BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of	)	
	)	No. 93R-1194
AMP Incorporated	)	
	)	

Representing the Parties:

For Appellant:	Thomas A. Bowen, Attorney
For Respondent:	Cody Cinnamon, Counsel
Counsel for Board of Equalization:	Charles D. Daly, Tax Counsel

O P I N I O N

This appeal is made pursuant to section 26075, subdivision (a),[1] of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claim of AMP Incorporated for refund of franchise tax in the amounts of $617,939, $539,792, and $471,543 for the income years ended December 31, 1985, 1986 and 1987, respectively.[2]

The sole issue in this matter is whether there was unity of ownership between appellant and Pamcor, Inc. (Pamcor) during the appeal years. The parties agree that the other requirements for a unitary business were met during those years.

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[1] Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as in effect for the income year in issue.

[2] Because of its concession regarding another issue, appellant has reduced its claims for refund to the following amounts: (1) $46,488 for 1985, (2) $38,853 for 1986, and (3) $40,468 for 1987.

Appellant is a New Jersey corporation whose business is manufacturing and selling electrical components. Pamcor is a Puerto Rico corporation which was formed by appellant. It appears undisputed that 97 percent of Pamcor's voting stock was distributed proportionately to appellant's shareholder's in 1954. To ensure that any transfer of AMP stock would also result in the transfer of the same proportion of Pamcor stock to the same transferee, the stock of AMP was "tied" to the stock of Pamcor through the mechanism of a trust. The trust held legal title to the Pamcor stock deposited with it by AMP shareholders and provided the depositing AMP shareholders with a legend on their AMP stock certificates to the effect that the owner of the AMP stock was also the beneficial owner of a proportionate number of shares of Pamcor stock. Under the terms of the trust, each depositing AMP shareholder would continue to have the right to vote personally with respect to the deposited Pamcor stock (or to vote by proxy) and to receive dividends from that stock. Each depositing AMP shareholder also had the right to recover his Pamcor stock upon the termination of the trust, with the exception that AMP would hold the Pamcor stock and treat Pamcor as a wholly owned subsidiary if all of the stock of Pamcor was held by AMP or the trust at that time. Appellant states that eventually all of the Pamcor shareholders transferred their stock to the trust and alleges that over 95 percent of Pamcor stock was beneficially held during the appeal years by a "widely diverse body" of AMP shareholders while the remainder of the Pamcor stock was beneficially held by AMP itself.

For the appeal years, appellant and Pamcor did not file a combined report. On audit, respondent determined that appellant and Pamcor were engaged in a single unitary business during those years and were subject to combined reporting procedures. This Board had previously concluded in the Appeal of AMP Incorporated ("AMP I"), decided on January 6, 1969, that appellant and Pamcor were engaged in a single unitary business during income years 1960-1962. We stated in AMP I that unity of ownership existed between the two entities for those years because the controlling ownership of Pamcor through appellant's ownership of approximately 16 percent of Pamcor's stock and the trust's ownership of approximately 57 percent of Pamcor's stock for the benefit of appellant's shareholders was "substantially the same" as the controlling ownership of appellant.

The dispute between the parties regarding unity of ownership between appellant and Pamcor during the appeal years centers around conflicting developments in decisional authority that occurred between the rendering of our opinion in AMP I and the amendment of Revenue and Taxation Code section 25105 in 1994. The 1994 amendments to Revenue and Taxation Code section 25105 obviously represent a decision by the Legislature to provide a "bright-line" resolution for many of the conflicts in this area. Certainly the unity of ownership question in the factual context that we are considering here is answered for income years to which the amended statute applies. For those years, there would be per se unity of ownership

between appellant and Pamcor because they are "stapled entities" under Revenue and Taxation Code section 25105, subdivision (b)(3).[3] However, because the amendments to Revenue and Taxation Code section 25105 apply only to income years beginning on or after January 1, 1995, there is no statutory per se rule for "stapled interests" that is applicable to earlier income years, such as those at issue here. Therefore, it is appropriate for us to examine the conflicting lines of case authority regarding unity of ownership that are applicable to the income years before us.

In the Appeal of Shaffer Rentals, Inc., decided on September 14, 1970, we rejected respondent's position that unity of ownership under Revenue and Taxation Code section 25101 required controlling ownership by only one individual or entity. We concluded there that unity of ownership was established between two corporations because the combined interests of three family members represented virtually all of the stock of each of the two corporations. In reaching our conclusion, we analogized Revenue and Taxation Code section 25102 to Internal Revenue Code (IRC) section 482, which authorized various adjustments by the respective California and federal taxing authorities with respect to entities "owned or controlled directly or indirectly by the same interests."

