

# *CA Apportionment Formula Double Counts Daimler's Leased Vehicles*

June 26<sup>th</sup>, 2023

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# ***Why Are We Here?***

- Daimler requests alternative apportionment pursuant to CRTC § 25137.
- Alternative formulas are permitted when income is not fairly apportioned under the standard formula.
- FTB has consistently argued for exclusion of receipts that produce little to no economic profit when they unfairly represent Taxpayer's income in the state.
- Double counted, undone receipts with zero economic profit unfairly represent Daimler's income in California and should be excluded.

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# ***California Apportionment Formula***

- The California income/franchise tax calculation starts by totaling a company's income.
- California is only permitted to tax California sourced income, determined by an apportionment formula.
- California's apportionment formula apportions income to the state by dividing California sourced sale receipts by total sale receipts, to arrive at an apportionment percentage.
- The apportionment percentage is the amount of a company's total income that can be taxed by California.

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# *California Single Sales Apportionment*

California Sales

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Everywhere Sales



Apportionment %

# California Apportionment versus Income

- Taxable income is the amount of gross income received minus valid business expenses (deductions). Income determines the size of the overall pie.
- Apportionment determines the division of the pie.



- **The scope of this petition is limited to apportionment.**

## *Alternative Apportionment - Case Comparison*

- FTB and courts have routinely excluded low or no profit receipts that unfairly represent taxpayers' income in California.

	<i>Pac Tel</i>	<i>Microsoft</i>	<i>General Mills</i>	<i>Daimler</i>
<b>% of Income</b>	<2%	<2%	-1.4-<2%	0%
<b>% of Receipts</b>	36%	73%	8-30%	36-44%

- In this case, when Taxpayer repurchases vehicles from dealerships for the same amount that it initially sold the vehicles for, it has **zero** economic profit from such undone sales, and yet such sales account for between **36 – 44%** of the California numerator.

# *Vehicle Sales in Apportionment Formula*

- Apportionment formula as applied to vehicle manufacturers.
- Example: 100 cars sold nationwide, 10 sold in California.

10 cars sold to CA dealers (\$50k each)

\$500K

**10%**

100 cars sold nationwide (\$50k each)

\$5M

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## *Purchase – 1 Transaction in the Apportionment Formula*

- After the initial sale from a manufacturer to the dealership, **there is no further effect on a manufacturer's California apportionment formula.**



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## ***Problem – Double Counted Leasing Receipts***

- Vehicle manufacturers with leasing subsidiaries have receipts from the same vehicle **counted twice** in the apportionment formula.
- This affects only those manufacturers that have leasing subsidiaries.
- Can distort the level of California activity.
  - Double counting results in out-of-state profits being pulled into California **when** there is proportionally more leasing in California.

# Vehicle Leases in Apportionment Formula

- Apportionment formula as applied to vehicle manufacturers.
- Example: 100 total = 90 sold to consumers outside California, 10 leased in California.

10 cars sold to CA dealers (\$50k each)

+ lease income (\$25k each)

+ sale after lease (\$25k each)

\$1M

**18%**

100 cars sold to nationwide dealerships  
(\$50k each)

+ lease income (10 x \$25k)

+ sale after lease (10 x \$25k)

\$5.5M

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## ***Daimler's Leased Vehicles Doubled Counted***

- Daimler sells vehicles to third-party, independent, authorized dealerships.
- Consumers go to these third-party dealerships to lease a new vehicle.
- Daimler leasing affiliate buys leased vehicle from dealership and collects lease payments and receipts from ultimate sale of vehicle.
- Both the sales to the dealership and the lease related payments on the same vehicle are included in the standard apportionment formula.

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# *Lease – 3 Transactions in Apportionment Formula Capture the Vehicle Value Twice*

