

BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of }  
BAY ALARM COMPANY )

For Appellant: E. A. Westphal  
Chairman of the Board

For Respondent: Claudia K. Land  
Counsel

O P I N I O N

This appeal is made pursuant to section 25666 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Bay Alarm Company against proposed assessments of additional franchise tax in the amounts of \$12,283.00, \$8,045.00, and \$6,082.00 for the income years 1974, 1975, and 1976, respectively.

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**Appellant**, a California corporation, is engaged in the business of installing burglar alarms and maintaining a monitoring service for its customers, most of whom are commercial establishments located in the **San Francisco Bay Area**. During the years in issue, appellant also **maintained** an investment portfolio consisting of stocks, Treasury bills, and interests in real property.

On May 24, 1974, appellant acquired a 44.13 percent interest in NewMexCow, a general partnership formed to engage in the business of leasing dairy cows. Shortly after the partnership was formed, it entered into lease and dairy management agreements with Wayne **Palla Dairy** and Wayne **Palla Enterprises**. The NewMexCow herd was maintained in Portales, New **Mexico**, under those agreements. Pursuant to another partnership agreement, effective January 1, 1975, **NewMexCow** merged with **LeaseCow**, a similar partnership whose operation was located in Bakersfield, California. The NewMexCow name was retained, and appellant acquired a 40.87 percent interest in the reformed partnership.- NewMexCow was dissolved in 1977 after the **Portales** and Bakersfield herds were sold to Wayne **Palla Dairy**.

The business conducted by NewMexCow proved to be unprofitable and the partnership sustained a loss in each year of its existence. On its California franchise tax returns for the income years in issue, appellant treated its entire distributive share of the partnership losses as nonbusiness income and specifically allocated them to California, its commercial domicile. Upon audit of those returns, respondent determined that appellant's interest in NewMexCow was not a part of appellant's burglar alarm business but rather constituted a separate trade or business. Respondent computed appellant's distributive share of **NewMexCow's** business income, which was a net loss in each year, and for 1975 and 1976 apportioned it between New Mexico and California by means of a two-factor formula consisting of property and **sales**, since there was no payroll. For 1974 respondent assigned the entire loss to New Mexico since, in that year, the partnership did business only in New Mexico. Respondent's adjustments resulted in an increase in appellant's California taxable income in each year since the redetermined losses were less than the losses originally reported by appellant.

Initially, appellant argued that the specific allocation of its distributive share of **NewMexCow's** losses to California was proper. It has apparently

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abandoned that position and now contends that it was indeed engaged in two separate businesses during the appeal **years**, one being its burglar alarm business and the other being a unitary "**investment business**" consisting of its aforementioned investment portfolio as well as its partnership interest in NewMexCow. Given the multistate activities of its "**investment business**," appellant argues, the income derived therefrom should be apportioned to California by formula. Respondent, on the other hand, maintains that the investment activities conducted by appellant were not extensive enough to constitute, in and of themselves, an "**investment business**," and were merely an adjunct of appellant's burglar alarm business. Respondent maintains that appellant's partnership interest in NewMexCow did, however, constitute a separate trade or business whose income has been apportioned in accordance with applicable **regulations**.

The first issue presented by this appeal is whether appellant's various investment activities, including its partnership interest in NewMexCow, constituted a unitary "**investment business**," the income from which must be apportioned by formula. After resolving this **question**, we must then determine the proper assignment of appellant's distributive share of the partnership's losses.

When a taxpayer derives income from sources both within and without California, it is required to measure its California franchise tax liability by its net income derived from or attributable to sources within this state. (Rev. & Tax. Code, § 25101.) If the taxpayer is engaged in a unitary business, the amount of income attributable to California sources must be determined by applying an apportionment formula to the total income derived from the combined unitary operations. (See Edison California Stores, Inc. v. McColgan, 30 Cal. 2d 472 [183 P.2d 16](1947).) If, however, the business within this **state** is truly separate and distinct from the business without the state so that the segregation of income may be made clearly and accurately, the separate accounting method may properly be used. (Butler Bros. v. McColgan, 17 Cal.2d 664, 667 [111 P.2d 334] (1941), affd., 315 U.S. 501 [86 L.Ed. 991] (1942).)

