation section 25137(c)(1)(A).**

Regulation section 25137, subsection (c)(1)(A), was adopted for tax years beginning after December 31, 1972. In its original form, that regulation stated:

> Where substantial amounts of gross receipts arise from an incidental or occasional sale of a fixed asset used in the regular course of the taxpayer's trade or business, such gross receipts shall be excluded from the sales factor. For example, gross receipts from the sale of a factory or plant will be excluded.

The original version of Regulation section 25137, subsection (c)(1)(A), explicitly dealt with receipts on the sale of fixed assets and did not address receipts from the sale of intangibles**.** The rationale behind the original version of Regulation section 25137(c)(1)(A) is that substantial amounts of gross receipts from occasional sales of fixed assets should be excluded from the sales factor because the gross receipts from those types of sales do not fairly reflect the day-to-day business operations of the taxpayer and hence cause excessive income to be apportioned to the state where the sale occurred. Typically, appreciation is built up over time so that the gross receipts upon sale of a business represent years of growth, rather than a single event in the year of sale. If only the year of sale is looked at and the receipts are assigned to the state where the sale took place, then the build up of the value of the business in the prior years is not recognized. (See LR 97-1).

This same rationale applies to gross receipts from an occasional sale of intangible property that was held or used in the regular course of taxpayer's business. It is not logical to distinguish between fixed assets and intangibles when choosing which receipts are to be included in the sales factor, as the rationale for excluding receipts from substantial/occasional sales is the same for fixed and intangible assets.

This approach was first set forth in Legal Ruling 97-1[2] in 1997, and was later codified in amendments to Regulation section 25137(c)(1)(A) in 2001.[3] Under the Administrative Procedures Act, Legal Rulings reflecting FTB positions are not prohibited underground regulations.[4] The fact that there was not a regulation on this issue during 1997 is not dispositive.

Under the current version of Regulation 25137, subsection (c)(1)(A), gross receipts from an occasional sale of intangible assets are excluded if they are considered substantial. While this regulation does not apply for taxable years before 2001, it can be referred to for an understanding of the current law, how it would apply to these facts, and recognition that it is desirable to have a consistent approach across the years. The current regulation states that there is a substantial amount of gross receipts from an occasional sale "if its *exclusion results in a five percent or greater decrease in the sales factor denominator* of the taxpayer or, if the taxpayer is part of a combined reporting group, a five percent or greater decrease in the sales factor denominator of the group as a whole." When the $27.5 million gross proceeds from the sale of good will is excluded from the sales factor, the denominator goes from $37,478,688 to $9,934,772, which is a 73.5% decrease, well above the 5% decrease required to show that the gross receipts are substantial. Since the one-time gain from the sale of goodwill is substantial, Legal Ruling 97-1 applies so that the gain is excluded from the sales factor.

- **When There is No Identifiable Income Producing Activity Then Receipts are Excluded from the Sales Factor Under Regulation Section 25137, Subsection (c)(1)(C)**

Regulation 25137, subsection (c)(1)(C), states:

> Where business income from intangible property cannot readily be attributed to any particular income producing activity of the taxpayer, such income cannot be assigned to the numerator of the sales factor for any state and shall be excluded from the denominator of the sales factor. For example, where business income in the form of dividends received on stock, royalties received on patents or copyrights, or interest received on bonds, debentures or government securities results from the mere holding of the intangible personal property by the taxpayer, such dividends and interest shall be excluded from the denominator of the sales factor.

If this Board decides that Legal Ruling 97-1 does not apply and hence the proceeds from the sale of good will would be included in the sales factor, then in the alternative, the proceeds should be excluded under Regulation section 25137, subsection (c)(1)(C). This regulation excludes receipts from both the numerator and the denominator of the sales factor when there is no

---

[2] Legal Ruling 97-1, Exclusion of Gross Receipts from Incidental or Occasional Sales of Intangible Property From the Sales Factor.

