

Approved January 25, 1984
Date

MINUTES OF THE HOUSE COMMITTEE ON ASSESSMENT AND TAXATION

The meeting was called to order by Representative Jim Braden at
Chairperson

9:00 a.m./~~p.m.~~ on January 19, 1984 in room 519S of the Capitol.

All members were present ~~except~~.

Committee staff present:

Tom Severn, Legislative Research
Wayne Morris, Legislative Research
Don Hayward, Revisor of Statutes' Office
Nancy Wolff, Secretary to the Committee

Conferees appearing before the committee:

Ron Hall, Southwestern Bell Telephone Company
Bill Edds, Department of Revenue
Tom Sheridan, Department of Revenue
Don Low, Kansas Corporation Commission

The minutes of the meetings of January 12, 1984, and January 13, 1984, were approved as printed.

Hearings were held on House Bill 2610, which would amend K.S.A. 79-3279 to require that certain telephone companies apportion business income to Kansas using one factor, Kansas regulatory net income to total regulatory net income before state income taxes. The current method of taxation is based on a three-factor system based on property, payroll and sales.

Wayne Morris, of staff, gave a brief review of the Special Interim Committee on Assessment and Taxation's report as outlined in the Report on Kansas Legislative Interim Studies to the 1984 Legislature. He also reviewed the reasons as to why this legislation was requested by Southwestern Bell Telephone Company. Copies of the current law (Exhibit I), as well as a review of a 1980 house bill (Exhibit II) and a copy of the bill from the 1980 session (Exhibit III) were given to the committee.

The Chairman read a short statement from Jeff Russell, United Telephone, which stated:

"While this legislation does not affect United Telephone, we feel it is a fair and equitable method of taxation."

Ron Hall, Southwestern Bell Telephone Company, gave testimony in favor of House Bill 2610. (Exhibit IV)

Bill Edds, Department of Revenue, spoke in opposition to House Bill 2610. (Exhibit V) He introduced Mr. Tom Sheridan, Chief of the Audit Bureau of the Department of Revenue to assist in responding to questions from the committee. Mr. Sheridan stated that a primary concern of the Department of Revenue would be that the telephone utility provide an accounting system that would provide the Department with an audit trail.

The Chairman requested Don Low of the Kansas Corporation Commission to provide information to the committee as to what "regulatory" net income is comprised.

The hearing was adjourned to be continued at the next meeting to be held on January 20, 1984 at 9:00 a.m.

79-3290. Ascertaining net income of certain corporations and business entities required to keep standard classification accounting records. The basis of ascertaining the net income of every corporation or business entity as defined by subsection (f) of K.S.A. 79-3271, when such business entity is required by the interstate commerce commission or federal power commission to keep records according to its standard classification of accounting, shall be the "net revenue from operations" of such corporation as shown by the records kept in accordance with that classification of accounts, when their business is wholly within this state, and when their business is part within and in part without the state, their net income within this state shall be ascertained by taking their gross "operating revenues" within this state, including in their gross "operating revenues" within this state the equal mileage proportion within this state of their interstate business and deducting from their gross "operating revenues" the proportion average of "operating expenses" or "operating ratio" for their whole business as shown by the records kept in accordance with the standard classification of accounts: *Provided*, That if the standard classification of "operating expenses" prescribed by the interstate commerce commission for railroads differs from the standard classification of "operating expenses" prescribed for other public utilities, such other public utilities shall be entitled to the same operating expenses as prescribed for railroads.