However, in the Appeal of Douglas Furniture of California, Inc., decided on January 31, 1984, we overruled our opinion in Shaffer Rentals. In Douglas Furniture, we concluded that Revenue and Taxation Code section 25102 and IRC section 482 were irrelevant to a determination of unity of ownership under Revenue and Taxation Code section 25101 and stated the rule that "unity of ownership does not exist unless controlling ownership of all corporations is held by one individual or entity." Our justification for adoption of the "single individual or entity" rule advocated by respondent in Douglas Furniture was stated as follows:

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[3] In pertinent part, Revenue and Taxation Code section 25105 reads as follows:

> (a) For purposes of this article, other than Section 25102, the income and apportionment factors of two or more corporations shall be included in a combined report only if the corporations, otherwise meeting the requirements of Section 25101 or 25101.15, are members of a commonly controlled group.
> (b) A "commonly controlled group" means any of the following:
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> * * *
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> (3) Any two or more corporations that constitute stapled entities.
> (A) For purposes of this paragraph, "stapled entities" means any group of two or more corporations if more than 50 percent of the ownership or beneficial ownership of the stock possessing voting power in each corporation consists of stapled interests.
> (B) Two or more interests are stapled interests if, by reason of form of ownership restrictions on transfer, or other items or conditions, in connection with the transfer of one of the interests the other interest are also transferred or required to be transferred.

> 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.[4] 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. (Footnote added.)

This Board has consistently followed the "single individual or entity" test after we had announced it in Douglas Furniture. However, two appellate opinions that were decided subsequently to Douglas Furniture have called that test into question. In Hugo Neu-Proler Internat. Sales Corp. v. Franchise Tax Bd. (1987) 195 Cal.App.3d 326, the court applied former Revenue and Taxation Code section 25105[5] to the question of unity of ownership of a corporation owned by a partnership formed by two equal partners and found that such unity existed as a result of "indirect ownership" even though neither of the partners had more than a 50 percent interest in the corporation through their partnership. Another appellate court, in Rain Bird Sprinkler Mfg. Corp. v. Franchise Tax Board (1991) 229 Cal.App.3d 784, agreed with the result in Hugo Neu-Proler and applied the "indirect" language of former section 25105 to find unity of ownership under section 25101 among a large number of family corporations even though no one individual or entity necessarily owned more than 50 percent of the voting stock of any of the corporations. Noting that nothing in the language of former Revenue and Taxation Code section 25105 required that ownership be held by a single individual or entity to meet the unity of ownership test, the court in Rain Bird explicitly declined to be bound by the "single individual or entity" test stated in Douglas Furniture. (Rain Bird Sprinkler Mfg. Corp. v. Franchise Tax Board, supra, 229 Cal.App.3d at 791-793.) In explaining its disagreement with a "bright line test of more than 50 percent and a single individual or entity," the court in Rain Bird stated its position as follows:

> The problem with the administrative construction which imposes the single individual or entity restriction on top of the more-than-50-percent rule is that it is inconsistent with present corporate realities. Nowhere in the State Board of Equalization cases is there any explanation why the single individual or entity

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[4] In the Appeal of Revere Copper and Brass Incorporated, decided on July 26, 1977, we stated that, in general, controlling ownership can only be established by common ownership, directly or indirectly, of more than 50 percent of a corporation's voting stock.

[5] Revenue and Taxation Code section 25105 stated during the appeal years that "[d]irect or indirect ownership or control of more than 50 percent of the voting stock of the taxpayer shall constitute ownership or control for the purposes of this article."

> requirement is necessary. In today's corporate world, with stock ownership widely scattered, minority control is more common than majority control. We must surmise the law in this area is directed toward recognizing business realities. When there are two or more businesses operating as a single enterprise and a majority of each is owned by the same persons acting in concert, it is unrealistic to deny the unitary nature of the enterprise on the basis of lack of unity of ownership. Here, we have closely related family members who own a majority of the stock in each of the corporations and operate them as a single business enterprise. The reality is this family has one business enterprise, not a multitude. (Rain Bird Sprinkler Mfg. Corp. v. Franchise Tax Board, supra, 229 Cal.App.3d at 793.)