[3] After the 2001 amendments, Regulation 25137, subsection (c)(1)(A), stated, "Where substantial amounts of gross receipts arise from an occasional sale of a fixed asset *or other property* held or used in the regular course of the taxpayer's trade or business, such gross receipts shall be excluded from the sales factor." {Emphasis added.)

[4] The Administrative Procedures Act (California Government Code sections 11340-11529) expressly excludes Franchise Tax Board Legal Rulings from the public notice and comment procedures required of regulations. (Gov. Code §§ 11340.9(b)[exception to all of Chapter 3.5 for Franchise Tax Board Legal Rulings], 11340.5(a) [general rule against underground regulations].)

identifiable income producing activity. The issue then is whether there was an identifiable income producing activity ("IPA") and cost of performance of those IPAs associated with the goodwill sale. Income from the mere holding of intangible personal property is excluded. (Cal. Code Regs., tit. 18, § 25137, sub. (c)(1)(C).)

Once income is determined to be business income, and if the underlying transaction involved the sale of "other than tangible personal property" under RTC section 25136, then a cost of performance analysis is required if the income producing activity occurs in more than one state.[5] If the sale of the intangible was part of the regular business operation of the taxpayer, then one would look at the different facets of the business operation, identify the income producing activities that lead to the operational income, and associate costs with each activity. In the case of goodwill, which relates to the value of the business as a whole, there is no one activity that should be looked at in determining where its value arose.

If on the other hand, the sale of the intangible was an extraordinary event under the functional test, then the underlying business is not examined. Rather, the actual sale transaction is evaluated for costs associated with implementing that one sale. Taxpayer has full access to all of the information and documents from the sale of the goodwill and has supplied no evidence that would allow a cost of performance analysis. Without such an analysis, there is no identifiable income producing activity that produced the gain and the receipts would be excluded under Regulation section 25137, subsection (c)(1)(C). Under the standard method, it is taxpayer's burden to prove by clear and convincing evidence that there is an identifiable income producing activity associated with the sale of goodwill. Taxpayer has not met this burden. Staff recommends that Regulation section 25137, subsection (c)(1)(C), operate to exclude the gain from the sales factor.

- **Sales Factor Conclusion:**

Taxpayer has made no showing that application of the standard apportionment regulations and legal rulings to exclude the gain from the sales factor results in an apportionment factor that unfairly represents the extent of taxpayer's activities in California; hence staff recommends that its petition on this issue be denied.

***Business Income***

Taxpayer asserts an alternative argument requesting "under 25125 [to] allocate the entire gain to Michigan, the commercial domicile." This is essentially a request to use RTC section 25137 to change the characterization of the gain from the sale of goodwill from apportionable business income to allocable nonbusiness income. In addition, in order to apply the allocation rules under RTC section 25125, the goodwill would need to be found to be tangible personal property as RTC section 25125 applies only to real property or tangible personal property. Both parties agree that goodwill is intangible personal property. Accordingly, even if recharacterization of income were a proper basis for a RTC section 25137 petition, RTC section 25125 could not be applied on these facts.

California court and State Board of Equalization ("SBE") precedent support the conclusion that gains from the sale of goodwill give rise to business income. In *Appeal of Borden*, the SBE

[5] Cost of performance analysis means that income producing activities must be identified as well as costs associated with each of those income producing activities in order to determine which state has the majority of the costs of performance of income producing activities. Whichever state has the majority of the costs receives all of the receipts in its sales factor numerator for that particular income producing activity. Any states that have less than a majority of the costs of performance for an income producing activity receive zero receipts in their sales factor numerator for that particular income producing activity.

