BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
DOUGLAS FURNITURE OF CALIFORNIA, INC.)

For Appellant: Hilton Chodorow
Attorney at Law

For Respondent: Kendall E. Kinyon
Supervising Counsel

O P I N I O N

This appeal is made pursuant to section 260.75, subdivision (a), of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claims of Douglas Furniture of California, Inc., for refund of franchise tax in the amounts of $54,347 and $61,070 for the income years 1972 and 1973, respectively.

Appeal of Douglas Furniture of California, Inc.

The sole question presented by this appeal is, whether unity of ownership existed between appellant and Douglas Furniture Corporation, Inc., an Illinois corporation, during the 1972 and 1973 income years.

During the appeal years, appellant manufactured dining room furniture and game tables, which it sold in states west of the Mississippi River. Its manufacturing plant and headquarters were in the Los Angeles area. Douglas Furniture Corporation, Inc., (hereinafter "Douglas-Illinois") also manufactured dining room furniture. All the stock of Douglas-Illinois was owned by four individuals, members of the same family. All the stock of appellant was owned by these same four individuals and other members of their family,, The voting stock of the two companies was owned as follows:

	Appellant	Douglas-Illinois
Arthur D. Cohen	19.9%	25%
Morton R. Cohen	19.9%	25%
Milton A. Cohen	19.9%	25%
Helen & Myron Applebaum	19.9%	25%
Other Family Members	20.4%	--
	100.0%	100%

Appellant's stock owned by the three above-named Cohens and the Applebaums was subject to a voting trust, the terms and conditions of which are not disclosed in the record.

During and following the appeal years, there was a substantial flow of goods and interchange of ideas between the two companies. They participated in joint research and development projects, provided each other with corporate financing, used the same advertising, and used the same corporate name, Douglas Furniture. In 1974, appellant acquired a controlling stock interest in Douglas-Illinois.

For the years 1972 and 1973, appellant filed a combined report with its subsidiaries, but did not include Douglas-Illinois in the combined report. This combined report was the subject of a "no change" audit by respondent. When appellant's returns for 1974 and 1475 were audited, respondent sent a letter indicating that, after appellant's acquisition of the Douglas-Illinois stock, the two companies appeared to be engaged in a unitary business. Appellant then filed amended combined reports for 1972 and 1973 which included Douglas-Illinois and

requested refunds for those years. Respondent denied the claims, contending there was no unity of ownership between the two companies for those years.'

When a taxpayer derives income from sources both within and without California, its California franchise tax liability must be measured by its net income derived from or attributable to sources within this state. (Rev. & Tax. Code', § 25101.) If a taxpayer is engaged in a single unitary business with affiliated corporation:;, its income attributable to California sources is determined by applying an apportionment formula to the total income derived from the combined unitary operations of the affiliated companies. (Edison California Stores, Inc. v. McColgan, 30 Cal.2d 472 [183 P.2d 16] (1947).) The existence of a single unitary business is established either by the presence of the three unities of ownership, operation, and use (Butler Bros. v. McColgan, 17 Cal.2d 664 [111 P.2d 3343 (1941), affd., 315 U.S. 501 [86 L.Ed. 991] (1942)) or by a showing that the operation of the business done within California is dependent on or contributes to the operation of the business outside California. (Edison California Stores, Inc. v. McColgan, supra, 30 Cal.2d at 431.) Implicit in this latter test is an ownership requirement. The only disagreement between the parties is whether the ownership requirement. is met; all other requirements for unity are conceded to be present.

In the Appeal of Revere Copper and Brass incorporated, decided by this board on July 26, 1977, we stated the general standard for unity of ownership:

> The ownership requirement contemplates an element of controlling ownership over all parts of the business: the lack of controlling ownership standing alone requires separate treatment regardless of how closely the business activities are otherwise integrated. ... Generally speaking, controlling ownership can only be established by common ownership, directly or indirectly, of more than 50 percent of a corporation's voting stock.

Respondent contends that, to meet the ownership requirement for unity, a single individual or entity must own more than 50 percent of the voting stock of each corporation to be included in the unitary group. 'Appellant argues that the ownership requirement is satisfied where the aggregate interests of several family members constitute more than 50 percent of the voting stock in the corporations.

Appellant relies on the Appeal of Shaffer Rentals, Inc., decided by this board on September 14, 1970. In that appeal, several members of one family owned outright and as trustees of trusts benefiting other family members all the voting stock of two corporations.- Respondent had determined that unity of ownership was not present and disallowed a combined report. In reversing the action of the Franchise Tax Board, we relied on interpretations of certain language in Revenue and Taxation Code sections 24725 and 25102 and Internal Revenue Code (IRC) section 482, the federal counterpart of section 24725. These statutes, which give the respective state and federal taxing agencies discretion to adjust the reporting of certain taxable entities in order to clearly reflect their income, all refer to entities "owned or controlled directly or indirectly by the same interests ... . " On the basis of federal cases interpreting this language in IRC section 482, we held that the corporations in Shaffer Rentals were owned or controlled by the same interests and that unity of ownership was present.