**Sale from Daimler to dealership**



Lease payments paid by lessee to leasing company

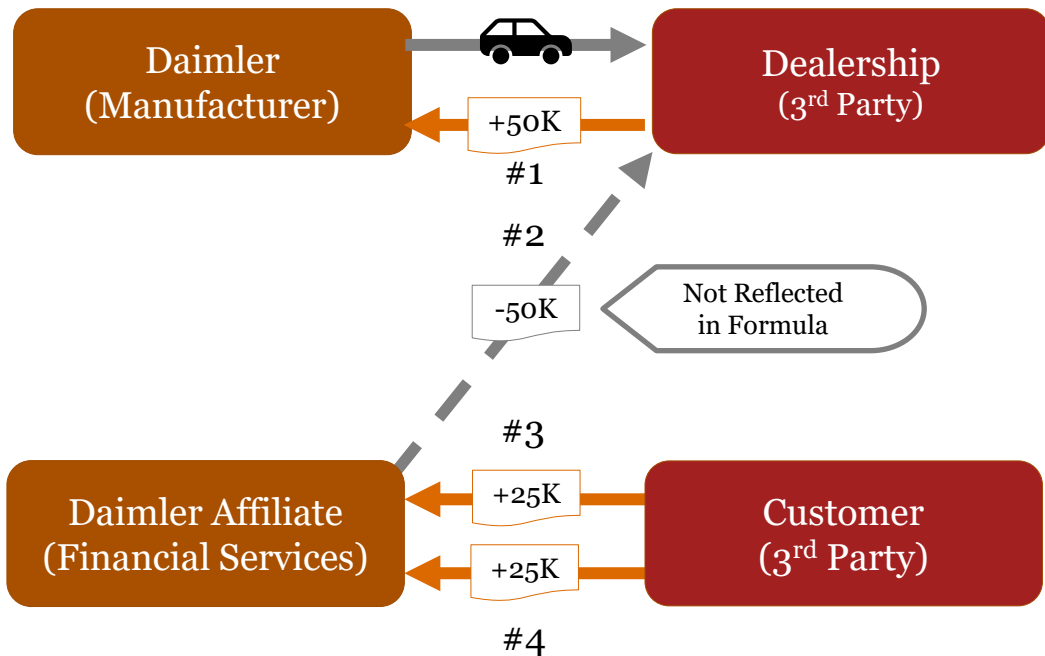


The final sale to the lessee or a third party



Double counted sale

# Lease of One Vehicle = Double Receipts



**Transaction 1:**  
\$50,000 vehicle sold

**Transaction 2:**  
Daimler Affiliate purchases vehicle back  
from dealership;  
Sale from #1 is undone;  
**Not reflected in the formula**

**Transaction 3:**  
Lessee makes \$25,000  
of lease payments over 3 years

**Transaction 4:**  
Lessee (or dealership) purchases  
vehicle for \$25,000 of residual  
value at the end of the lease term

100K

**Result:** \$50k vehicle  
\$100k included in apportionment formula in total

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## ***Proposed Remedy – Remove Undone Sales***

- Removal of undone sales in the apportionment formula.
  - Removing the undone sales to the dealerships from the apportionment formula would equitably and reasonably resolve the issue.
- This remedy would NOT reduce Daimler's income. The remedy more fairly reflects the portion of income derived from California.
- Same remedy that the FTB requested and the courts granted in *Pacific Telephone & Telegraph*, *Microsoft*, *General Mills*, etc.

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# *Rebuttal to FTB's Red Herring Arguments*

# ***FTB Does Not Address Double Counting Caused by CA Apportionment Formula***

<b>FTB Arguments</b>	<b>Fair Apportionment Related?</b>	<b>Factually Correct?</b>
<b>There is No Repurchase/Separate Entities</b>	<b>No</b>	<b>No</b>
<b>TP Chose Form/Poor Tax Planning</b>	<b>No</b>	<b>No</b>
<b>ABS Included in Sales Factor</b>	<b>No</b>	<b>No</b>
<b>Depreciation on Leased Vehicles</b>	<b>No</b>	<b>No</b>
<b>Alleged Lack of Documentation at Audit</b>	<b>No</b>	<b>No</b>



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# *Daimler Responded to Every IDR*

- FTB asked for and received:
  - **Financial statements;**
  - **Trial balance information with account descriptions;**
  - **Intercompany transaction detail;**
  - **Apportionment workpapers;**
  - **Query reports of lease acquisitions within California;**
  - **Dealer agreements; and**
  - **Lease contracts.**
- FTB never raised factual concerns over the entirety of the 2+ year audit.

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## ***Auditor Reviewed & Confirmed Key Facts***

- **“According to the trial balances provided by the taxpayer and as explained by the taxpayer, the sale to an authorized dealership and the purchase of those vehicles by the taxpayer’s financial subsidiary are recorded and accounted for as two separate transactions.”** – Audit Determination, Page 10.
- FTB’s Audit Determination **DOES NOT** mention factual disagreement once.

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## *Annual Report Confirms Vehicle Repurchases are at the Same Price*

- “The revenue received from the sale of Group products to the dealers is estimated by the Group as **being of the magnitude** of the respective addition to leased equipment at Daimler Financial Services.” – 2018 Annual Report, Page 246.

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# *Lease Contract Provided to FTB Confirms Repurchase*

- Page 1, Parties
  - ““we”, “us”, and “our” refer to the Lessor and, after the lease is assigned, to DAIMLER TRUST, or its successors and assigns; “Assignee” refers to DAIMLER TRUST or its successors and assigns.”
- Page 9, Paragraph 25
  - **“Mercedes-Benz Financial Services USA LLC (“MBFS”), as the servicing agent for Daimler Trust, has the power to act on Daimler Trust’s behalf to administer, enforce and defend this lease. You agree to pay all amounts due under this lease to MBFS or as otherwise directed by MBFS.”**

# ***FTB Has Not Explained Why This is Fair***

- Double counting receipts in the case of vehicle leases fails to fairly reflect Taxpayer's true market for vehicles.

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+ lease income (\$25k each)

+ sale after lease (\$25k each)

\$1M

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