BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
THE GRUPE COMPANY, ET AL.)

Appearances:

For Appellant: J. Terry Eager
Certified Public Accountant

For Respondent: Gary M. Jerrit
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 The Grupe Company, Grupe Sales Company, Grupe Development Company, and Grupe Farms, Inc., against proposed assessments of additional franchise tax in the amounts and for the years as follows:

Appellant	Income Year	Proposed Assessment
Grupe Sales Company	1975	$10,148.00
	1976	12,810.78
	1977	59,541.91
Grupe Development Company	1975	20,240.53
	1976	18,806.74
Grupe Farms, Inc.	1976	5,082.64
The Grupe Company	1977	5,915.75

The issues fordecision are: (1) whether appellants were engaged in a unitary business and, thereby, entitled to file a combined report; and (2) if not, whether appellants may now revoke elections to capitalize certain carrying costs and to 'recognize gain using the, installment method of reporting gain which they made in returns filed for the years on appeal,

During the years at issue, Greenlaw Grupe, whose business operations were headquartered in Stockton, California, owned 100 percent of the stock of The Grupe Company (hereinafter "appellant") and Grupe Farms, Inc. Appellant, in turn, owned 80 percent of the stock of The Grupe Development Company and of the Grupe Sales Company. The appellant and its affiliates were engaged in a vertically integrated intrastate land development operation during the years at issue. Appellant bought land prior to development and had engaged in some farming activities in the past. Grupe Development Company purchased land from appellant and developed residential and commercial buildings which Grupe Sales Co. marketed.

On November 1, 1975, appellant entered into an agreement in which it leased 40 acres of agricultural land located in Denio, Nevada, from Craig Moore for five years at $4,800 per year. The subject 40 acres were part of a 4,000 acre ranch owned by Mr. Moore. At the time it entered into the lease, appellant also entered into an employment contract with Mr. Moore to farm the 40 acres. The employment agreement indicated that Mr. Moore farmed a significant number of similar acres on adjacent land and would farm the subject 40 acres simultaneously with that land. Mr. Moore was to farm the subject leased premises in a competent manner using proper farming practices to produce alfalfa hay and other similar crops. To accomplish this end, the agreement provided that Mr. Moore would have absolute and sole discretion to farm the land. Mr. Moore agreed, however, to meet with representatives of appellant, not less than quarterly, "for the purpose of answering their questions concerning high range farming, its profitability and future." (Resp. Ex.. B at 4.) The agreement indicated that as its other farming activities involved row crops, the appellant's 'major reason for entering into the Nevada farming venture was to develop expertise similar to Mr. Moore's so that management decisions could be made concerning future agricultural operations in basic range land in Nevada.

Except for the leasing of the subject 40 acres, all of the operations of appellant and its affiliates

were conducted entirely within California. On the theory that it was engaged in a single unitary business, appellant filed a combined report for the years at issue. Respondent concluded, however, that no connection existed between the California operations and the Nevada operations, and that, accordingly, appellant was not engaged in a unitary business and was not entitled to file a combined report. Proposed assessments were issued reflecting these determinations, Appellant protested and respondent's denial of that protest led to this appeal.

Next, appellant contends that if it is concluded not to be unitary, it should now be entitled to revoke certain elections it made in its return. Respondent, however, argues that once the election to capitalize carrying costs was made on the original return, such election is binding. Also, respondent contends that amendment of appellant's election to use the installment method is not properly before this board since there would be no tax effect involved during the years at issue. Appellant counters that equity requires that an invalid or erroneous return (i.e., its combined reports) should not be held to be its original return and any elections made thereon should not be binding.

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 with an affiliated corporation or corporations, the amount of business income attributable to California soures must be determined by applying an apportionment formula to the total income derived from the combined unitary operations of the affiliated companies. (See Edison California Stores, Inc. v. McColgan, 30 Cal.2d 472 [183 P.2d 16] (1947); John Deere Plow Co. v. Franchise Tax Board, 38 Cal.2d 214 [238 P.2d 5691 (1951), app. dism., 343 U.S. 939 [96 L.Ed. 13451 (1952).)

The California Supreme Court has determined that a unitary business is definitely established by the existence 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 a centralized executive force and general system of operation. (Butler Bros. v. McColgan, 17 Cal.2d 664 [111 P.2d 334) (1941), aff'd., 315 U.S. 501 [86 L.Ed. 991] (1942).) The Supreme Court has also held that a business

is unitary when the operation of the business within California contributes to, or is dependent upon, the operation of the business outside the state. (Edison California Stores, Inc. v. McColgan, supra, 30 Cal.2d at p. 481.) These principles have been reaffirmed in later cases. (Superior Oil Co. v. Franchise Tax Board, 60 Cal.2d 406 [34 Cal.Rptr. 545 386 P.2d (1963); Honolulu Oil Corp. v. Franchise Tax Board, 60 Cal.2d 417 [34 Cal.Rptr. 552, 386 P.2d 40] (1963).)