concluded that goodwill is undeniably an important asset of the business and contributes materially to producing business income. (*Appeal of Borden, Inc*. 77-SBE-007, February 3, 1977.) The SBE held that any income from the sale of assets that are integral parts of a unitary business (including income from the sale of a business division) is business income even if it arose from an occasional sale or other extraordinary disposition of property. *Borden* and these principles were expressly affirmed by the California Supreme Court in *Hoechst Celanese Corporation v. FTB* (2001) 25 Cal.4th 508, *cert. denied* (2001) 151 L.Ed. 2d 53, and recently followed in *Jim Beam Brands v. Franchise Tax Bd*. (2005) 133 Cal.App.4$^{th}$ 514. (*Celanese, supra*, at p. 530, 533.) The underlying principle in these cases is that any income from assets that are integral parts of the unitary business is apportionable business income. Property that was developed or acquired and then maintained using business resources, thus furthering the unitary business, should lead to gains that are attributed to the business as a whole.

## CONCLUSION

Taxpayer's proposed apportionment formula lowers the overall apportionment percentage by including the gain from the sale of goodwill in both the sales and property factor denominators. In its summary, taxpayer argues, "The California warehouse did not produce the goodwill, the Michigan activities did." But Michigan was not the only state where the goodwill was developed and existed. It was developed and existed in all the states where taxpayer did business through the years. If the videos were not delivered on a national basis, the business would not have had the value that it did upon sale. There has not been the requisite showing of distortion under RTC section 25137 that would warrant deviating from the standard formula that excludes intangibles from the property factor and excludes occasional substantial sales from the sales factor. In fact, by all indicators, the standard formula accurately reflects taxpayer's activities in California. Staff recommends that taxpayer's petition under RTC section 25137 be denied on this issue.

# EXHIBIT A

Standard Apportionment Formula
Silog, Inc - 1997

| | **Transportation** | **Other** | **Total** |
|---|---|---|---|
| Property | | | |
| CA | | | 2,113,858 |
| ALL | | | 7,424,174 |
| Percent | | | **28.4726%** |
| | | | |
| Payroll | | | |
| CA | | | 394,888 |
| ALL | | | 3,750,069 |
| Percent | | | **10.5302%** |
| | | | |
| Sales | | | |
| CA | 0 | 347,655 | 347,655 |
| ALL | 7,026,059 | 2,908,712 | 9,934,772 |
| Percent | | | **3.4994%** |
| Double | | | **6.9987%** |
| | | | |
| Total % | | | **46.0015%** |
| Divided by 4 | | | **11.5004%** |

**JOSEPH P. GALASSO, JR.**
**ATTORNEY AT LAW, P.C.**
100 NORTH CROOKS ROAD, SUITE 103
CLAWSON, MICHIGAN 48017-1440
(248) 435-8989

May 10, 2006

Colleen Berwick
Legal Branch
MS A2.60
P O Box 1720
Rancho Cordova, CA 95741-1720

In re: 25137 Hearing for SILOG, INC. (FORMERLY VI&A, INC.)
CCN: 1631069
Taxable Year: 12/31/1997
Case: 110153048245856

Dear Ms Berwick:

Thank you for the opportunity to present materials in advance of the scheduled June 19, 2006 hearing. I plan to attend the meeting in person and would like a morning session if possible due to the airline schedule. I will attempt to keep the facts and arguments as concise as possible.

DISPUTED ITEMS

The principal dispute is the proper methodology for apportionment of the gain on the sale of goodwill (intangibles) which occurred in 1997. The operations for 1997 apportionment, while in dispute, is diminimus to the appeal.

FACTS

The Company, is a transportation service company formed under Michigan law in 1987 with its commercial domicile being Michigan. The Company's principal business is transportation of video products for first time stocking, secured from duplicators (manufacturers) selected by content providers (studios) to retail and rack jobbers on a time sensitive basis, so that all retailers have an equal opportunity for the inauguration of the title. It operated through short-term real estate leases in Michigan, California, Illinois and New Jersey. The locations are determined by the location of the duplicator to minimize costs of handling. If the duplicators moved their manufacturing facility, Silog would move their facility close by. Further, Silog rents the remaining capital inputs (e.g. trucks) and contracts for labor on a time sensitive basis due to non-continuous delivery. The Company never takes title to the goods.

