Docusign Envelope ID: 07C5E64F-E118-82CC-831A-E757A7FFC613

OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Consolidated Appeals of: **WESTERN DISTRIBUTING COMPANY,** **A. SHEPHERD,** **C. AND D. GUADAGNI,** **K. SMITH,** **L. GUADAGNI,** **M. SMITH AND B. VANSTONE,** **D. AND M. GUADAGNI,** **S. AND E. GUADAGNI,** **T. SMITH (DEC'D) AND T. SMITH, AND** **V. AND J. GUADAGNI**	OTA Case Nos. 230914432, 230914433, 230914434, 230914435, 230914436, 230914437, 231014441, 231014442, 231014444, & 231014445

OPINION

Representing the Parties:

For Appellants: Edwin P. Antolin, Attorney

For Respondent: Kenneth B. Havens, Jr., Attorney
Katie Frank, Supervising Attorney

For Office of Tax Appeals: Grant S. Thompson, Attorney

S. HOSEY, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, Western Distributing Company (WDC) and the above-referenced individuals (Shareholder-Appellants, and together with WDC, appellants) appeal actions by respondent Franchise Tax Board (FTB) proposing additional tax and late filing penalties for the 2010 tax year in the following amounts:

Appellant(s)	Proposed Additional Tax	Late Filing Penalty	Case No.
WDC	$ 60,874.00	None	230914432
A. Shepherd	$ 9,768.00	$ 2,442.00	230914433
C. and D. Guadagni	$ 94,928.00	$23,732.00	230914434
K. Smith	$ 10,253.00	$ 2,653.25	230914434
L. Guadagni	$ 9,815.00	$ 2,453.75	230914435
M. Smith and B. Vanstone	$ 9,534.00	$23,893.50	230914437

D. and M. Guadagni	$ 9,553.00	$ 2,388.25	230914441
S. and E. Guadagni	$ 9,515.00	$ 2,378.75	230914442
T. (Dec'd) and T. Smith	$101,382.00	$25,345.50	231014444
V. and J. Guadagni	$120,302.00	$30,075.50	230914441[1]

Office of Tax Appeals (OTA) Panel Members Sara A. Hosey, Veronica I. Long, and John O. Johnson held an oral hearing for this matter in Sacramento, California, on March 17 and March 18, 2026. At the conclusion of the hearing, the record was closed, and this matter was submitted for an opinion pursuant to California Code of Regulations, title 18, section 30209(b).

ISSUES

1. Whether WDC's beverage distribution division (Western Beverage) operated as a unitary trade or business with WDC's other divisions.
2. Whether the tax benefit rule requires the inclusion of additional income based on deductions reported by WDC.
3. Whether the special apportionment formula for trucking companies that is set forth in California Code of Regulations, tit. 18, (Regulation) section 25137-11 applies to all of WDC or only to its transportation division (Western Transportation).
4. Whether appellants have shown that the use of an alternative apportionment method is warranted pursuant to R&TC section 25137.
5. Whether appellants have shown that the Shareholder-Appellants had reasonable cause for failing to file timely California income tax returns.
6. Whether appellants are entitled to additional interest abatement.

FACTUAL FINDINGS

Overview

1. WDC was a Denver-based S corporation. Because WDC was an S corporation, the Shareholder-Appellants were subject to tax on their pro rata share of WDC's taxable income, but WDC was also subject to California's 1.5 percent entity-level franchise tax (measured by net income) imposed on S corporations.
2. WDC conducted various business activities through 14 divisions. Western Beverage and Western Transportation were its largest divisions. Through Western Beverage, it conducted beverage distribution activities solely in Colorado. Through Western Transportation, it conducted an interstate long-haul trucking business. Western

[1] FTB's proposed actions also reflect applicable interest.

Transportation picked up and delivered goods in California. Other divisions included a division that manufactured parts for automobile races, a division that operated a graphic design and printing shop, and a division that operated a travel agency.

