



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
))
SHAFFER RENTALS, INC.)

Appearances:

For Appellant: Dudley M. Lang
 Attorney at Law

For Respondent: Jack E. Gordon
 Counsel

O P I N I O N

This appeal is made pursuant to section 26077 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claims of Shaffer Rentals, Inc., for refund of franchise tax in the amounts of **\$4,472.25**, **\$4,471.61**, \$2,684.84 and **\$2,806.72** for the income years 1963, 1964, 1965 and 1966, respectively.

Appellant Shaffer Rentals, Inc., and Shaffer Tool Works are California corporations with their principal places of business located in Brea, California. The latter company is engaged in the development, production, and sale of oil tools and equipment, while appellant's activities involve the rental of these products. Both corporations operate in California and certain other states, and in various foreign countries. Shaffer Tool Works owns all the stock, except for certain qualifying shares, of Shaffer Western Hemisphere, Inc., and Shaffer de Mexico, S.A. These subsidiaries operate outside the United States and engage in activities similar to those of their parent and appellant.

The above corporate group was organized and developed by William A. Shaffer, and during his **life-**

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time he owned all the stock of appellant and Shaffer Tool Works. Mr. Shaffer died in 1945 and pursuant to his will the stock of the two companies was *distributed to his children, Donald Shaffer, Esther Sandman, and Elizabeth Wilson, and to a testamentary trust. Subsequently, the above individuals redistributed certain amounts of the Shaffer Tool Works stock to their children or to trusts for the benefit of **their children** and other close relatives. The **following chart specifies** the ownership of the two corporations during the period at issue.

<u>Shareholder</u>	<u>Shaffer Tool Works Shares</u>	<u>%</u>	<u>Appellant Shares</u>	<u>%</u>
Donald Shaffer	210	21	4	16
Children:				
Charles Shaffer	10	1		
Dee Shaffer	10	1		
Carol Shaffer	10	1		
Mary Shaffer	10	1		
Esther Sandman	210	21	4	16
Children:				
Mrs. Marjorie Whitehorse	20	2		
Mrs. Dorothy Yeats	20	2		
Elizabeth Wilson	32	3.2	4	16
Children:				
Mrs. Linda McCrosky	3	.3		
Mrs. Edna K. Meyers	3	.3		
Dennis Wilson	3	.3		
Donald Wilson	3	.3		
Revocable Trust Trustee' and Beneficiary: Elizabeth Wilson	160	16		
Revocable Trust Trustee: Elizabeth Wilson Beneficiary: Elvin Wilson	14	1.4		
Short Term Trust Trustee: Elizabeth Wilson Beneficiaries: Elizabeth Wilson's children	16	1.6		

(chart continued on next page)

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<u>Shareholder</u>	<u>Shaffer Tool Works Shares</u>	<u>%</u>	<u>Appellant Shares</u>	<u>%</u>
Short Term Trust Trustee: Elizabeth Wilson Beneficiaries: Elizabeth Wilson's children and grandchildren	16	1.6		
W. D. Shaffer Testamentary Trust Trustee: Donald Shaffer Beneficiaries: 'Donald Shaffer, Esther Sandman, Elizabeth Wilson, and their aunt (an income beneficiary of \$200 per month)	<u>250</u>	25	<u>13</u>	<u>52</u>
TOTAL	1000	100.0	25	100

Since his father's death, Donald Shaffer has been the chief operating officer and chairman of the board of directors of both appellant and Shaffer Tool Works. **Appellant states** that by virtue of these positions Donald Shaffer exercised complete operating control of the corporate group.

In respect to the years in question, appellant used its own allocation formula to compute its franchise tax liability. **Shaffer** Tool Works and Shaffer Western Hemisphere, Inc., filed combined reports pursuant to the theory that they were engaged in a single unitary enterprise. Subsequently, appellant decided that these three companies plus Shaffer de Mexico, S.A., were all members of **one unitary** business, and filed claims for refund accordingly. **However** the Franchise Tax Board determined that an absence of unity of ownership between appellant and Shaffer Tool Works prevented such a classification. At the hearing of this matter that board agreed that all of the **other** requirements for characterization of the corporate group as a single unitary enterprise had been satisfied. Therefore, whether sufficient unity of ownership existed between the above two corporations **is** the sole issue presented by this appeal.

When a taxpayer derives income from sources both within and without California, its tax liabilities shall be measured by the net income derived from or attributable to sources within this state. (Rev. & Tax. Code, § 25101.) If a business is unitary, the income attributable to California must be computed by formula allocation rather

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than by the separate accounting method. (Butler Bros. v. McColgan, 17 Cal. 2d 664 [111 P.2d 334], aff'd, 315 U.S. 501 [86 L. Ed. 991].)

If several taxable entities are involved, unity of ownership is a prerequisite to the existence of a single unitary business. (Edison California Stores, Inc. v. McColgan, 30 Cal. 2d 472 [183 P.2d 163; Appeal of Jack Harris, Inc., Cal. St. Bd. of Equal., Jan. 3, 1967.) This board has characterized the above unity as a common controlling ownership over the various entities involved. (Appeal of Jack Harris, Inc., supra.) The Franchise Tax Board has taken the position that such controlling ownership must be held by only one individual or entity. That board states that even if combination of more than one owner's interest is allowable, each owner must have the same interest in every entity involved, and there is no authority for attribution of ownership interests among family members.