Appellant's situation here is very similar to that in the Appeal of Shaffer Rentals, supra, and appellant contends that, on that basis, we should reach the same result in this appeal as we did there. Respondent, however, relies on our more recent decision in the Appeal of Revere Copper and Brass Incorporated, supra. That appeal involved the question of whether unity of ownership existed where two corporations each owned exactly 50 percent of another corporation and shared equal-control over it. In Revere Copper, we first distinguished Shaffer Rentals factually, but then went on to disapprove the analysis of that appeal. We held that Revenue and Taxation Code section 25101 1/ provides "the statutory authority for formula apportionment of the net income of

1/ Section 25101 provides, in pertinent part:

> When the income of a taxpayer subject to the tax imposed under this part is derived from or attributable to sources both within and without the state the tax shall be measured by the net income derived from or attributable to sources within this state in accordance with the provisions of Article 2 ... of this chapter [the Uniform Division of Income for Tax Purposes Act] . . . .

a unitary business where corporations are included in a combined report," and, because of the "basic differences between section 25101 on the one hand, and sections 24725, 25102 and section 482 of the Internal Revenue Code . . . on the other," interpretations of the latter three sections were not authoritative in deciding whether unity of ownership existed. We specifically rejected the argument that majority stock ownership was unnecessary if it were shown that a 50 percent owner had control over the owned corporation through equally shared control with the other 50 percent owner.

Although in Revere Copper, supra, we did not overrule the decision in Shaffer Rentals, supra, we feel compelled to do so now. The result in Shaffer Rentals was based on our finding that sections 24725 and 25102 did not impose the condition that controlling ownership must be held by one individual or entity for unity of ownership to exist. However, whatever conditions those sections do or do not impose is irrelevant when deciding whether or not unity of ownership exists. Those sections grant discretion only to the Franchise Tax Board to permit or require the filing of a combined report or to otherwise apportion or allocate a taxpayer's income if it determines that such treatment is necessary in order clearly to reflect the taxpayer's income. They do not give a taxpayer the ability to force the Franchise Tax Board to accept a combined report. (See Handlery v. Franchise Tax Board, 26 Cal.App.3d 970 [103 Cal.Rptr. 465] (1972).)

> A taxpayer cannot compel the Franchise Tax Board to act, that is, to permit or require submission of a combined report. If the board does not act, then under section 25102 there is no reviewable exercise of discretion.

(Pacific Coast Properties, Inc., et al., Cal. St. Bd. of Equal., Nov. 20, 1968.)

Therefore, our decision in Shaffer Rentals, where we reviewed the Franchise Tax Board's failure to permit a combined report under section 25102 and forced that agency to accept a combined report, was in error and must be overruled.

In Butler Bros. v. McColgan, supra, and Edison California Stores, Inc. v. McColgan, supra, the apportionment and allocation of the net income of unitary businesses pursuant to the predecessors of section 25101 was approved and unity of ownership was set as one of the standards

for determining whether a unitary business exists. For many years prior to our decision in Shaffer Rentals, the Franchise Tax Board interpreted unity of ownership to require more than 50 percent ownership of a subsidiary corporation by a parent. (See Appeal of Revere Copper and Brass Incorporated, supra,,) While such an administrative interpretation is not binding on us, we may properly look to it for guidance and accept or reject it according to the validity of its reasoning, its consistency, "and all those factors which give it power to persuade, if lacking power to control." (Skidmore v. Swift & Co., 323 U.S 134, 140 [89 L.Ed. 124] (1944); see 2 Davis, Administrative Law Treatise, §§ 7.8, 7.10 (2d Ed. 1979).)

The interpretation of the Franchise Tax Board has the advantages of being easily administered and eliminating uncertainty for taxpayers. It is most persuasive, however, because it satisfies the standard for unity of ownership which we reiterated in Revere Copper, supra. (See page 3, supra, of this opinion.), The basic test to be met is that of controlling ownership over all parts of the business. In order to ensure that two or more corporations are appropriately treated as a single integrated enterprise, the controlling ownership must be held by one individual or entity. If no one individual or entity holds controlling ownership of all the corporations involved, there is no assurance that the corporations will be operated as a unit, and the requirement of controlling ownership over all parts of the business is not met.

While other requirements for unity are not readily definable by any standardized set of facts (see Container Corp. v. Franchise Tax Bd., -- U.S. --, -- (fn. 17) [77 L.Ed.2d 545] (1983)), a "bright-line" test which is easily administered, eliminates uncertainty, and satisfies the principles of unitary business theory is particularly appropriate for the determination of unity of ownership. Therefore, we find that unity of ownership does not exist unless controlling ownership of all involved corporations is held by one individual or entity.

The shareholders of appellant and Douglas-Illinois presumably chose to hold stock in a particular way for their benefit. Having so chosen, they must bear the tax consequences. (See Handlery v. Franchise Tax Board, supra, 26 Cal.App.2d at 984.) In same situations the interests of several individuals in two or more corporations may coincide to the extent that a combined report is necessary in order to properly reflect the

income of the corporations. Then the Franchise Tax Board may, in its discretion, permit or require the filing of a combined report. (Rev. & Tax. Code, § 25102; Appeal of Household Finance Corporation, Cal. St. Bd. of Equal., Nov. 20, 1968.) The right of a taxpayer to file a combined report, however, results only from the demonstrated existence of a unitary business, which we have held cannot exist unless controlling ownership of all involved corporations is held by one individual or entity.

Because no one individual or entity had controlling ownership over both appellant and Douglas-Illinois during 1972 and 1973, unity of ownership did not exist during those years. Without unity of ownership, the two corporations could not be engaged in a single unitary business and did not have the right to force the Franchise Tax Board to accept a combined report. Respondent's action, therefore, must 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 26077 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claims of Douglas Furniture of California, Inc., for refund of franchise tax in the amounts of $54,347 and $61,070 for the income years 1972 and 1973, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 31st day of January, 1984, by the State Board of Equalization, with Board Members Mr. Nevins, Mr. Dronenburg, Mr. Collis, Mr. Bennett and Mr. Harvey present.

Richard Nevins, Chairman

Ernest J. Dronenburg, Jr., Member

Conway H. Collis, Member

William M. Bennett, Member

Walter Harvey*, Member

*For Kenneth Cory, per Government Code section 7.9