3. On January 11, 2010, WDC sold the assets of Western Beverage.[2]

4. FTB audited WDC and determined that its various business activities, including the activities of Western Beverage, constituted a single unitary trade or business with income apportionable to California. FTB also determined that income from the sale of the Western Beverage assets constituted apportionable income and that all WDC's apportionable income had to be apportioned pursuant to the special apportionment formula for trucking companies that is set forth in Regulation section 25137-11. After audit and protest proceedings, FTB issued proposed assessments reflecting its determination. Appellants then filed these timely appeals, which OTA consolidated.

History

5. WDC started in the 1930s as a beer distributor. Through the years, it expanded into different activities, which ultimately operated as divisions.

6. V. Gaines (VG) became its CEO in 1977 and continued to serve as its CEO during the tax year at issue.

7. VG initially formed Western Transportation as a subsidiary of WDC in 1977. In 1986, Western Transportation became a division of WDC.

8. WDC began distributing beer in Denver after prohibition ended and became known as Western Beverage Distribution of Colorado (Western Beverage).

9. In 1977, WDC purchased six long-haul trucks. VG originally planned to use them to pick up Western Beverage's inventory, but they eventually became a profitable interstate transportation business. In 1986, the long-haul trucking operations became a division of WDC. In 1987, VG, as President of WDC, and C. Gaines (CG)[3] as its Secretary, filed a trade name for the trucking business to operate as Western Distributing Transportation Corp. (Western Transportation).

---

[2] Most of the assets consisted of beer distribution rights. The remaining assets included inventory and tangible assets. V. Gaines, WDC's CEO, describes the sale simply as a sale of "Western Beverage's assets" and refers to the "sale of Western Beverage." FTB describes the sale of beverage distribution rights as "the core" of Western Beverage's business.

[3] CG is VG's brother.

10. WDC acquired beer distributorships and beverage rights in the early 1990s and early 2000s.

Ownership

11. VG owned 84.1 percent of WDC's voting shares. CG and T. Smith (TS) owned the remaining voting shares, and, together with VG, constituted WDC's board of directors. The major holders of nonvoting stock were VG, who owned 29.4660 percent of shares, TS, who owned 23.7267 percent of shares, and CG, who owned 22.6667 percent of shares. No other shareholder owned more than 3.1176 percent of its nonvoting shares.

Management & Operations

12. As WDC's President and CEO, VG adopted a decentralized management system in which each division operated separately from the others and their managers ran their businesses independently. He regularly spoke with division managers and made suggestions but, in his words, they were "ultimately responsible" for whether to accept his suggestions and for business operations decisions. In addition to being the CEO and President of WDC, VG traveled around the country as a professional race car driver over 40 weeks per year.

13. In addition to VG, the officers of WDC, and their areas of responsibility, are set forth below.

- C. Boggs (CB), Vice President and CFO;
- D. Guadagni (DG), Vice President,[4] responsible for Western Transportation as a whole;
- CG, Vice President, responsible for Western Beverage's sales;
- G. Bauer (GB), Vice President, responsible for Western Beverage's sales;
- S. Guadagni (SG), Vice President, responsible for Western Beverage's operations;
- S. Johnson, Vice President and general manager for a division named FineLine Signs & Graphics; and
- B. Scollon, manager of a division named GRP Connecting Rods.

14. WDC's corporate office included 10 accounting employees, two information technology employees, and three building maintenance staff.

[4] DG is VG's son.

15. WDC did not have central advertising, marketing, sales, or legal departments.[5] Advertising and sales activities were conducted separately by each division. Western Beverage's sales department included approximately 100 people.

16. CB and accounting personnel prepared tax returns and financial statements based on financial reports sent by the divisions, which the divisions prepared using a variety of accounting systems. CB and VG monitored the businesses with the financial statements. Divisions also conducted their own bookkeeping and accounting.