From the net operating income thus ascertained shall be deducted: (a) Taxes paid or accrued in this state for the income year other than Kansas income taxes; (b) a proportion of total federal taxes, other than federal income taxes as provided by K.S.A. 79-32,138 (c) (ii), paid or accrued during the income year allocated to Kansas on a fair and equitable basis or bases; (c) a proportion of interest paid or accrued during the income year computed on the following basis: find the percentage that the investment in system operating property bears to the total investment of the system companies; apply such percentage to the total interest paid or accrued by all the system companies on indebtedness in the hands of the public and allocate to Kansas the proportion of the interest paid or accrued thus determined in the ratio that operating revenues in Kansas bears to total operating revenues of the system; (d) a proportion of losses from retirement of nondepreciable property and from special obsolescence of depreciable property, not includible in operating expenses, and a proportion of losses on retired depreciable property, not compensated by insurance, allocated to Kansas in the ratio that the operating revenues in Kansas bear to the total operating revenues of the system, and the balance shall be deemed to be their net income taxable under this act. That in determining the taxable income of a corporation engaged in the business of operating a railroad under this section, the net operating income shall be increased or decreased, as the case may be, on account of joint facility rent income and joint facility rents expense accruing in this state. In the case of a railroad located entirely within this state, the net operating income shall be increased or decreased to the extent of any credit or debit balance received or paid, as the case may be, on account of car or locomotive hire; and when any railroad is located partly within and partly without this state, the said net operating income shall be increased or decreased as the case may be, on account of car or locomotive hire, in the respective ratio

which total car or locomotive mileage in Kansas bears to total car or locomotive mileage of the system.

For the purposes of this section the words "interstate business" shall mean, as to transportation companies, operating revenue earned within the state by reason of the interstate transportation of persons or property into, out of, or through this state, and as to transmission companies the interstate transmission of messages into, out of, or through this state. The words "equal mileage proportion within the state" shall mean the proportion of revenue received by the company operating in this state from interstate business as defined in the preceding paragraph, which the distance of movement over lines in this state bears to the total distance of movement over lines of the company receiving such revenue. If the director shall find, with respect to any partic-

ular company, that its accounting records are not kept so as to reflect with exact accuracy such division of revenue by state lines as to each transaction involving interstate revenue, the director may adopt such regulations, based upon averages, as will approximate with reasonable accuracy the proportion of interstate revenue actually earned upon lines in this state. The words "proportionate average of 'operating expenses' or 'operating ratio'" shall mean the proportion of gross revenue of a company, on its whole business absorbed in operating expenses, as defined in the classification of accounts.

In determining the taxable income of a railroad company operating two or more lines of railroad not physically connected, and when one of such railroad lines is located wholly within this state, the actual earnings and expenses of such line in this state, insofar as they may be severable, shall be used in determining net income taxable in this state.

History: L. 1963, ch. 485, § 20; L. 1972, ch. 374, § 2; July 1.

79-3291. Alternative methods to effectuate equitable allocation and apportionment of taxpayer's income, when. If the allocation and apportionment provisions of K.S.A. 79-3290 do not fairly represent the extent of taxpayer's business activity in this state, the taxpayer may petition for or the secretary of revenue may require in respect to all or any part of taxpayer's business activity, if reasonable, the employment of any other method to effectuate an equitable allocation and apportionment of taxpayer's income: *Provided, however*, For the purpose of this act, the net income of every corporation or business entity, as defined by subsection (f) of K.S.A. 79-3271, when such business entity is required by the federal communications commission to keep its books and records in accordance with its uniform system of accounts, shall be the Kansas net income of such corporation or business entity as determined from such books and records.

History: L. 1963, ch. 485, § 21; L. 1972, ch. 342, § 100; July 1.

✓ Income Tax - Regulated Utilities

1980 H.B. 2736 amends various provisions of the income tax statutes pertaining to regulated public utilities. Under the bill, most regulated utilities will allocate income to Kansas under a three-factor formula in the Uniform Division of Income for Tax Purposes Act, and will define income in the same manner as other corporations. Railroads and interstate motor carriers for hire will apportion their income to Kansas on the basis of a single factor mileage formula. Utilities will be allowed adjustments in their tax returns for a period of five to ten years to allow for the differences between the old and new methods of accounting required in computing their income tax. The bill also prohibits the assessment of additional taxes or interest against utilities which were required to file under the old statutes when the Secretary of Revenue determines that the amount of such an assessment would be substantially the same as the amount of the tax decrease that would result during the adjustment period.

