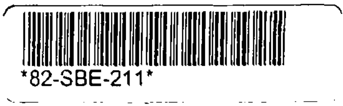

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

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

Appearances:

For Appellant: Robert L. Miller
Assistant General Counsel

For Respondent: Jon Jensen
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 Albertson's, Inc., against proposed assessments of additional franchise tax in the amounts of $10,888, $7,686, and $21,767 for the income years ended February 3, 1973, February 2, 1974, and February 1, 1975, respectively.

Appeal of Albertson's, Inc.

The question presented by this appeal is whether respondent properly included in appellant's apportionable business income its distributive share of the income of the Skaggs-Albertson's partnership,

Appellant operates a chain of supermarkets. During the appeal years, appellant did business in California and nine other western states. Although food items constituted the major offerings in appellant's stores, some general merchandise was available in all of them. The stores were generally located in neighborhood shopping centers with other retailers, such as drug, home supply, or discount stores. In appellant's annual reports for its fiscal years ended in 1971 and 4972, it stated its intention to develop "one-stop" markets by increasing its emphasis on nonfood items.

Skaggs Companies, Inc, ("Skaggs") operated a chain of "super" drug stores. Skaggs and appellant both recognized the trend toward one-stop stores, and each had previously made unsuccessful attempts to integrate the other's type of merchandise into its own stores. In 1968, Skaggs and appellant formed a partnership, called "Skaggs-Albertson's" (hereinafter sometimes referred to as "the partnership"), to operate "combination" stores. The combination stores offer customers "the frequent 'grocery' shopping that one might expect at a neighborhood supermarket, and at the same time make available the same product selection that is sold at a typical super drug or small discount general merchandise facility."

Appellant and Skaggs each held a 50 percent interest in the partnership. The partnership apparently operated in states other than those in which appellant did business. An administrative committee was formed to direct the operations of the partnership, each partner appointing half the committee members. During the appeal years, appellant appointed its chairman of the board, its vice-chairman and chief executive officer, and its president as its three representatives on the committee. The committee in turn appointed officers to oversee the. partnership's day-to-day business operations, The executive vice president and the controller of Skaggs-Albertson's were both former employees of appellant. The committee functioned independently as to the everyday operation of the partnership, but both partners had to approve major decisions such as substantial asset commitments or long-term objectives, actions which were required relatively frequently because of the rapid growth

of the partnership business. Either partner could veto any such action.

The partnership maintained its own accounting, data processing, advertising, construction, legal, personnel, and industrial relations staffs. It submitted quarterly financial statements to appellant, as required by the Securities and Exchange Commission, and weekly sales statistics and labor analyses, Appellant leased computer time to the partnership during the appeal years in amounts ranging from $42,851 in fiscal 1973 to $102,869 in fiscal 1975. The partnership also paid appellant approximately $25,000 per year for economic research on new store sites.

In October 1972, appellant and Skaggs each made a loan of $400,000 to the partnership when, money was needed to purchase a new store. Leases for new partnership store sites were reviewed and approved by each of the partners, executed by one of them, and then assigned to the partnership. Appellant apparently signed about one-half of such leases. The partnership was audited in alternating years by the partners' respective accounting firms.

The partnership used some of the same advertising and public relations programs which were used by appellant. Both also used "private labels" to offer products comparable to national name-brand products at lower prices, and some of those used were apparently the same for both sets of stores.

For the years on appeal, appellant filed its California franchise tax returns on the basis of a combined report, including the income from th'e operations of its grocery stores in its apportionable income, but excluding its 50 percent share of the partnership's income. Respondent determined that that income should have been included, and issued proposed assessments reflecting that adjustment.

A taxpayer which derives income from sources both within and without this state 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.) The California-source income of such a taxpayer must be computed in accordance with the provisions of the Uniform Division of Income for Tax Purposes Act (UDITPA) contained in sections 25120-25139 of the Revenue and Taxation Code, (Rev. & Tax. Code, § 25101.) If the business conducted within and without the state is unitary, the portion of the business income from the unitary business which is attributable to sources within

California must be determined by formula apportionment. (See Cal. Admin. Code, tit. 98, reg. 25909, subd, (f).)