17. WDC maintained a line of credit, which was secured by Western Beverage's assets and linked to WDC's checking account. CB provides a declaration which states that the credit line was used by Western Beverage and that Western Transportation had its own debt.

18. WDC had an insurance policy which included commercial general liability coverage and employee benefits coverage. The policy documentation lists WDC as a whole, as well as Western Beverage and other divisions, as named insureds, and required monthly payments of $21,575.[6]

19. WDC's human resources functions were largely centralized. It maintained a central retirement plan, and its central office handled payroll, and employee health and benefits. However, divisions made their own hiring and firing decisions. A portion of each manager's compensation was based on the performance of their division.

20. Each division had one or more Vice Presidents or managers who managed the day-to-day management of the division while periodically discussing operations with VG.

    a. DG, who was responsible for Western Transportation, provides a declaration stating that the corporate office had "very little involvement" in its "day-to-day management and operations[,]" and that VG and CB "only sometimes provided advice." He provides the example of replacing their fleet of trucks and states that he consulted with VG and CB but the "decision to buy was [his] responsibility ....."

    b. GB, who was partly responsible for Western Beverage's sales, provides a declaration stating that he had "very limited contact" with corporate executives

[5] FTB's protest determination letter states that "WDC had one website which promoted all divisions." FTB has not cited the single website in its briefing, and it is not in the record.

[6] CB's declaration states that "[b]ecause of the different nature of each business, each division had different underwriting, different policies, and different deductibles." The declaration further states that "[t]he expense of auto, building and worker's compensation policies was allocated to each business."

and staff. He states he met "periodically" with VG for "about an hour and discuss[ed] how the beverage distribution business was performing." He further states that because the business was doing well, "they left us to run the business as we saw fit" and were "very hands-off."

c. SG, who was responsible for Western Beverage's operations, provides a declaration and testimony at the hearing stating that VG "periodically checked in to see how were doing but did not manage the businesses." He further indicates that CB and VG provided strategic advice but states that "the decisions were ultimately up to me and the other Western Beverage managers."

d. Other division managers provided declarations that similarly indicated that the divisions were managed independently.

21. Intercompany transactions were at the discretion of division managers and conducted at arms-length prices. Western Beverage occasionally hired Western Transportation, at Western Transportation's standard rates, to transport goods to Western Beverage's warehouse. In 2009, the last full tax year preceding the tax year at issue, amounts paid by Western Beverage constituted less than one percent of Western Transportation's revenue and less than one percent of the volume of beverages distributed by Western Beverage.

22. Each division generally controlled its own purchasing with little oversight. Division managers would let VG and CB know of plans for large purchases, such as for a $100,000 truck, so that they could, in the words of VG, "review their plan and ensure the reports showed that enough cash was available."

23. WDC's divisions used a single checking account, and VG signed the vast majority of checks. The divisions also had blank checks and the ability to write checks independently if needed. The centralized checking account allowed VG and CB to monitor cash flow. Divisions made purchasing decisions, placed orders with vendors and sent the vendors' invoices to the corporate office for payment.

Tax Reporting

24. On its California tax returns for the 2006 to 2010 tax years, WDC reported it had no separate trades or businesses and reduced WDC's California unitary business income by expenses incurred by Western Beverage. The deduction of Western Beverage's expenses contributed to $741,899 of net losses WDC apportioned to California during the 2006 to 2010 tax years.

25. For the 2010 tax year, WDC reported income from the sale of WDC's assets on its federal tax return. On its California tax return, it reported $68,180,087 of income from the sale as nonbusiness income sourced to Colorado. Since WDC reported the gain as nonbusiness income, it did not apportion any of the gain to California.[7] It reported a California apportionment percentage of 4.9339 percent and apportioned a loss of $157,000 to California.

