BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
DIANA SHOP OF WAUKESHA, INC.)

Appearances:

For Appellant: Charles R, Lees, Certified Public Accountant

For Respondent:: A. Ben Jacobson, Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to Section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of Diana Shop of Waukesha, Inc., to proposed assessments of additional franchise tax in the amounts of $700.44, $594.87, $531.58, $1,449.05 and $62.08 for the income years ended January 31, 1950, 1951, 1952 and 1953, and for the period of six months ended July 31, 1953, respectively.

Appellant is a California corporation which, during the years involved herein, operated' a retail women's apparel shop in Oakland, Prior to February 1, 1949, the Oakland shop was one of many owned by Angerman Co., Inc. On that date each shop was separately incorporated in the state in which it did business. This resulted in the formation of sixty separate corporations. Diana Stores Corporation acquired the stock of Angerman Co,, Inc., in 1952 and 1953, and on August 1, 1953, it dissolved Angerman Co,, Inc. Since that time it has owned the stock of all the Angerman subsidiaries as well as the stock of 117 other separately incorporated apparel shops. On July 31, 1953, the operation of the California shops was discontinued and their assets were sold.

Diana Stores Corporation, the parent, maintained its home office in New York City and there operated a central purchasing department. The items so purchased were sold to the subsidiaries at the parent's cost, plus a service charge which was computed so as to cover the parent's operating expenses. Most of the advertising done by the subsidiaries was directed from the-home office. The parent standardized all operations which permitted of standardization, including, for example, merchandise layouts and store window displays.

The parent corporation purchased all insurance for the various subsidiaries and handled all of the bookkeeping, accounting and tax work. Each store was under the supervision of a traveling supervisor who was responsible for the operation of the stores within his territory. The supervisor, in turn, was under the jurisdiction of the home office. Local managers controlled the operation of the individual store to the extent of hiring personnel, ordering merchandise and fixing sales policy. The parent determined the subsidiaries' dividends, which were its main source of income.

During the period in question, Appellant and the other subsidiaries computed their income for franchise tax purposes upon the basis of separate accounting. The Franchise Tax Board determined that the various stores in the group were engaged in a unitary business and apportioned the entire income within and without the State through the usual formula of property, payroll and sales.

The issues are whether or not Appellant and the other corporations composing the group of stores under the common ownership of Diana Stores Corporation were engaged in a unitary business and, if so, whether the property, payroll and sales allocation formula may properly be used to determine the portion of unitary income attributable to California sources.

The test which will govern the disposition of the first issue is stated in Edison California Stores, Inc. v. McColgan, 30 Cal. 2d 472, 481, as follows:

> "If the operation of the portion of the business done within the state is dependent upon or contributes to the operation of the business without the state, the operations are unitary ..."

In the Edison California Stores case, the taxpayer was a California corporation and one of several corporations owned by Edison Brothers Stores, Inc., a Delaware corporation. Edison Brothers Stores, Inc., operated out of St. Louis, Missouri, where it maintained a central management department, central purchasing department and various other central administrative departments. The parent corporation there did the purchasing for the subsidiaries and kept the main accounting records for the subsidiaries. Each subsidiary was charged with the cost of the merchandise plus a specified percentage and a proportion of the general overhead. The court applied the above test and concluded that in view of the method of operation it could "not properly be contended that the taxpayer . . . is doing a separate business."

Comparing that case with the case before us, we note that the parent corporation here also maintained a central purchasing department and handled the bookkeeping, accounting and tax work for the subsidiaries. Furthermore, the parent here retained direct managerial control through its traveling supervisors and itself determined when the subsidiaries would declare a dividend. It appears, then, that there is no substantial difference between the factual situation presented in the Edison California Stores case and that presented here. Here, as there, the portion of the business done within the State was dependent upon and contributed to the operations without the State. We conclude, in accordance with the holding in that case, that Appellant may not properly be considered to have engaged in a separate business.

Appellant also contends that even if the business was unitary it is unreasonable and arbitrary to use the three-factor allocation formula to determine the income attributable to California. It states that rents in California were higher than elsewhere and points to the fact that even if the service charge made by the parent were eliminated, separate accounting figures would still show a loss on the California operations. It also points out that the California stores were eventually disposed of because of the losses shown by separate accounting.

Arguments substantially the same as these have been consistently rejected by the courts. (See John Deere Plow Co. v. Franchise Tax Board, 38 Cal. 2d 214, appeal dismissed, 343 U.S. 939; Edison California Stores, Inc. v. McColgan, supra; and Butler Brothers v. McColgan, 17 Cal. 2d 664; aff'd. 315 U.S. 501.

In the John Deere Plow Co. case, supra, the taxpayer produced evidence showing that wages and salaries and selling and general expenses were higher in California than elsewhere. The court met these facts with the following statement (p. 224):

> "Varying conditions in the different states wherein the integrated parts of the whole business function must be expected to cause individual deviation from the national average of the factors in the formula equation, and yet the mutual dependency of the interrelated activities in furtherance of the entire business sustains the apportionment process."

Appellant's position is even weaker than that of the taxpayer

in the John Deere case-because the rentals here do not enter into the allocation formula, while the California wages in the John Deere case did enter into the formula and had the effect of apportioning a greater amount of income to California.

The results obtained by separate accounting do not aid the Appellant, In Butler Brothers v. McColgan, supra, as in this case, the separate accounting figures of the taxpaysr showed a Loss in California. The United States Supreme Court there emphasized that although separate accounting figures may be useful or necessary as a business aid, they do not impeach the result reached by formula allocation.

O R D E R

Pursuant to the views expressed in the Opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to Section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protests of Diana Shop of Waukesha, Inc., to proposed assessments of additional franchise tax in the amounts of $700.44, $594.87, $531.58, $1,449.05 and $62.08 for the income years ended January 31, 1950, 1951, 1952 and 1953, and the period of six months ended July 31, 1953, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 15th day of September, 1959, by the State Board of Equalization.

Paul R. Leake, Chairman

George R. Reilly, Member

John W. Lynch, Member

Richard Nevins, Member

_____, Member

ATTEST: Dixwell L. Pierce, Secretary