The existence of a unitary business is established if either of two tests is met. (Appeal of F. W. Woolworth Co., Cal. St. Bd. of Equal., July 31, 1972.) ~~The California~~ Supreme Court has-determined that the existence of a unitary business is definitely established

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by the presence of: (1) unity of ownership; (2) 'unity of operation as evidenced by central purchasing, advertising, accounting and management divisions; and (3) **unity** of use in its centralized executive force and general system of operation. (Butler Bros., v. McColgan, supra, 17 **Cal.2d** at 678.) The court has also **stated** that a business is unitary when the operation of the portion of the business done within California is dependent upon or contributes to the operation of the business outside California, (Edison California Stores, Inc., supra, 30 **Cal.2d** at 481.)

After carefully reviewing the record on appeal, we are satisfied that respondent properly determined that appellant's various investment activities, including its partnership interest in **NewMexCow**, did not constitute a single unitary "investment business," the income from which must be apportioned by formula. We are particularly impressed with the lack of any significant common relationship between **appellant's** investments in real property, securities, and the partnership. Each investment is separate and distinct. In no way do any of appellant's investments contribute to or depend upon any of the other investments for their success or failure. Due to the disparate nature of each of appellant's investments and the lack of any significant common relationship between them, we cannot consider these activities as constituting a single integrated economic unit. (See Appeal of Hollywood Film Enterprises, Inc., Cal. St. Bd. of Equal., March 31, 1982; cf. Appeal of Saga Corporation, decided this date.) To recite that the **required unity** of ownership is **present**, that all of appellant's investment activities were conducted in the same **manner**, that all of the investments were structured for minimum management, that they were all accounted for in the same fashion, or that all investment decisions were made by the **same** corporate officers is an empty ritual. There simply are no significant relationships between appellant's various investment activities which would justify a determination that the activities constituted a single unitary business under either of the two established tests.

Appellant's reliance upon pur decision in Appeal of Capital Southwest Corporation, decided January 16, 1973, to support its **contention that** all of the income derived from its investment activities should be apportioned by formula is misplaced. That appeal dealt with the issue of whether certain dividends and capital gains constituted apportionable income to a recognized

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unitary business. It has no relevance to the issue of whether appellant's various investment activities actually constituted a unitary business.

Since we have concluded that the partnership was not part of a unitary investment **business**, we must now consider whether respondent properly apportioned appellant's distributive share of the partnership losses.

Respondent's regulations provide for such an apportionment. (Cal. Admin. Code, tit. 18, reg. 25137, subd. (e)(7)(A) & (B) (art. 2.5).) The regulations provide that when the activities of the partnership and the taxpayer do not constitute a unitary business' the taxpayer's share of the partnership's business shall be treated as another business of the taxpayer. If the partnership derives business income from sources entirely outside this state, **none** of its income is assignable to California. (Cal. Admin. Code, tit. 18, reg. 25137, subd. (e)(7)(B) (art. 2.5).) If, on the other hand, the partnership derives business income from sources within and without this state, California's portion of business income shall be determined on the basis of **the** standard three-factor formula of property, payroll, and sales. After determining California's portion of the partnership's business income, the taxpayer's share of such business income shall be reported as business income from a separate business by the taxpayer. (Cal. Admin. Code, tit. 18, reg. 25137, subd. (e)(7)(A) (art. 2.5).)

Respondent followed the procedure outlined above. In 1974 respondent assigned all of the partnership's loss to New Mexico since, for that year, New Mexico was the only state in which the partnership did business. For 1975 and 1976 respondent apportioned the partnership's losses between California and New Mexico on the basis of a two-factor formula since there was no payroll. We are unaware of any defect in this procedure, and appellant has suggested none. Accordingly, respondent's action in this matter must be sustained.

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**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 Bay Alarm Company against proposed assessments of additional franchise tax in the amounts of **\$12,283.00, \$8,045.00, and \$6,082.00** for the income years 1974, 1975, and 1976, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this **29th** day of June **1982** by the State Board of Equalization, with Board Members Mr. Bennett, **Mr. Dronenburg**, and **Mr. Nevins** present.

William M. Bennett, Chairman  
Ernest J. Dronenburg, Jr., Member  
Richard Nevins, Member  
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