Audit, Protest, and Appeal

26. On October 5, 2016, FTB issued a Notice of Proposed Assessment (NPA) to WDC. The NPA reflected FTB's determination that the $68,180,087 of income from the sale was apportionable business income and increased WDC's apportionment factor from 4.9339 percent to 6.6047 percent.
27. On October 10, 2016, FTB issued NPAs to the Shareholder-Appellants reflecting its proposed adjustments to WDC's apportionable business income and apportionment factor.
28. On December 2, 2016, WDC and Appellant-Shareholders protested FTB's proposed assessments. FTB has agreed to abate interest from this date through November 3, 2017. A protest hearing was held, and FTB requested and received additional information from appellants.
29. On August 29, 2023, FTB issued Notice of Actions (NOAs) to WDC and the Shareholder-Appellants that affirmed its NPAs.
30. Appellants then filed this timely appeal.

DISCUSSION

Issue 1: Whether Western Beverage operated as a unitary trade or business with WDC's other divisions.

I. Introduction

The underlying issue in this appeal is whether income recognized by WDC from the sale of the assets of Western Beverage constitutes income from a unitary business with business activities in California. (Cf. *Appeal of Smith*, 2023-OTA-069P (*Smith*).) If WDC conducted a single unitary business, and Western Beverage's activities were a part of that business, then

[7] On appeal, appellants do not dispute that the income is business income. However, they argue that none of the income is apportionable to California because it arises from Western Beverage's business, which appellants contend is a separate trade or business that does not do business in California.

income from the sale of Western Beverage's assets constitutes apportionable business income and a portion of that income will be apportioned to California.[8]

The term "unitary business" generally refers to business activities that are sufficiently interrelated or dependent upon or contributory to one another to be considered a single, or unitary, business. (*Smith*, *supra*.) The apportionment of unitary business income takes into account activities of the entire unitary business, even if the business is conducted by separate entities. (See, e.g., *Mobil Oil Corp. v. Commissioner of Taxes of Vermont* (1980) 445 U.S. 425, 441; R&TC, § 25101; Cal. Code Regs., tit. 18, § 25101(a).) This methodology reflects that geographical or transactional separate accounting "often ignores or captures inadequately the many subtle and largely unquantifiable transfers of value that take place among the components of a single enterprise." (*Container Corp. of America v. Franchise Tax Bd.* (1983) 463 U.S. 159, 164-165.)

FTB's determination regarding the existence or non-existence of a unitary business is presumptively correct, and the taxpayer bears the burden of proving otherwise. (*Appeal of Kikkoman International, Inc.*, 82-SBE-098, 1982 WL 11776.) To prevail, appellants must show that alleged unitary connections are so weak it compels the conclusion that a single integrated economic enterprise does not exist. (*Ibid.*; see also *Smith*, *supra*.)

There are two alternative tests for determining whether a business is "unitary." (*A.M. Castle & Co. v. Franchise Tax Bd*. (1995) 36 Cal.App.4th 1794, 1802-1806 (*A.M. Castle*).) First, the existence of a unitary business may be established by applying what is known as the "three unities test." (*Butler Bros. v. McColgan* (1941) 17 Cal.2d 664, 678 (*Butler Bros.*), affd. (1942) 315 U.S. 501.) Under this test, a unitary business is "definitely established" when there is (1) unity of ownership, (2) "[u]nity of operation as evidenced by central purchasing, advertising, accounting and management divisions," and (3) unity of use in the centralized executive force and general system of operation. (*Ibid*.) "All three unities must be found to

[8] As noted in *Smith*, *Hoechst Celanese Corp. v. Franchise Tax Bd.* (2001) 25 Cal.4th 508, the court found that R&TC section 25120(a) establishes both a "transactional test" and a "functional test" for determining whether income constitutes business income. (*Id*. at pp. 520-526.) The satisfaction of either test leads to a determination that income is apportionable business income. (*Id*. at p. 526.) In applying the functional test, the critical inquiry is the relationship between the property sold and the taxpayer's business operations. (*Id*. at p. 527.) In general, gain from the sale of a unitary asset generates apportionable business income, at least under the statutory functional test. (See, e.g., *Jim Beam Brands Co. v.*
Franchise Tax Bd. (2005) 133 Cal.App.4th 514 [gain on the sale of stock in unitary subsidiary generates business income].) If Western Beverage's assets were a part of WDC's unitary business, then a portion of that income will be apportioned to California because WDC, through Western Transportation, conducts business in California.

exist." (*Dental Ins. Consultants, Inc. v. Franchise Tax Bd.* (1991) 1 Cal.App.4th 343, 348 (*Dental Ins*.).)