In Legal Ruling ("LR") 91-1, dated November 12, 1991, respondent announced its agreement with the court in Rain Bird that former Revenue and Taxation Code section 25105 was the governing section with respect to the determination of unity of ownership under section 25101. LR 91-1 states that it examines the requirements for unity of ownership under 25105. Although LR 91-1 does not expressly reject the "single individual or entity" test in Douglas Furniture, a review of any number of the 18 sections of LR 91-1 confirms that the legal ruling implicitly rejects that test. Of particular interest, section 8 of the legal ruling holds that when a group of shareholders, acting in concert, jointly own or control the voting stock of two or more corporations, unity of ownership exists under section 25105. Section 8 of the legal ruling emphasizes respondent's view that concerted ownership or control is not limited to members of the same family.

In the instant matter, appellant takes the position that the "single individual or entity" test stated in Douglas Furniture remains good law before this Board. Relying heavily upon Hugo Neu-Proler, Rain Bird, and its own LR 91-1, respondent takes the position that we should abandon that test and reverse Douglas Furniture. We must agree with respondent's position and disagree with that of appellant.

As we have indicated above, the three reasons for our adoption of the "single individual or entity" test in Douglas Furniture were: (1) ease of administration by respondent, (2) the elimination of uncertainty for taxpayers, and (3) the satisfaction of the principles of unitary business theory. However, we are no longer convinced that any of those reasons remains valid. With regard to the first reason, respondent has made very clear through the promulgation of LR 91-1, a 26 page document, that it accepts both the holding and the broad rationale stated by the court in Rain Bird. Any attempt by this Board to compel respondent to change its administrative position with regard to unity of ownership would not foster ease of administration by respondent but would result in heavier administrative burdens for respondent and create more confusion. Similarly, we think that uncertainty for taxpayers would not be eliminated if we reaffirm a "single individual or entity" test but rather that uncertainty for taxpayers would be increased as the result of the continuing inconsistent positions held by this Board and a number of appellate courts.

Finally, we are no longer persuaded that the principles of unitary business theory require a "single individual or entity" test. In the Appeal of Revere Copper and Brass Incorporated, decided on July 26, 1977, we stated that the general standard for unity of ownership contemplates an element of controlling ownership over all parts of a unitary business. In Douglas Furniture, we emphasized our belief that such controlling ownership over all part of a business could be achieved for certain only if controlling ownership were held by one individual or entity. However, as the court in Rain Bird stated, stock ownership in today's world is widely held, and business realties must be recognized in determining unity of ownership. We think that it is appropriate for us to adapt to those business realities by rejecting the "single individual or entity" test and by recognizing that unity of ownership is consistent with a group of shareholders who act in concert to operate two or more corporations as a single economic unit. Therefore, we take this opportunity to announce that we will no longer follow the "single individual or entity" test of Douglas Furniture.

Although the statutory per se rule for "stapled interests" under Revenue and Taxation Code section 25105, subdivision (b)(3), is not available to resolve the unity of ownership issue for the appeal years, we think that the rationale for that per se rule applies here. Even though no single shareholder held even a large minority position in either corporation, each shareholder of appellant held a corresponding voting interest in Pamcor, and no such shareholder could dispose of his shares in one corporation without disposing of his corresponding shares in the other corporation. Under those circumstances, we think that the shareholders had every incentive to act together to operate appellant and Pamcor as a single economic unit, and we believe that they did so. Although appellant had stated that it would present evidence to show that there was no unity of ownership between it and Pamcor during the appeal years, the documentary evidence that it did present actually showed common shareholder voting patterns tending to confirm that the two corporations were operated as an integrated business enterprise. Appellant has presented no persuasive evidence to the contrary. Because appellant has not carried its burden of proving that respondent's determination of the existence of unity of ownership is incorrect (see Appeal of Kikkoman International Inc., Cal. St. Bd. of Equal., June 29, 1982), we must conclude that unity of ownership was present in the instant matter.

Accordingly, respondent's action in this matter 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 19333 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claim of AMP Incorporated for refund of franchise tax in the amounts of $617,939, $539,792 and $471,543 for the income years ended, December 31, 1985, 1986 and 1987, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 10th day of October, 1996, by the State Board of Equalization, with Board Members Mr. Klehs, Mr. Dronenburg, Mr. Andal, Mr. Sherman, and Mr. Halverson present.

Johan Klehs, Chairman

Ernest J. Dronenburg, Jr., Member

Dean F. Andal, Member

Brad J. Sherman, Member

Rex Halverson*, Member

*For Kathleen Connell, per Government Code section 7.9.