The existence of a unitary business may be established if either the three unities or the contribution or dependency test is satisfied. (Appeal of F. W. Woolworth Co., Cal. St. Bd. of Equal,, July 31, 1972; Appeal of Browning Manufacturing Co,, et al., Cal. St. Bd. of Equal., Sept. 14, 1972; Appeal of the Anaconda Company, et al., Cal. St. Bd. of Equal., May 11, 1972.) In concluding that it was engaged in a single unitary business with the Nevada operations, appellant relied upon the following factors: common financing, management, and accounting.

Respondent, as previously noted, argues that the only non-California activity pursued by the affiliated group, i.e., the Nevada operations, was not unitary with any of the affiliated group's other business endeavors under either the three unities or the contribution or dependency test. Since, during the years in issue, 'a taxpayer was qualified to report its income under California's combined reporting procedures only where it was engaged in a unitary business both within and without this state, respondent maintains that it properly determined that the affiliated group did not qualify to file a combined report,

Prior decisions of this board 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 a multistate operation.. (Appeal of E. Hirschberg Freeze Drying, Inc., Cal. St. Bd. of Equal., Oct. 28, 1980; Appeal of Kim Lighting & Manufacturing Co., Inc., Cal. St. Bd. of Equal., June 2, 1969; Appeals of Pacific Coast Properties, Inc., et al., Cal. St. Bd. of Equal., Nov. 20, 1968.) 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 activities have no right, at least for income years beginning prior to 1980, to file a combined report and be treated as a unitary business, even though they would have been considered as such had the business activities been interstate.

Upon careful review of the record on appeal, and for the specific reasons set forth below, we conclude that respondent correctly determined that the Nevada alfalfa operations were not unitary with any other aspect of the affiliated group's business activities and that, accordingly, the affiliated group did not constitute a unitary business and was not qualified to file combined reports pursuant to California's combined reporting and apportionment of income procedures.

The employment agreement which appellant entered into with Mr. Moore indicated that all the Nevada operations were managed by Mr. Moore. Mr. Moore farmed the subject 40-acre parcel in conjunction with his larger holdings. He maintained and supplied all machinery, tools, and seeds needed to farm that parcel. As indicated above, Mr. Moore had sole and absolute discretion to manage the Nevada operation. It is inconceivable that Mr. Moore would have had such discretion if he did not exercise complete control of the Nevada operations. (See Appeal of Myles Circuits, Inc., Cal. St. Bd. of Equal., June 29, 1982.) Despite appellant's assertions, the record is virtually devoid of any evidence establishing a unitary relationship between the Nevada alfalfa operations and any of the affiliated group's other business

* Section 25101.15 of the Revenue and Taxation Code, enacted by chapter 390 of the 1980 Statutes, 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.

activities. Moreover, we find that appellant's contention that it extended financing to the Nevada operation thereby indicating that the affiliated group constituted a single unitary business to be unconvincing. As we have indicated before, intercompany financing, standing alone, is not enough to mandate a finding that otherwise unrelated businesses are unitary. (Cf. Appeal of Simco, Incorporated, Cal. St. Bd. of Equal., Oct. 27, 1964.)

Concluding that appellant was not engaged in a unitary business during the years at issue requires us to address the issue of whether appellant may now revoke elections to capitalize certain carrying charges and to utilize installment reporting which it made in returns filed for the years at issue. Briefly, appellant argues that equity requires it to be entitled to revoke the elections made in the returns as filed which it asserts were based on the good faith belief that a combined report was appropriate under the circumstances. Appellant argues that equity requires that the invalid or erroneous combined report not be considered the original return and that any election made thereon not be binding.

Initially, we address appellant's contention that the erroneous combined reports not be considered the original returns for the years at issue. Appellant argues that since it is now required to file separate returns, equity requires that these later returns be considered its "original returns" for the purpose of any election which must be made. While this is a novel contention in this particular context, there appears to be no basis for appellant's position. Revenue and Taxation Code section 25401 prescribes the basic rules for filing returns for the franchise and corporation income taxes. Regulations promulgated under that section, in relevant part., provide as follows:

> Any return filed pursuant to Chapter 2 [The Bank and Corporation Franchise Tax] or Chapter 3 [Corporation Income Tax] of this part shall be deemed filed pursuant to the proper chapter of this part for the same income period, if the chapter under which filed is determined erroneous.

(Cal. Admin. Code, tit. 18, reg. 25401.)