Second, the existence of a unitary business may be established under the "dependency or contribution" test. (*Edison Cal. Stores v. McColgan* (1947) 30 Cal.2d 472 (*Edison*).) "Under this more general test, a business is unitary if 'there is evidence to indicate that the segments under consideration are . . . dependent upon or contribute to each other and the operations of the taxpayer as a whole.'" (*A.M. Castle*, *supra*, 36 Cal.App.4th 1794, 1803-1804, quoting Cal. Code Regs., tit. 18, § 25120(b), additional citations omitted.)

In evaluating whether unity exists, courts have considered, among other things: executive management control; shared functions such as purchasing, personnel, advertising, accounting, legal services, and financing; whether there are substantial intercompany flows of products, goods or raw materials; whether there is a sharing of technology and expertise; whether there is intercompany financing in which there is an exchange of value beyond the mere flow of funds from a passive investment; and whether the companies are in the same line of business. (See *A.M. Castle*, *supra*; *Container Corp. of America v. Franchise Tax Bd.*, *supra*,; *Tenneco West, Inc. v. Franchise Tax Bd*. (1991) 234 Cal.App.3d 1510 (*Tenneco*); *Dental Ins.*, *supra*.)

II. Three Unities Test

A. Unity of Ownership

Under the three unities test, the first question is whether there was unity of ownership. Each of WDC's operating divisions is owned by WDC, so they all share the same ownership. Therefore, unity of ownership exists.

B. Unity of Operations[9]

Unity of operation may be evidenced by central purchasing, human resources, advertising, and accounting. (*Butler Bros*., *supra*, at p. 678; *Chase Brass and Copper Co. v. Franchise Tax Bd.* (1970) 10 Cal.App.3d 496, 502-503 (*Chase Brass*).)

[9] In *Dental Ins*., *supra*, at p. 348, the court acknowledged that "[t]he categories of unity of operation and unity of use are somewhat artificial, and precise distinctions are therefore impossible, as they often overlap." It explained that the categories "are useful only to the extent they reflect the organizational and economic interrelation between the parent and subsidiary companies," which must be "significant" to find unity. (*Ibid*.)

1. Central Purchasing

a. General Purchasing Decisions

A preponderance of the evidence indicates that purchasing was generally decentralized and that WDC's use of a single checking account facilitated oversight of cashflow rather than group purchasing that generated economies of scale or other flows of value. WDC's general purchasing practices appear to have been largely decentralized, which cuts against FTB's argument that there was unity of operations.

b. Insurance

FTB argues that central purchasing is present here due to WDC's purchase of a single insurance policy from Travelers Insurance covering all divisions. The policy was issued to WDC and lists as named insureds WDC, as well as Western Beverage and other divisions. It requires monthly payments of $21,575 and provides general liability coverage and other coverage.