✓ Inheritance Tax - Exclusion

S.B. 573 amends the Kansas Inheritance Tax Act to allow a graduated exclusion from the tax for qualified farm and closely-held business property, if the person filing the return elects the exclusion. Qualified real property valued at less than \$250,000 will be completely excluded. Qualified real property with a value of between \$250,000 and \$835,000 will be partially excluded according to a schedule. The maximum amount which may be excluded will be \$337,500 for properties with a value of between \$400,000 and \$450,000. The exclusion will be in lieu of use valuation of either closely-held business property or farm property. The exclusion will be available to the estates of all decedents dying after December 31, 1980, and before January 1, 1986.

✓ Inheritance Tax - Miscellaneous Changes

S.B. 730 amends K.S.A. 1979 Supp. 79-1537 to classify stepparents of the decedent as class A distributees, rather

AN ACT relating to the taxation of income; concerning allocation and apportionment of income for income tax purposes; amending K.S.A. 79-3272, 79-3279 and 79-3288 and repealing the existing sections; also repealing K.S.A. 79-3290 and 79-3291.

Be it enacted by the Legislature of the State of Kansas:

Section 1. K.S.A. 79-3272 is hereby amended to read as follows: 79-3272. Any taxpayer having income from business activity which is taxable both within and without this state, other than activity as a financial organization or public utility or the rendering of purely personal services by an individual, shall allocate and apportion his or her net income as provided in this act.

Sec. 2. K.S.A. 79-3279 is hereby amended to read as follows: 79-3279. All business income of railroads and interstate motor carriers of persons or property for-hire shall be apportioned to this state by multiplying the business income by a fraction, in the case of railroads, the numerator of which is the freight car miles in this state and the denominator of which is the freight car miles everywhere, and, in the case of interstate motor carriers, the numerator of which is the total number of miles operated in this state and the denominator of which is the total number of miles operated everywhere. All business income of any other taxpayer shall be apportioned to this state by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three.

Sec. 3. K.S.A. 79-3288 is hereby amended to read as follows: 79-3288. If the allocation and apportionment provisions of this act including the provisions of K.S.A. 79-3279, as amended, do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for or the secretary of revenue may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

- (a) Separate accounting;
- (b) the exclusion of any one or more of the factors;
- (c) the inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state; or
- (d) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income;

or

(e) in the case of two or more businesses, whether or not incorporated and whether or not organized in Kansas, owned or controlled directly or indirectly by the same interests, which contrive through inter-company transactions to evade taxes imposed under this act, the secretary of revenue may distribute or allocate the gross income and deductions between or among such businesses or may require returns on a consolidated basis: ~~Provided, however, That nothing herein will effect or permit a different determination than now provided for those taxpayers covered by K.S.A. 79-3291. And provided further, That. The~~

burden of proof of any contrivance to evade taxes under this act shall rest upon the director of taxation or secretary of revenue.

New Sec. 4. (a) The secretary of revenue shall allow a transitional adjustment for change of methods of determining Kansas net income that shall apply only for those years a taxpayer determined Kansas net income in accordance with K.S.A. 79-3290 or 79-3291 as in effect on December 31, 1979. In computing

taxable income for any year when such computation is under a method different from the method prescribed under K.S.A. 79-3290 or 79-3291 as in effect on December 31, 1979, there shall be taken into account those adjustments which are determined to be necessary solely by reason of the change in such method of computation in order to prevent amounts from being duplicated or omitted. Adjustments shall be made ratably over a period not less than five years nor more than ten years commencing with the year of change of method of computing Kansas net income, except that if the net adjustments result in a tax amount of fifty thousand dollars or less, the total amount of adjustments shall be made in the year of change of method of computing Kansas net income. The taxpayer shall make an election in the year of change of method of determining Kansas net income of the number of years in the period over which said adjustments will be claimed subject to the provisions of the preceding sentence. Adjustments shall not be allowed for differences arising under a change in methods of computing Kansas net income for any years the taxpayer did not compute Kansas net income under the provisions of K.S.A. 79-3290 or 79-3291 as in effect on December 31, 1979.

