61-SBE-020

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
OHRBACH'S, INC.)

Appearances:

For Appellant: Adrian A. Kragen, Attorney at Law

For Respondent: Burl D. Lack, Chief Counsel;
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 Ohrbach's, Inc., to proposed assessments of additional franchise tax in the amounts of $11,683.05, $5,794.84 and $10,273.86 for the income years ended July 31, 1951, 1952 and 1953, respectively.

The issue presented is the propriety of the Franchise Tax Board's application of the usual three-factor formula in measuring Appellant's net income arising from business done within this State. Appellant asserts that its California store is not part of a unitary business and that even if it is, the formula used results in an arbitrary and unreasonable allocation of income to this State.

Appellant, a New York corporation, is engaged in the operation of retail department stores. Appellant is owned by the Ohrbach family and Jerome K. Ohrbach, president of the corporation, actively directs its business affairs.

For a number of years Appellant has operated stores in New York City and Newark, New Jersey. In 1948, a store in Los Angeles was opened. Staffed with its own buyers, merchandise managers and administrative personnel, this new store does most of its own buying and advertising. It is managed by Appellant's vice president, Kermit G. Claster. As general manager, he is responsible only to Jerome K. Ohrbach and the board of directors for the policies and operation of the store.

While the Los Angeles store is given a great deal of independence, the Franchise Tax Board points to many factors which tend to show that the California operation depends upon or contributes to the rest of Appellant's business.

During the period under review, Mr. Ohrbach and Mr. Claster each made several trips a year to the opposite coast on business. The Los Angeles and New York merchandise managers and other corporate executives also made similar trips. Mr. Ohrbach spent three or four months of each year at the Los Angeles store and Mr. Claster spent six or eight weeks each year at the New York store.

Not only were there exchanges of executive talent between New York and Los *Angeles,* but also there was a constant exchange of ideas concerning advertising, market conditions, and merchandising experience, via a direct teletype service.

The Los Angeles store maintained its own staff of buyers. The work of this staff, however, was closely integrated with and supplemented by the work of the staff at the New York store. The buyers of the Los Angeles store made their headquarters at the New York store when on buying trips there. Upon request, New York placed orders and reorders for the Los Angeles store. It reported on available merchandise, followed up on delivery dates and expedited shipments. Purchase orders were set up so that an order for each store could be made on one purchase order and such combined orders were frequently placed with suppliers. The salaries of the merchandise manager and the style coordinator, as well as the cost of foreign models of merchandise used in the buying program were shared by all stores. Excess cash of the Los Angeles store was remitted weekly to the New York store which, by a single voucher, paid all the merchandise accounts owed to each supplier by the several stores.

During each of the three years under review, merchandise with an average value in excess of $1,000,000 was transferred from one store to another. By far the greatest bulk of these shipments were made from New York to Los Angeles.

The New York store maintained an accounts payable ledger for all stores, placed their insurance, prepared payroll tax reports for them, handled a pension plan for all employees and paid expenses such as those: for teletype, travel and professional fees, which it then apportioned among the stores.

The test for determining whether Appellant's stores form a single unitary business is set forth in Edison California Stores, Inc. v. McColgan, 30 Cal, 2d 472, 481, where the court said: "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...." (See also, Butler Bros. v. McColgan, 17 Cal. 2d 664, aff'd, 315 U. S. 501.) If the unitary features of Appellant's operations are sufficient to reflect themselves in materially increased

profits for the entire group of stores, it necessarily follows, within the scope of the test announced by the court and the purpose of formula allocation, that the stores are engaged in a unitary business.

Without examining all of the factors cited by the Franchise Tax Board in detail, it appears that each of the Appellant's stores does contribute to or depend upon the others. The pooling of information and experience concerning merchandising, advertising, and the like, all contribute to more efficient, more profitable operations. The transfers of merchandise indicate that shifting excess goods from one store to another is sufficiently profitable to justify shipping them 3,000 miles. The centralization of cash funds permits more efficient utilization of them. Finally, while the Appellant makes much of the fact that there is no central purchasing, the evidence shows that the operations of the New York and Los Angeles stores are so integrated that most of the benefits of central purchasing are achieved.

Appellant also urges that its separate accounting records show that the formula methodarbitrarily attributes to California an unreasonable portion of its total income. It points to the fact that the out-of-state share of profits, allocated by the three-factor formula, is materially lower than what those operations have historically earned. However, once it has been established that a business is unitary, the fact that separate accounting produces a different result from that obtained by the three-factor formula is immaterial,, (John Deere Plow Co. v. Franchise Tax Board, 38 Cal. 2d 214; Edison California Stores, Inc. v. McColgan, supra.)

Appellant initially asserted that the formula used did not properly account for salaries earned outside of California by executives and buyers of the Los Angeles store. The Franchise Tax Board agreed to adjust the payroll factor if the necessary figures were supplied by Appellant. No such figures have been provided to the Franchise Tax Board or to us and we therefore are without any basis upon which to make such an adjustment.

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 Ohrbach's, Inc., to

proposed assessments of additional franchise tax in the amounts of $11,683.05, $5,794.84 and $10,273.86 for the income years ended July 31, 1951, 1952 and 1753, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 6th day of April, 1961, by the State Board of Equalization,

John W. Lynch, Chairman

Geo. R. Reilly, Member

Alan Cranston, Member

Paul R. Leake, Member

Richard Nevins Member

ATTEST: Dixwell L. Pierce, Secretary