Thus, if a return is filed under an erroneous chapter, the above regulation provides that such return

should be deemed to be filed under the proper chapter for section 25401 purposes. Indeed, to provide otherwise would not only create problems with respect to the orderly administration of the tax law (see later discussion), but would also require that the erroneous return be deemed invalid, possibly requiring the imposition of penalties. By analogy, we conclude here that the combined returns, although erroneous, should be deemed to be the original returns.

With this in mind, we can resolve the second issue concerning the propriety of revoking certain elections. The first group of elections concern those made to capitalize carrying costs of land pursuant to Revenue and Taxation Code section 24426. Section 24426 provides:

> Amounts paid or accrued for such taxes and carrying charges as, under regulations prescribed by the Franchise Tax Board, are chargeable to capital account with respect to property, if the taxpayer elects, in accordance with such regulations, to treat such taxes or charges as so chargeable.

In accordance with that statute, the Franchise Tax Board has prescribed regulations controlling the method whereby the taxpayer must exercise its election. In relevant part, those regulations provide:

> If the taxpayer elects to capitalize an item or items under this regulation, such election shall be exercised by filing with the original return for the year for which the election is made a statement indicating the item or items (whether with respect to the same project or to different projects) which the taxpayer elects to treat as chargeable to capital account. (Emphasis added.)

(Cal. Admin. Code, tit. 18, reg. 24426(a), subd. (3)(C).)

We have held before that this regulation is specific in requiring that the election to capitalize carrying charges must be exercised on the original return and that such election cannot be made in an amended return. (Appeal of Douglas Pacific Corporation, Cal. St. Bd. of Equal., Aug. 16, 1979; Appeal of Citizens Development Corporation, Cal. St. Bd. of Equal., July 31, 1973.)

The issue raised here, of course, presents the' opposite question. Can the election, once made i-n the original return, be revoked? Paraphrasing our holding in Appeal of Citizens Development Corporation, supra, appellant's election in the original return is fatal; appellant could not later change'its position, by amended returns. That being the case, appellant has established no basis in fact or authority for this board to grant its request to revoke the election made pursuant to section 24426 at th'is late date.

Appellant's argument with respect to revoking its election to use the installment method of reporting gain is also without merit. It is well settled that where a taxpayer elects to report the entire gain on the sale.of property in the year of sale, he cannot., after the expiration of the time allowed for filing a return, change his election to the installment method of reporting the gain. (Appeal of Villasenor Corporation, Cal. St. Bd. of Equal.., Aug. 18, 1980.; Appeal of Glenn R. and Julia A. Stewart, Cal. St. Bd. of Equal.,, Oct. 18, 1977; Appeal of Carl H. and Ellen G. Bergman, Cal. St.. Bd. of Equal., Feb.19, 1974).,, Those appeals., we relied on the decision of the United States Supreme Court in Pacific National Co. v. Welch, 304 U.S. 191 [82 'L,. Ed. 1282] (1938), which held that where a taxpayer makes an election not to 'use the installment reporting method, that election is binding and may not be changed after the expiration of the time allowed for filing the return. In so holding the Court stated:

> Change 'from one method [of reporting income] to [another] , as petitioner seeks, 'would require recomputation and readjustment of tax liability fo.r subsequent years and impose burdensome uncertainties upon the administration of the revenue laws. It would operate to enlarge 'the statutory period for filing returns . . . to include the period allowed for recovering overpayments. . . . There is nothing to suggest that Congress intended to permit :a taxpayer, after expiration of the time within which return is to be made, to have his tax liability computed .and settled according to [another] method. By reporting income from the sales in question according to '[one.] method., petitioner made an election that is binding upon it and t'he commissioner. (*Footnote omitted)

(304 U.S. at '194-195.)

In the instant case, we are, of course, presented with the reverse question from our previous opinions in that appellant initially reported gain on the installment sale method and now seeks to report the gain on the completed sale method.' However, such change produces the same "burdensome uncertainties upon the administration of the revenue laws" as noted above. For these reasons we would likewise conclude that appellant is now precluded from electing the completed sale method of accounting.

For the reasons noted above, the action of respondent must be sustained in this matter.'

Appeal of The Grupe Company, et al.

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 The Grupe Company, Grupe Sales Company, Grupe Development Company, and Grupe Farms, Inc., against proposed assessments of additional franchise tax in the amounts and for the years as follows:

Appellant	Income Year	Proposed Assessment
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The Grupe Company	1977	5,915.75

be and the same is hereby sustained.

Done at Sacramento, California, this 8th day of January, 1984, by the State Board of Equalization, with Board Members Mr. Dronenburg, Mr. Collis, Mr. Bennett, Mr. Nevins and Mr. Harvey present.

Ernest J. Dronenburg, Jr., Chairman

Conway H. Collis, Member

William M. Bennett, Member

Richard Nevins, Member

Walter Harvey*, Member

*For Kenneth Cory, per Government Code section 7.9