Based on the policy documentation provided by FTB, it appears that the divisions shared a common general insurance policy. VG's testimony confirmed that there was a common policy that would help drive down costs, but that the divisions were able to go to market and price out insurance to save costs if they so desired. OTA therefore finds that the divisions shared a significant common insurance policy. Unlike in *A.M. Castle*, and *Chase Brass*, it appears the shared policy might be fairly described as a basic or primary policy. The shared policy is a fact that weighs in favor of unity of operations.

c. Line of Credit

WDC maintained a line of credit, which was secured by Western Beverage's assets and linked to WDC's checking account. CB's testimony was that the credit line was used by Western Beverage and that Western Transportation had its own debt. As the line of credit was issued by a third party and used by Western Beverage and secured by its assets, it does not appear to have created significant flows of value between the divisions and is not a strong indication of unity of operations. (Cf. *Appeals of PBS Building Systems, Inc., et al.* (94-SBE-008) 1994 WL 719050 (*PBS*) [where the parent provided an unsecured, interest-free loan of $11 million].)

d. Intercompany Transactions

In the context of unity of operations, OTA considers the buying of auxiliary supplies and services, rather than the buying of goods or services associated with WDC's "line functions" or

core business activities.[10] (See *Chase Brass*, *supra*, at p. 502.) The latter activities are considered in the context of unity of use. (*Ibid*.) While WDC's divisions share some common services, such as an insurance policy and human resources functions, the evidence shows that purchases of intercompany goods and services were minimal and conducted at arm's length.

2. Human Resources

WDC's human resources functions were largely centralized. It maintained a central retirement plan, and its central office handled payroll, and employee health and benefits. However, divisions made their own hiring and firing decisions, and a portion of each manager's compensation was based on the performance of their division.[11]

In *Chase Brass*, the court noted the existence of a central retirement plan as a fact favoring unity of use. (*Chase Brass*, *supra*, at pp. 503-504.) However, in *Tenneco*, the court found that the taxpayer "lacked substantial centralized departments" despite the sharing of human resources functions. (*Tenneco*, *supra*, at pp. 1522, 1533.) WDC's centralized human resources are a factor that could support a finding of unity of operations, though it is not dispositive.[12]

3. Advertising

WDC did not have a corporate advertising, marketing or sales department. Advertising and sales activities were conducted separately by each division. The largely decentralized nature of advertising and sales activities weighs against a finding of unity of operations.

4. Accounting

WDC maintained central accounting staff that prepared financial statements, tax returns, and profit and loss statements. However, each division conducted its own bookkeeping and accounting, and Western Beverage's staff maintained its own records to account for sales and inventory.

---

[10] There "is not a clear demarcation between what is 'operation' and what is 'use' . . . ." (*Chase Bros.*, *supra*, at p. 502.) FTB's brief discusses intercompany sales under the heading of unity of operations.

[11] DG's declaration and testimony indicates that Western Transportation handled the compensation of its drivers but submitted payroll to WDC to issue checks.

[12] FTB argues that WDC's use of a single federal employment identification number also illustrates the centralization of human resources function. However, the use of a single federal employment identification number appears to flow from the fact that the divisions had no separate corporate existence, rather than indicating the centralization of human resource functions.

Tenneco stated that central accounting does not generally involve material savings and is "too weak a connecting link" to connect otherwise separate businesses. (*Tenneco*, *supra*, at p. 1529, fn. 8, quoting *F. W. Woolworth v. Taxation & Revenue Dep't* (1982) 458 U.S. 354, 369, fn. 22.)

5. Summary

To summarize, WDC's divisions generally made separate purchasing decisions and conducted separate advertising and sales. However, they shared a common insurance policy, human resource functions, and some accounting services. WDC had a line of credit that was secured by Western Beverage's assets and used by Western Beverage.

In comparison, *Chase Brass* found "considerable cooperation" as to unity of operation on the following general facts:

- the parent conducted some minor purchasing;
- there was some shared insurance but not for basic policies;
- the subsidiary had its own advertising program but used the same agency as the parent and included a statement that it was a subsidiary of the parent;
- the subsidiary and parent kept separate books of account but used the same accounting firm, with the parent preparing tax returns;
- the subsidiary obtained a $10 million loan from the parent, at a favorable interest rate; and
- there was a shared retirement plan. (*Chase Brass*, *supra*, at pp. 503-504.)