(b) No assessment of additional tax for any taxable years, or penalties or interest thereon, shall be made against any taxpayer required to compute Kansas net income for such years under the provisions of K.S.A. 79-3290 or 79-3291, as in effect on December 31, 1979 when, in the determination of the secretary of revenue, the amount of such assessment would be substantially offset by application of the transitional adjustment authorized by subsection (a) of this section if net income for such taxable years had been computed in compliance with the provisions of K.S.A. 79-3290 or 79-3291 as in effect on December 31, 1979.

Sec. 5. The provisions of this act shall be applicable to all taxable years commencing after December 31, 1979.

Sec. 6. K.S.A. 79-3272, 79-3279, 79-3288, 79-3290 and 79-3291 are hereby repealed.

Sec. 7. This act shall take effect and be in force from and after its publication in the statute book.

Approved April 18, 1980.

Ex. III 1/19/84

STATEMENT OF RONALD W. HALL
REGARDING HOUSE BILL 2610

THANK YOU FOR THE OPPORTUNITY TO ADDRESS YOU THIS MORNING CONCERNING SOUTHWESTERN BELL TELEPHONE COMPANY'S SUPPORT OF H. B. 2610. THE PURPOSE OF THIS BILL IS TO SUBSTITUTE A 1-FACTOR FORMULA INSTEAD OF THE PRESENT 3-FACTOR FORMULA IN DETERMINING KANSAS TAXABLE INCOME FOR REGULATED TELEPHONE COMPANIES WHICH OPERATE IN KANSAS AND AT LEAST ONE OTHER STATE. IN ORDER TO UNDERSTAND THE NEED FOR THIS BILL, SOME BRIEF HISTORY MIGHT BE HELPFUL.

IN ALL YEARS PRIOR TO 1979 SOUTHWESTERN BELL USED WHAT IS TERMED "SEPARATE ACCOUNTING" TO DETERMINE ITS KANSAS TAXABLE INCOME. IN OTHER WORDS, SOUTHWESTERN BELL UTILIZED THE ACTUAL REVENUES AND EXPENSES FROM ITS KANSAS OPERATIONS. SECTION 32-3291 SPECIFICALLY PROVIDED THAT TELEPHONE UTILITIES WHICH WERE REQUIRED BY THE FEDERAL COMMUNICATIONS COMMISSION TO KEEP THEIR BOOKS AND ACCOUNTING RECORDS IN ACCORDANCE WITH THE UNIFORM SYSTEM OF ACCOUNTS SHOULD UTILIZE SUCH BOOKS AND RECORDS IN DETERMINING KANSAS TAXABLE INCOME.

IN 1979, H. B. 2379 REPEALED SECTIONS 32-3290 AND 3291. THE EFFECT OF THIS CHANGE WAS TO SUBJECT SOUTHWESTERN BELL TO THE 3-FACTOR FORMULA APPORTIONMENT METHOD FOR THE FIRST TIME UNDER THE PROVISIONS OF THE UNIFORM DISTRIBUTION OF INCOME TAX PRACTICES ACT. IN EFFECT SOUTHWESTERN BELL WAS REQUIRED TO DETERMINE ITS KANSAS TAXABLE INCOME BY APPLYING A FRACTION TO ITS TOTAL FEDERAL TAXABLE INCOME. THIS FRACTION WAS DETERMINED

ON THE BASIS OF WHAT PERCENTAGE KANSAS SALES, PAYROLL AND PROPERTY WAS TO SOUTHWESTERN BELL'S TOTAL SALES, PAYROLL AND PROPERTY.

