

Section 2115's Peculiar Consolidation Rule

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Section 2115 of the California Corporations Code famously purports to impose numerous provisions of the General Corporation Law on foreign corporations if two tests are met. One of these tests, the so-called "business test", requires the average of the property factor, the payroll factor and the sales factor (as defined in Revenue & Taxation Code Sections 25129, 25132 & 25134). Yesterday, I [observed](#) how voter approval of Proposition 39 made this determination more difficult.

Section 2115 provides that the determination of the property, payroll and sales factors "shall be made on a consolidated basis, including in a unitary computation (after elimination of intercompany transactions) the property, payroll, and sales of the parent and all of its subsidiaries in which it owns directly or indirectly more than 50 percent of the outstanding shares entitled to vote for the election of directors, but deducting a percentage of the property, payroll, and sales of any subsidiary equal to the percentage minority ownership, if any, in the subsidiary". At first blush, this requirement seems entirely logical. It becomes less so when one considers that "subsidiary" is a defined term under the Corporations Code.

Section 189 of the Code defines a subsidiary (except in the case of Section 703) with respect to a specified corporation as a *corporation* shares of which possessing more than 50% of the *voting power* are owned directly or indirectly through one or more subsidiaries by the specified corporation. Because "corporation" is defined in Section 162 to mean corporations organized under the GCL and certain domestic corporations subject to the GCL, the use of the term "subsidiary" in Section 2115 would on its face exclude foreign corporations. It also excludes limited liability companies and other non-corporate entities whether organized in California or elsewhere. See [California's Myopic Definition Of "Subsidiary"](#)

I doubt that this was what the legislature intended. In fact, it seems that the legislature forgot that it had defined "subsidiary" because Section 2115 refers to subsidiaries in which a corporation owns directly or indirectly more than 50% of the outstanding shares entitled to vote for election. Because a corporation does not meet the definition of a "subsidiary" unless its parent owns more than 50% of the voting power (defined in Section 194.5), the 50% requirement in Section 2115 is redundant surplusage.

While this may seem painfully arcane, applying the GCL's definition of "subsidiary" to Section 2115 could in many cases make the difference in determining whether the business test is met.

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