However, *Tenneco* found that the taxpayer "did not have substantial centralized departments" based on the following facts:

- minimal common advertising or centralized research;
- "insubstantial amounts of intercompany sales";
- "insubstantial amounts of common purchasing of raw materials";
- the ability of a subsidiary president to enter into purchasing agreements and negotiate collective bargaining agreements;
- independent legal activities;
- decentralized accident reporting, claims, and insurance;
- the inability of most employees to participate in the company's retirement plan; and

- a central accounting department as well as separate subsidiary accounting departments that prepared separate state tax returns.

(*Tenneco*, *supra*, at pp. 1528-1529.)

As to the unity of operations analysis, WDC's operational activities appear generally similar to those in *Chase*. However, there are some differences. On the one hand, WDC's divisions shared a common primary insurance policy and human resources functions, which were not present in *Chase Brass*. On the other hand, WDC's line of credit seems less significant than the $10 million loan in *Chase Brass* because the line of credit was obtained from a third party, secured by Western Beverage's assets, and used by Western Beverage. WDC's activities are also similar, in many ways, to those in *Tenneco*. However, WDC's shared insurance policy, human resource functions, and retirement plan suggest more shared operational functions than existed in *Tenneco*.

Based on *Chase Brass*, it appears the facts here are sufficient to support FTB's determination of unity of operations. *Tenneco* found a lack of substantial centralized departments on facts that are similar in many ways, but there are more shared operational activities here than in *Tenneco*. Considering the facts here in light of *Chase Brass* and *Tenneco*, OTA finds that, while the issue is a close one, appellants have not shown error in FTB's determination of unity of operations.

C. Unity of Use

Unity of use generally refers to a centralized executive force and general system of management. (*Butler Bros.*, *supra*, at p. 678.) In *Chase Brass*, the court stated that "[t]he integration of executive forces is an element of exceeding importance." (*Id.* at p. 504.) In its discussion of unity of use, the court also discussed intercompany purchases. (*Id*. at pp. 505-506.)

Appellants argue that WDC did not have centralized management and that VG and CB only provided the type of high-level oversight that an investor would exercise over an investment. In support, appellants point to the declarations and testimony provided by VG, CB, SG, and the managers of its divisions. VG testified that his model was to find various operating businesses (with products he supported), bring them into the business, but let them operate independently.

FTB argues that, because WDC and its divisions operated within a single corporate entity, "there was complete overlap between WDC's board of directors and executive officers

and the management of divisions." Pointing to WDC's single checking account and VG's signing of checks, FTB contends that VG and CB managed all revenue and expenses and division managers "were required to consult [BG and VG] for all expenditures, even if made in the regular course of business." FTB also states that VG's ability to sell the core assets of Western Beverage demonstrate his "management and absolute control of the divisional business and assets."

A preponderance of the evidence indicates that Western Beverage and Western Transportation were managed independently and that VG and CB exercised the type of oversight that might be exercised by an investor over a substantial investment. The declarations and testimony provided by appellants support appellants' contention that each division was generally managed independently, with minimal oversight from VG and CB.[13]

For example, GB, who was partly responsible for Western Beverage's sales, states that VG and CB "left us to run the business as we saw fit." CG, who managed Western Beverage's sales with GB, states that, while VG sometimes made suggestions, he and other Western Beverage's managers "ultimately . . . ran the business, made the decisions for the business, and were responsible for the performance of the business."

As to Western Transportation, DG states that he worked exclusively for Western Transportation and that it operated separately from WDC's other divisions. He further states that he supervised managers of Western Transportation and WDC's corporate office had "very little involvement" with day-to-day management and operations. He states VG and CB "only sometimes provided advice." As an example, he consulted with VG and CB regarding replacing Western Transportation's fleet of trucks but "the decision to buy" was his responsibility. (*Ibid*.)

