

BEFORE THE STATE BOARD OF EQUALIZATION
OF ~~THE~~ STATE OF CALIFORNIA

In the Matter of the Appeal of)
HOLLOWAY INVESTMENT COMPANY)

Appearances:

For Appellant: Richard H. Wise
Attorney at Law

For Respondent: Kendall E. Kinyon
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 Holloway Investment Company against proposed assessments of additional franchise tax in the amounts of \$5,900 and \$7,146 for the years 1974 and 1975, respectively.

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The issue *is* whether respondent properly classified gains realized in 1974 and 1975 on sales of certain Illinois property interests as business income subject to formula apportionment.

Appellant is an Illinois corporation which was originally formed by the **Holloway** family to make and sell the famous Holloway Milk Duds. The factory and other manufacturing assets of the company were located in Illinois. In 1960 appellant sold its manufacturing facilities and, thereafter, limited its activities to holding and managing investments. Sometime **after** 1960, but prior to the appeal **years**, appellant moved from Illinois to California. During this time the corporate founder died and his son, Charles Holloway, acquired his father's stock interest. Charles became the president and only full time employee of the corporation.

After appellant terminated the candy business, it retained some remnants of its former activity, including two parcel;; of Illinois real property. The basis for the 1974 assessment in issue involves the treatment of a gain from the sale of one of those parcels, a vacant lot which had been used as a parking lot for appellant's factory employees prior to 1960. After the sale of the candy operations in 1960, the lot was retained and leased to a **parking** lot operator.

During 1974 and 1975 appellant was a general or limited partner in five unrelated partnerships. All of the partnerships were involved **in** either commercial or residential real'estate ventures. Four of the five partnerships owned and operated real property located in California and were acquired after appellant terminated its candy operations and moved to California. Appellant also owned a limited partnership interest in the fifth venture, Market Basket Shopping Center (**Market Basket**). Market Basket owned and operated a small shopping center in Illinois. Appellant had acquired its interest in this partnership in 1959, the year before its sale of the candy operations. In 1975 Market Basket sold its assets and liquidated. The gain realized from the liquidation formed the basis for the 1975 assessment in question.

Appellant's other assets included **stock**, bonds, option contracts, savings certificates and cash deposits. During 1974 and 1975 appellant received income in the form of dividends, interest, rents, **partnership** distributions and gains from the sale or liquidation of property interests.

Appeal of Holloway Investment Company

On the theory that it was not engaged, in a single unitary business, appellant reported the gains realized on the 1974 sale of the former parking lot and on the 1975 liquidation of Market Basket as nonbusiness income specifically allocable to their Illinois **situs**. Respondent determined that appellant was conducting a unitary business regularly engaged in investing in securities, real property and real property partnerships. Accordingly, respondent concluded that the gains realized on the sale of the Illinois real property and the liquidation of the Illinois limited partnership constituted business income subject to formula apportionment. Appellant protested the proposed assessments. After the protest was denied, this appeal was initiated.

Since its adoption in 1966, the Uniform Division of Income for Tax Purposes Act (Rev. & Tax. Code, §§ 25120-25139) (UDITPA) has provided a comprehensive statutory scheme of apportionment and allocation rules to measure California's share of the income earned by a taxpayer engaged in a multistate or multinational unitary business. UDITPA distinguishes between "business income," which must be apportioned by formula, and "nonbusiness income," which is specifically allocated by **situs** or commercial domicile. Business income is defined as:

income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.

(Rev. & Tax. Code, § 25120, subd. (a).)

Nonbusiness income, on the other hand, is defined as "all income other than business income." (Rev. & Tax. Code, § 25120, subd. (d).)