In order to obtain guidance for decision of the instant appeal it is necessary to examine the ownership or control provisions of statutes whose purpose and procedure are analogous to those of the unitary business concept of section 25101. Such similarity is present in sections 24725 and 25102 of the Revenue and Taxation Code which are concerned with clearly reflecting the income of affiliated taxable entities, and authorize the use of allocation of income to accomplish this purpose. The scope of both sections is defined in terms of taxable entities "... owned or controlled directly or indirectly by the same interests...." (Emphasis added.)

Grenada Industries, Inc., 17 T.C. 231, aff'd, 202 F.2d 873, cert. denied, 346 U.S. 819 [98 L. Ed. 345], involved the Commissioner's allocations of certain income from two partnerships to two affiliated corporations, under the predecessor of the, almost identically worded federal counterpart of section 24725. The Tax Court upheld one of these allocations, and in reference to ownership or control stated at pages 253 and 254:

Throughout the years in question the J. A. Goodman family owned 35 per cent, the L. L. Goodman family 35 per cent, the Kobin family 20 per cent, and Barskin 10 per cent of the common stock of Industries and National. The same percentage interests were applicable to both partnerships, Hosiery and Abar, until

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1943, when they were changed slightly (but in the same proportion) so as to admit Solar's wife as a record partner with a 9.09 per cent interest--an event which in no way affected the control or management of either enterprise. Although it is true that the record ownership of the stock or partnership interests may not have **been in** the same persons or the same family trusts, the fact is that the 35-35-20-10 ratio (representing the proportionate interests of the Goodman and Kobin families and **Barskin** in relation to each other) was at all times maintained and that the actual control at all times material, represented by those interests, was really exercised by **J. A. Goodman, L. L. Goodman, Kobin, and Barskin.**

* * *

It is wholly unimportant that the Goodman trusts which owned stock in National and Industries were not the same Goodman trusts which were the record partners in Hosiery and **Abar**. The significant thing is that each of the two Goodmans in fact exercised control that was commensurate with the holdings of his family, and that Kobin in fact exercised control commensurate with the holdings of his family. We have no doubt that all four organizations were "owned or controlled directly or indirectly by the same interests." Cf. Forcum-James Co., 7 T.C. 1195, 1215-1216.

The Forcum-James Co. case, supra, involved an ownership or control situation very similar to Grenada Industries, Inc. supra, 17 T.C. 231, aff'd, 202 F.2d 873, cert. denied, 346 U.S. 819 [98 L. Ed. 3455, except there was some variation between the **individuals'** or families' ownership interests in the partnership and their interests in the corporation. (Forcum-James Co., 7 T.C. 1195, vacated per stipulation, 176 F.2d 311; see L. E. Shunk Latex Products, Inc., 18 T.C. 940.)

In reference to the **instant** appeal, we are not convinced of the merit of the Franchise Tax Board's **position that** the controlling ownership must be held by one individual or entity. Respondent has not submitted any reason for this limitation, and section 24725, its federal counterpart, and section 25102 do not impose such a restriction. Nor is this type of ownership required for classification of a single corporation, operating both

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both within and without California, as a unitary business.

Donald Shaffer, Esther Sandman, and Elizabeth Wilson each owned, directly or beneficially (A eal of AMP Inc., Cal. St.: Bd. of Equal., Jan. 6, 1969 x i - mately equal interests in both corporations at issue. Even if the stock held by the relatives of these individuals is ignored, their combined interests included substantially all of the stock of the two companies. We conclude that unity of ownership existed between appellant and Shaffer Tool Works, and therefore these corporations and Shaffer Western Hemisphere5 Inc., and Shaffer de Mexico, S.A., were engaged in a single unitary business during the years in question.

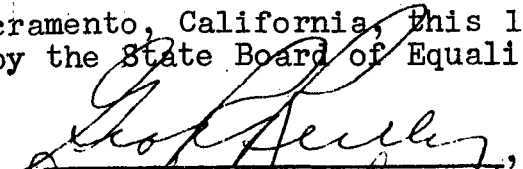
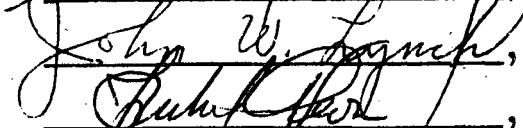

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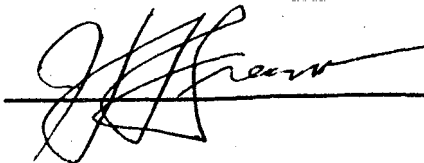
Pursuant to the views expressed in' the opinion of the board on file in this proceeding, and good cause appearing therefor,

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IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 26077 of the Revenue and Taxation, Code, that the action of the Franchise Tax Board in denying the **claims of Shaffer Rentals, Inc.**, for refund of franchise tax in the amounts of \$4,472.25, \$4,471.61, \$2,684.84 and \$2,806.72 for the income years 1963, 1964, 1965 and 1966, respectively, be and the same is hereby reversed.

Done at Sacramento, California, this 14th day of September, 1970, by the State Board of Equalization.


_____, Chairman

_____, Member

_____, Member
_____, Member
_____, Member

ATTEST:  _____, Secretary