THE SIMPLE PROBLEM WITH THIS APPORTIONMENT IS THAT KANSAS REPRESENTS IN EXCESS OF 8% OF SOUTHWESTERN BELL'S SALES, PAYROLL AND PROPERTY BUT CONTRIBUTES ONLY 6% OF SOUTHWESTERN BELL'S TAXABLE INCOME. THE EFFECT IS THAT SOME \$20,000,000 OF TAXABLE INCOME WHICH IS EARNED AND TAXED IN STATES OTHER THAN KANSAS IS EFFECTIVELY APPORTIONED TO KANSAS AND TAXED AGAIN.

H. B. 2610 WOULD SIMPLY SUBSTITUTE A NEW FORMULA FOR THE PRESENT 3-FACTOR FORMULA WHICH IS MORE CLOSELY RELATED TO THE ACTUAL EARNINGS OF A CORPORATION IN THE STATE. THE BILL WOULD CONTINUE TO APPORTION A TELEPHONE UTILITY'S FEDERAL TAXABLE INCOME TO KANSAS BUT WOULD APPORTION UTILIZING "REGULATORY NET INCOME BEFORE INCOME TAXES". THIS BILL WOULD RESULT IN KANSAS TELEPHONE UTILITIES THAT DO BUSINESS IN ANOTHER STATE DETERMINING THEIR KANSAS TAXABLE INCOME BASED UPON THEIR EARNINGS IN KANSAS.

H. B. 2610 WOULD PERMIT THE KANSAS DEPARTMENT OF REVENUE TO CONTINUE TO RELY ON THE UNITED STATES INTERNAL REVENUE SERVICE TO AUDIT THE FEDERAL TAX RETURN. THE DEPARTMENT COULD AUDIT THE APPORTIONMENT FACTOR BASED UPON UNIFORM REPORTS FILED WITH THE KANSAS STATE CORPORATION COMMISSION AND THE FEDERAL COMMUNICATIONS COMMISSION. IN FACT, THE DEPARTMENT HAS PARTICIPATED IN THE DRAFTING OF THE LANGUAGE OF THIS BILL AND HAS TESTIFIED BEFORE THE JOINT INTERIM COMMITTEE THAT THE PROCEDURE IS WORKABLE.

IN SUMMARY, SOUTHWESTERN BELL ONLY SEEKS TO DO WHAT IS FAIR TO ITS CUSTOMERS IN KANSAS. PASSAGE OF THIS BILL WOULD

PERMIT US TO PAY KANSAS STATE INCOME TAX BASED UPON THE INCOME
ACTUALLY EARNED IN THE STATE. THIS CONCLUDES MY REMARKS BUT
I WOULD BE HAPPY TO ANSWER ANY QUESTIONS MEMBERS OF THE
COMMITTEE MIGHT HAVE.



Kansas
DEPARTMENT OF REVENUE

MEMORANDUM

State Office Building
TOPEKA, KANSAS 66625

To: House Assessment and Taxation Committee Date: January 19, 1984

From: Kansas Department of Revenue Re: House Bill 2610

The Kansas Department of Revenue is opposed to HB 2610 for several reasons.

1. "Separate accounting" for telephone companies is a mixed bag of direct and apportioned costs. Some expenses are charged direct to Kansas, and others are apportioned to Kansas based on different formulas. Since telephone company separate accounting already is determined in part by formula apportionment, the Kansas statutory three-factor formula apportionment is more appropriate.
2. The Kansas Supreme Court has specifically ruled on the use of formula apportionment versus separate accounting to determine income of a multistate business attributable to Kansas. In Amoco Production Company vs. Arnold, 213 Kan. 636, 518 P2d 453 (1974), it was held that formula apportionment was the preferred method of determining income of a multistate business attributable to Kansas and the use of separate accounting or any other method enumerated by K.S.A. 79-3288 was to be the exception. The statutory preference for formula apportionment, of necessity, restricts the application of separate accounting to businesses which are clearly nonunitary. Southwestern Bell is clearly unitary!
3. In the Container case, the Court conceded that the three-factor formula "is necessarily imperfect" as applied in this case but was nevertheless fair and that Container's arguments that utilization of the formula was distortive and unfair was not evidenced by the record to be so outrageous as to require the Court to deny its utilization. In this regard, the