Before it becomes necessary to consider whether the gains in question constitute business or nonbusiness income, however, we must be able to conclude that appellant's activities constitute a single unitary business under either the three-unities test (Butler Bros. v. McColgan, 17 Cal.2d 664 [111 P.2d 334] (1941), *affd.*, 315 U.S. 501 [86 L.Ed. 991] (1942)) or the contribution or dependency test (Edison California Stores, Inc. v. McColgan, 30 Cal.2d 472 [183 P.2d 16] (1947)). For our purposes, unless a unitary business exists, there can be

Appeal of Holloway Investment Company

no "business income;" the income in question would merely be specifically allocated by **situs**. Respondent's regulations dealing with business and nonbusiness income recognize the necessity for determining that appellant's activities constitute a single integrated economic enterprise by providing, in part:

Income of any type or class and from any source is business income if it arises from transactions and activity occurring in the regular course of a trade or business. Accordingly, the critical element in determining whether income is "business income" or "nonbusiness income" is the identification of the transactions and activity which are the elements of a particular trade or business. In general all transactions and activities of the taxpayer which are dependent upon or contribute to the operations of the taxpayer's economic enterprise as a whole constitute the taxpayer's trade or business and will be transactions and activity arising in the regular course of, and will constitute integral parts of, a trade or business. ...

(Cal. Admin. Code, tit. 18, reg. 25120, subd. (a) (art. 2.5)) (Emphasis added.)

The facts of record in this appeal may be summarized as follows: Prior to the **1960** sale of its manufacturing facilities, appellant was engaged in the single unitary business of manufacturing and selling candy. **Appellant's** unitary candy business terminated at, or near, the time the business was sold. Thereafter, appellant retained some of the property related to the manufacturing operation, including the parking lot. Appellant also retained Market Basket, an investment acquired the year before the sale of the candy operation. Finally, over a period of years appellant acquired various other totally unrelated investments which were located or managed from its new corporate home in California.

Based upon this record, we cannot conclude that appellant's various investment activities constituted 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 any of appellant's various investments. From all that appears in the record, each investment is separate and distinct. In no way do any of appellant's investments contribute to or depend upon any of the other

Appeal of Holloway Investment Company

investments for their success or failure. Because of 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 Unitco, Inc., Cal. St. Bd. of Equal., June 21, 1983; Appeal of Bay Alarm Company, Cal. St. Bd. of Equal., June 29, 1982; Appeal of Hollywood Film Enterprises, Inc., Cal. St Bd. of Equal., March 31, 1982.)

In concluding that the out-of-state activities of a purported unitary business must be related in some concrete way to the in-state activities, the United States Supreme Court recently stated:

there [must] be some sharing or exchange of value not capable of precise identification or measurement--beyond the mere flow of funds arising out of a passive investment or a distinct business operation--which renders formula apportionment a reasonable method of taxation.

(Container Corp. v. Franchise Tax Board, No. 81-523, slip op. at 4 (U.S.S.C. June 27, 1983).)

There simply is no significant "sharing or exchange of value not capable of precise identification or measurement" between appellant's various investment activities which would justify a determination that the activities constituted a single unitary business thus rendering formula apportionment a reasonable **method** of taxation.

Respondent relies on Appeal of Capital h - west Corporation, decided January 16, 1973, and Appeal of Isidor Weinstein Investment Co., decided April 6, 1977, **to support its position.** Capital Southwest is not helpful to respondent because the fact that the taxpayer was engaged in a unitary business was uncontested. In this appeal, appellant has steadfastly denied that it was engaged in a single unitary business. Similarly, Weinstein, a burden of proof case, does not help respondent materially. In that appeal the taxpayer contended that it was not engaged in a unitary business. However, when the taxpayer failed to offer any evidence to substantiate its contention, we held that the taxpayer had failed to disprove respondent's determination that the business was unitary.

Appeal of Holloway Investment Company

Since we have concluded that appellant is not engaged in a single unitary business, it **follows** that appellant properly reported the **1974 and 1975** gains from the sale and liquidation of Illinois property as being 'specifically allocable to their Illinois **situs**.'

Appeal of Holloway Investment Company

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 Holloway Investment Company against proposed assessments of additional franchise tax in the amounts of \$5,900 and \$7,146 for the years 1974 and 1975, respectively, be and the same is hereby reversed.

Done at Sacramento, California, this 17th day of August , 1983, by the State Board of Equalization, with Board **Members** Mr. Bennett, Mr. Collis, Mr. Dronenburg, Mr. Nevins and Mr. Harvey present.

William M. Bennett , Chairman
Conway H. Collis - , Member
Ernest J. Dronenburg, Jr. , Member
Richard Nevins , Member
Walter Harvey* , Member

*For Kenneth Cory, per Government Code section 7.9