The value drivers of the business and the related costs of performance are all created, located and housed in Michigan: The drivers are:

1. The transportation department which coordinates the delivery and pickups for all four facilities of product, operates exclusively with Michigan personnel. The related vendor lists were created and developed in Michigan.
2. The software used in the business was developed and operated exclusively in Michigan with Michigan personnel.
3. The program design and development for each movie title was performed in Michigan by Michigan personnel.
4. The company know-how and trade secrets were developed and used exclusively by Michigan personnel.
5. The Company officers and owners were Michigan residents for all years the Company was active.

I do not believe that Ms McElhatton disputes these facts.

CALIFORNIA POSITION AND ARGUMENT

The California Department of Revenue seeks to tax the gain on sale of goodwill (intangibles) using the standard three factor formula.

Unfortunately, the formulae do not fairly represent the income allocable to California because the very item generating the income is not represented in two of the three factors.

In short, this service business was valuable because of its intangibles, not because it had a facility under short-term leases, one of which was in California. The entire value added was created in Michigan (transportation department, program design, software, know-how and trade secrets), not by warehouses or warehouse workers.

The activities were clearly identifiable and produced the income being allocated (gain on sale of goodwill – intangibles). See items 1-5 above.

California has taken the position that the taxpayer is required to use the three factor formula even though the intangible property sold is not represented in the property formula and the sales proceeds are not in the sales factor. By doing so, the warehouse activity alone is represented in this formula which clearly does not fairly apportion the income.

It appears that the case law moved most items into business income, but did not contemplate adjusting the formulae to reflect the change fairly. Hiding behind regulations for the sale of fixed assets which this is not and which do not contemplate intangible property sales, refusing to use separate formulae, overweight factors with non-value added amounts do not fairly apportion income.

It is our opinion that the State of California failed to address the lack of representation in the property factor for intangible assets. . See BNA Portfolio, California Tax Management at 1910.027, footnote 341 citing Cal Regs. 717.18, 25120(c)2. "In general, gain or loss from the sale of a capital assets is business income if the property was included in the property factor of the apportionment formula". Again, the State would like the income, but not the amount in a factor. Further, as I cited to you previously, Hellerstein , in his treatise on State Taxation at 9-126 cites the fact that states are putting something in the property factor to reflect this "discrepancy." If the original cost of the property is unascertainable, the property is included in the factor at the fair value as of the date of the acquisition by the taxpayer. I believe this is provided for at 25130(a)2. Since the asset is one of the continual improvement, I would suggest a 10% discount to the sales price as being the correct number for the property factor.

With respect to the sales factor, none of the payments received for the goodwill were from California activities or from capital located nor associated with California. The costs of performance in creating the assets were all in Michigan.

SUMMARY

Lost in the translation is the basic concept of apportionment. The threshold for apportionment is not just some mathematical formulae, but an honest attempt to reflect the sale of activities from which the value is generated. The California warehouse did not produce the goodwill; the Michigan activities did. See Container Corp. of America vs. Franchise Tax Board, 463 US 159,170 (1983). It follows as a matter of principle that the factors associated with the generation of the income should be reflected in the taxpayers apportionment formulae. The factors in a reasonable sense must reflect how the income is generated. See also Complete Auto Transit Inc. vs. Brady, 430 US 274 (1977).

REQUESTED RELIEF

Petitioner respectfully requests relief under 25137 and such other statutes and regulations as appropriate to effectuate an equitable apportionment of the income from the sale of goodwill (intangibles); specifically, the property factor should be increased for the sale price of the intangibles less 10% and the location of the asset should be Michigan. The sales price should be included in the sales factor and source to 100% Michigan on a cost of performance basis.

In the alternative under 25125 allocate the entire gain to Michigan, the commercial domicile.

Respectfully submitted by:

Joseph P. Galasso, Jr.

/dh

cc: Laurie McElhattan
Irene Correia
Mary Ritter
Salvatore Craparotta