Court is consistent with its prior decisions related to formula apportionment, as such, taxpayers will be required to show more than mere potential for double taxation or even actual double taxation in order to have formula apportionment in a particular case overturned as running afoul of the Constitution.

4. The Kansas Department of Revenue has found Southwestern Bell to be a unitary business. Separate accounting does not properly reflect the activities and income of a unitary business.
5. The Kansas Corporation Commission is opposed to the separate accounting method employed by Southwestern Bell in its calculation of Kansas income tax to be included in its rate base. The Commission does allow and prescribe formula apportionment to be used in its rate base. We are furnishing copies to this committee relating to the state income tax deduction to be included in the rate base.

THE COMMISSION FINDS THAT STAFF'S TREATMENT OF JDITC IS APPROPRIATE. THEREFORE, WE ADOPT STAFF'S TREATMENT OF JDITC.

2. STAFF'S TREATMENT OF ESOP CREDITS.

STAFF REMOVED THE RECOGNITION OF THE RECAPTURE OF PAST ESOP CREDITS FROM EXPENSES ON THE BASIS THAT THE CREDIT WAS FOR THE BENEFIT OF EMPLOYEES, AND WAS NOT SUPPOSED TO COST THE RATEPAYERS ADDITIONAL FUNDS. THIS EXPENSE ARISES FROM A CHANGE IN THE TAX LAW, AND IN VIEW OF ALL THE FACTS AND CIRCUMSTANCES, WE FIND THAT STAFF'S ADJUSTMENT SHOULD NOT BE ACCEPTED IN THIS CASE. ACCORDINGLY, THE ADJUSTMENT IS REJECTED.

3. STAFF'S USE OF A STATUTORY TAX RATE.

STAFF CALCULATED APPLICANT'S INCOME TAX LIABILITY ON A DIRECT ACCOUNTING BASIS BY APPLYING THE STATUTORY KANSAS TAX RATE OF 6.75% TO ITS ACTUAL KANSAS BOOK JURISDICTIONAL INCOME. THIS APPROACH IS TO BE CONTRASTED WITH THE FACT THAT APPLICANT NOW PAYS INCOME TAXES BASED UPON AN APPORTIONMENT FORMULA THAT REQUIRES APPLICANT TO MULTIPLY ITS TOTAL SYSTEM INCOME BY A FRACTION COMPRISED OF AVERAGE PROPERTY, PAYROLL AND SALES FACTORS. K.S.A. 79-3279. STAFF CLAIMS THAT A DIRECT ACCOUNTING METHOD IS MORE EQUITABLE BECAUSE IT PROVIDES A BETTER REPRESENTATION OF APPLICANT'S KANSAS INCOME.

UNTIL RECENTLY, APPLICANT WAS ALLOWED TO FILE ITS INCOME TAX RETURN ON A DIRECT ACCOUNTING BASIS USING A STATUTORY RATE. HOWEVER, IN 1980 THE LEGISLATURE REPEALED K.S.A. 79-3291 AND, AS A RESULT, APPLICANT HAS BEEN REQUIRED TO USE THE THREE FACTOR APPORTIONMENT FORMULA IN K.S.A. 79-3279. APPLICANT AGREES WITH STAFF THAT THE THREE FACTOR APPORTIONMENT FORMULA DOES NOT ACCURATELY REFLECT ITS KANSAS OPERATIONS, AND RESULTS IN GREATER TAX LIABILITY THAN WOULD BE REQUIRED IF TAXES WERE BASED ON ACTUAL EARNINGS. INDEED, SINCE 1981, APPLICANT HAS TWICE REQUESTED PERMISSION FROM THE KANSAS DEPARTMENT OF REVENUE TO CHANGE BACK TO THE DIRECT ACCOUNTING METHOD OF TAX CALCULATION, AND BOTH