Two alternative tests are used for-determining whether a business is unitary. The "three unities' test of Butler Bros. v. McColgan, 17 Cal.2d 664 [111 P.2d 334] (1941), affd., 315 U.S. 501 [86 L.Ed. 991] (1942), provides that a unitary business exists when the unities of ownership, operation, and use are present, In Edison California Stores, Inc. v. McColgan, 30 Cal.2d 472 [183 P.2d 16] (1947), the California Supreme Court said that a business is unitary if the operation of the business done within this state depends upon or contributes to the operation of the business outside the state; this is the "contribution or dependency" test, *Implicit in this second test is an ownership requirement. (Appeal of Revere Copper and Brass Incorporated, Cal. St. Bd. of Equal., July 26, 1977.)

In the case of affiliated corporations engaged in a unitary business, 100 percent of the net business income of all the affiliated corporations is combined to determine the apportionable income, and 900 percent of the property, payroll, and sales of all the affiliated corporations is used to determine the apportionment formula, This is done even if there is less than 900 percent ownership of another corporation, as long as there is controlling ownership. Controlling ownership is generally established by common ownership, directly or indirectly, of more than 50 percent of a corporation's voting stock. (Appeal of Revere Copper and Brass, Inc., supra. But see, Appeal of Signal Oil and Gas Company, Cal, St. Bd. of Equal-b,. Sept. 94, 1970.)

Under the UDITPA regulations, interests in partnerships are treated somewhat differently. Subdivision (e) of regulation 25937 provides that if the partnership's activities and the taxpayer's activities constitute a unitary business under established standards, disregarding ownership, requirements, the taxpayer's share of partnership income and apportionment factors is included in the taxpayer's combined report, (Cal. Admin. Code, tit. 98, reg. 25937, subd. (e) (art. 2.5).) We have previously decided that the provisions of this regulation should be used in apportioning and allocating partnership income for all years to which UDITPA is applicable. (Appeal of Saga Corporation, Cal. St. Bd. of Equal., June 29, 1982.)

The burden is on appellant to prove by a preponderance of the evidence that the unitary connections present were, in the aggregate, so trivial and insubstan-

tial as to require a holding that a single unitary business did not exist. (Appeal of Saga Corporation, supra.) Appellant has failed to carry that burden.

Appellant contends that its own activities and those of the partnership do not constitute a unitary business under either of the two tests for unity, It argues that appellant did not control the partnership, the two entities were engaged in distinct kinds of business, there was no integration of executive forces, no sharing of significant knowledge, and no intercompany product flow or centralized purchasing. Appellant maintains that it was simply an investor and that the partnership operated independently of the partners.

Although agreeing that regulation 25137, subdivision (e) does not require more than 50 percent ownership of the partnership, appellant argues that control of the partnership by the taxpayer is still necessary for a finding of unity. It urges that bnly where one partner dominates the partnership, either through the terms of the partnership agreement, economic power, or otherwise, may that partner and the partnership be considered unitary. Because appellant and Skaggs have equal control over the partnership, appellant concludes that it cannot be found to be unitary with the partnership,

The ownership requirement for unity contemplates an element of controlling ownership over all parts of the business. (Appeal of Revere Copper and Brass, Inc., supra.) The concept of control over the entire business is fundamental in the-case of affiliated corporations because where unity is found between such corporations, all the income and apportionment factors of each corporation are combined to determine the California taxable income, Partnerships are appropriately treated differently because they are not taxable entities and only the partner's distributive share of partnership income and apportionment factors will be'included in the combined report, We believe that in stating that unity is to be determined without regard to ownership requirements, regulation 25137, subdivision (e), refers not merely to percentage ownership requirements, but also to controlling ownership over the business. We conclude, therefore, that lack of control over the partnership business, by itself, does not preclude unitary treatment of a partner and its share of the partnership business.

