

Appeal of E. Hirschberg Freeze Drying, Inc.

The sole issue presented by this appeal is whether appellant and its wholly owned subsidiary were entitled to file a combined report for the income year in issue.

Appellant was incorporated under the laws of this state in 1968. It is in the business of freeze drying products for other businesses and of processing similar products for its own sales operations. In 1973 appellant formed a new corporation, Innovative Foods, Inc. (hereinafter referred to as "Innovative"), for the sole purpose of purchasing unprocessed products for resale, at no profit, to appellant. Both appellant and its wholly owned subsidiary, Innovative, have their corporate offices in this state and all of their business activities are limited to California.

For the income year in question, appellant filed a franchise tax return combining its income and deductions with those of Innovative. Respondent, however, determined that the two affiliated corporations were not entitled to file a combined report because neither engaged in business outside California. Consequently, respondent computed the income of each corporation separately. Since Innovative's expenses were not allowed as offsets against appellant's income, the net effect of respondent's action was to increase appellant's income, giving rise to the proposed assessment in issue here.

Appellant explains that Innovative was formed solely for the purpose of buying unprocessed products later to be processed' and sold by appellant. Appellant argues that since it is completely interdependent with its subsidiary, there was a joint endeavor to conduct a single enterprise, i.e., an intrastate "unitary" business, entitling the two corporations to file a combined report. In reliance upon section 25102 of the Revenue and Taxation Code, appellant objects to respondent's refusal to accept its combined report. Section 25102, in pertinent part, provides that in the case of two or more corporations owned by the same interests, respondent may permit the submission of a combined report if one is offered, or require such a submission if it determines that a combined report is necessary to reflect the proper income of the corporations.

When two or more corporations are engaged in an interstate unitary business, with part of the income derived from sources within this state, a combined

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report is required to compute their net income from the business. Thereafter, formula apportionment is required to determine the net **income** derived from California sources by any corporation subject to taxation. (Rev. & Tax. Code, § 25101; Edison California Stores, Inc. v. McColgan, 30 Cal.2d 472 [183 P.2d 16] (1947).) It has been held that a business is unitary when the operations within this state contribute to or are dependent upon the operations outside California. (Edison California Stores, Inc. v. McColgan, supra; Superior Oil Co. v. Franchise Tax Board, 60 Cal.2d 406 [34 Cal.Rptr. 545, 386 P.2d 33] (1963); Honolulu Oil Corp. v. Franchise Tax Board, 60 Cal.2d 417 [34 Cal.Rptr. 552, 386 P.2d 40] (1963).)

Prior decisions of this board, however, have upheld the position taken by respondent that corporations engaged solely in intrastate businesses have no inherent right to file a combined report merely because they are carrying on what would be regarded as a unitary business if it were an interstate operation. (Appeal of Chanticleer Investment Company, Cal. St. Bd. of Equal., Jan. 7, 1975; Appeals of Pacific Coast Properties, Inc., et al., Cal. St. Bd. of Equal., Nov. 20, 1968; Appeals of Bret Harte Inn, Inc., et al., Cal. St. Bd. of Equal., Feb. 18, 1970; Appeal of Kim Lighting and Mfg. Co., Inc., Cal. St. Bd. of Equal., June 2, 1969.) The above cited decisions are buttressed by Handlery v. Franchise Tax Board, 26 Cal.App.3d 970 [103 Cal.Rptr. 465] (1972), which held that the unitary business concept is applicable only with respect to interstate operations. Consequently, corporations engaged solely in intrastate business have no right, ~~at~~ least for income years beginning prior to 1980, ~~to~~ to file a combined

17 Section 25101.15 of the Revenue and Taxation Code, enacted by chapter 390 of the Statutes and effective July 10, 1980, permits intrastate "unitary" businesses to file combined reports for income years beginning on or after January 1, 1980. Consequently, it is of no assistance to appellant here. Section 25101.15 provides:

If the income of two or more taxpayers is derived solely from sources within this state and their business activities are such that if conducted within and **without** this state a combined report **would** be required to determine their business income derived from sources within this state, then such taxpayers shall be allowed to determine their business income in accordance with Section 25101.

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report under section 25102 and be treated as part of a unitary business, even though they would have been, considered as such had the business activity been interstate. Section 25102, as previously noted, does not authorize corporations to submit a combined report; rather, it gives respondent the discretionary authority to permit or require such a submission if it determines that a combined report is necessary in order to reflect the corporations' proper income. A taxpayer cannot compel respondent to permit or require submission of a combined report. (Appeals of Pacific Coast Properties, Inc., et al., supra; Appeal of Household Finance Corporation, Cal. St. Bd. of Equal., Nov. 20, 1968.) Accordingly, we must conclude that **respondent's** action in this matter be sustained.

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 protest of E. Hirschberg Freeze Drying, Inc., against a proposed assessment of additional franchise tax in the amount of **\$5,212.00** for the income year ended September 30, 1974, be and the same is hereby sustained.

Done at Sacramento, California, this 28th day of ~~October~~ , 1980, by the State Board of Equalization, with **Members Nevins**, Reilly, Dronenburg and Bennett present.

Richard Nevins _____, Chairman
-- Ernest J. Dronenburg, Jr. Member
- George R. Reilly _____, Member
William M. Bennett _____, Member
: _____, Member