REQUESTS HAVE BEEN DENIED. APPLICANT HAS ALSO TESTIFIED BEFORE LEGISLATIVE COMMITTEES CONCERNING THE NEED TO CHANGE THE LAW. THIS AGAIN HAS BEEN UNSUCCESSFUL.

WHATEVER THE MERITS OF THE CRITICISMS OF STAFF AND APPLICANT, CURRENT LAW REQUIRES APPLICATION OF THE THREE FACTOR FORMULA. THIS LEGAL REALITY MUST BE RECOGNIZED BY THE COMMISSION. HOWEVER, WE NOTE THAT DIRECT ACCOUNTING OFFERS A TAXPAYER DOING BUSINESS IN MORE THAN ONE STATE THE OPPORTUNITY TO MANIPULATE ITS INCOME AND DEDUCTIONS IN ATTRIBUTING THE SAME TO THOSE STATES THAT OFFER THE MOST ADVANTAGEOUS TAX TREATMENT. AS A RESULT, THE TAXPAYER HAS AN OPPORTUNITY TO AVOID TAX ON A GOOD DEAL OR, IN SOME CASES, ALL OF ITS INCOME DERIVED FROM ANY ONE PARTICULAR STATE. THE THREE-FACTOR FORMULA METHOD OF APPORTIONMENT PRECLUDES THIS OPPORTUNITY. UNDER THIS METHOD THE TAXPAYERS ARE FULLY ACCOUNTABLE FOR 100% OF THEIR INCOME TO THOSE STATES IN WHICH THEY DO BUSINESS PURSUANT TO THE OBJECTIVE MEASUREMENTS OF HOW MUCH LABOR WAS USED, HOW MUCH CAPITAL WAS EMPLOYED, AND WHERE THE SALES TOOK PLACE.

EXPERTS RECOGNIZE THAT MATHEMATICAL PRECISION IN DETERMINING A NET INCOME FOR A PARTICULAR STATE, DUE TO THE ABSTRACT NATURE OF THE NET INCOME CONCEPT, IS IMPOSSIBLE. WHILE FORMULA APPORTIONMENT IS PREMISED ON THIS FUNDAMENTAL FACT, DIRECT ACCOUNTING OPERATES ON A PREMISE THAT IS DEVOID OF ECONOMIC REALTY IN ENDEAVORING TO TREAT SEPARATELY WHAT IS, IN FACT, INSEPARABLE. INEVITABLY THE DIRECT ACCOUNTING METHOD ARRIVES AT AN ARBITRARY AND CAPRICIOUS RESULT.

WE FIND, UNDER THE CIRCUMSTANCES, THAT STAFFS ADJUSTMENT IS INAPPROPRIATE. THE ADJUSTMENT IS REJECTED.

4. STAFF'S TREATMENT OF INTEREST ON SHORT-TERM TPUC.

IN CALCULATING APPLICANT'S INTEREST DEDUCTION FOR INCOME TAX PURPOSES, STAFF INCLUDED INTEREST ON SHORT-TERM TPUC, AND APPLICANT OBJECTED TO THIS TREATMENT. SINCE STAFF EXCLUDED SHORT-TERM TPUC FROM RATE BASE, APPLICANT CLAIMS THAT DEDUCTING ASSOCIATED INTEREST FOR INCOME TAX PURPOSES VIOLATES MATCHING PRINCIPLES, AND THAT IT ALLOWS THE