Appellant argues that it was engaged in a very different type of business from that of the partnership, pointing out the differences in concept, trade areas, and

merchandising approach. The similarities between the types of business engaged in, however, are obvious and significant. Appellant was in the business of selling groceries and some general merchandise, the latter receiving increasing emphasis during the appeal years, The partnership sold both groceries and general merchandise, apparently devoting a larger portion of floor space to general merchandise than did appellant. This difference in proportion of the type of goods sold does not detract to any great extent from the basic similarity in at least the grocery business in which both entities engaged. It is neither unfair nor unwarranted to conclude that the two were, to a significant degree, engaged in similar types of businesses.

The integration of executive forces was manifest in the instant situation, with the chief officers of appellant at all times serving on the partnership's administrative committee. Integration of top executive forces is an influential factor in determining unity; for the partnership "to have the assistance and direction of high executive authority of such a corporation . . . is an invaluable resource." (Chase Brass and Copper Co. v. Franchise Tax Board, 10 Cal.App.3d 496, 504 (87 Cal.Rptr. 239) (1970).) The partnership had not only the assistance and direction of the particular executives of appellant who served on the administrative committee, but also that of appellant's entire decision-making executive force, since the partners themselves approved such major decisions as substantial asset commitments and long-range objectives.

Similarity in the types of businesses and integration of executive forces lead almost inevitably to the conclusion that a mutually beneficial exchange of knowledge occurred between two entities, (Appeal of Anchor Hocking Glass Corporation, Cal. St, Bd. of Equal,, Aug. 7, 1967.) We find totally unconvincing appellant's bare statement that such a conclusion in this case is unjustified. A partnership could be formed between any two investors who would then hire all the expertise needed to run a combination store, but when a grocery store operator and super drug store operator join to create a chain of combination stores, they clearly do so because each has valuable knowledge and expertise to contribute, That the partners in Skaggs-Albertson's recognized and took advantage of this situation is demonstrated by the fact that they joined and succeeded in this effort after each had previously made an unsuccessful attempt to integrate the other's type of operation into its own.

The partnership's ability to turn to appellant for necessary financial aid is also an indicator of unity. (Appeal of I-T-E Circuit Breaker Company, Cal. St, Bd. of Equal., Sept. 23, 1974.) Appellant supplied the partnership with a $400,000 loan during the appeal years when it needed extra money for a purchase. In addition, appellant executed approximately one-half of the leases for the partnership and essentially acted as guarantor on them after they were assigned to the partnership. The partnership was thus able to make use, at least indirectly, of appellant's credit. Such indirect financial assistance has also been found to point toward unity. (Container Corp. of America v. Franchise Tax Board, 117 Cal.App.3d 988 [--Cal.Rptr--] (1981), prob. juris. noted, May 3, 1982, -- U.S. -- (Dock. No. 81-523).)

Appellant also provided the partnership with economic research and computer time. Even though the partnership paid for these items, and could have obtained them elsewhere, the very fact that they were obtained from appellant indicates that the parties found a mutual benefit in this arrangement. (Cf. Chase Brass & Copper Co. v. Franchise Tax Board, supra, 10 Cal.App.3d at 503 (loans).) The partnership also used some of the same or similar advertising and public relations programs as appellant, and used appellant's accounting firm for every other audit. While perhaps not extremely significant individually, these factors in the aggregate fill in the already clear outline of unity which is present in this situation,

The foregoing factors, in the aggregate, show a degree of contribution and dependency between appellant and the partnership which fully satisfies us that respondent's finding of unity was appropriate. The elements of the partnership's independence and separateness emphasized by appellant are simply insufficient to convince us that the partnership was not engaged in a unitary business with appellant. Respondent's action, therefore, is sustained.

Appeal of Albertson's, Inc.

ORDER

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 Albertson's, Inc., against proposed assessments of additional franchise tax in the amounts of $10,888, $7,686, and $21,767, for the income years ended February 3, 1973, February 2, 1974, and February 1, 1975, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 21st day of September, 1982, by the State Board of Equalization, with Board Members Mr. Bennett, Mr. Collis, Mr. Dronenburg and Mr. Nevins present.

[signature], Chairman

[signature], Member

[signature], Member

[signature], Member

________________, Member