FTB cites *Chase Brass* in support of its position that there was a complete overlap between WDC's board and officers and the board and officers of its divisions. In *Chase Brass*, the court stated that control over "major policy matters" are what is important. (*Chase Brass*, *supra*, at p. 504.) It found that such major policy matters were the concern of the parent and that the parent's Board of Directors spent most of its time to problems facing the copper industry, including the development and maintenance of its fabricating subsidiaries. (*Ibid*.)

The facts here are materially different from those in *Chase Brass*. VG's declaration and testimony at the hearing indicates that, rather than spending most of his time working on major policy matters related to WDC's divisions, he traveled over 40 weeks per year as a professional pro stock race car driver. CB's declaration states that division managers "had authority to run

[13] FTB relies on the declarations in its briefing and arguments.

the divisions as they saw fit." He further states that he helped prepare profit and loss statements to allow VG and him to "monitor how each business was doing." As noted above, DG's declaration indicates that the decision about whether to replace Western Transportation's fleet of trucks was his responsibility. A preponderance of the evidence indicates that CB and VG exercised the type of oversight that an investor might exercise over a significant investment. In this respect, the facts here are more similar to the facts of *Tenneco* than the facts in *Chase Brass*.

WDC's control over Western Beverage appears no more extensive, and perhaps less extensive, than the control exercised by Tenneco or its subsidiaries. In *Tenneco*, Tenneco had a "jealously-guarded policy of operating autonomy on the part of [its subsidiaries]" and its subsidiaries enjoyed "a high degree of local autonomy and flexibility of action . . . ." (*Tenneco*, *supra*, at p. 1527.) This seems similar to the autonomy enjoyed by Western Beverage and other divisions of WDC. However, Tenneco's management activities also included "[an] annual planning process, weekly meetings between the chief executive officer and executive committee, internal audit, corporate-wide procedures manual, financial strategy with debt targets and dividend payout ratios, approval of major capital expenditures, external financing, cash management, real property disposition, guaranties, loans and advances to and from divisions, insurance, and overruling subsidiaries' ideas . . . ." (*Id*. at p. 1528.) On these facts, *Tenneco* sustained the trial court's determination that Tenneco's control was "such as would exist between any parent and its subsidiaries." (*Id*. at pp. 1526, 1530-1531.)

While VG signed checks, each division made its own purchasing decisions and submitted the purchase orders to the central office to be paid. VG testified that pre-approval for large purchases was done "very little" and that he could not think of any purchases that had been denied. There is no evidence of VG or CB rejecting a requested expenditure, and no evidence to support FTB's contention that the managers were required to consult with headquarters' executives on all expenditures. Instead, the record indicates checks were routinely issued at the request of the divisions and that WDC's check-processing operations served a cash management function. *Tenneco* affirmed the trial court's judgment that cash management, among other activities, evidenced the type of behavior one would expect in any parent-division relationship. (*Tenneco*, *supra*, at p. 1528.)

OTA is not persuaded that the organization of business activities within a single corporate entity, with one set of officers and directors, necessarily indicates strong centralized management. In *Edison*, *supra*, 30 Cal.2d 472, the California Supreme Court explained that the analysis of whether a unitary business exists does not depend on whether business activities

are conducted within a single corporation or in multiple corporations. (*Edison*, *supra*, at pp. 480-482.) The unitary analysis is concerned with the substance of the relationship between business activities, not the form in which such activities are conducted. (See *Chase Brass*, *supra*, at p. 505 [finding that unity of ownership was present in substance, even if lacking in form]; *Edison*, *supra*, at p. 482 [stating that "the accident of different labels" does not change the unitary analysis].) While the existence of common officers and directors may be a factor in the unitary analysis, it is not necessarily decisive. (See *Appeal of Insul-8 Corp*. (92-SBE-007) 1992 WL 92342; *PBS*, *supra*.)

OTA is also not persuaded by FTB's contention that VG's ability to sell the assets of Western Beverage demonstrates the existence of centralized management. Generally, the parent of a subsidiary has the power to sell the subsidiary, but that does not mean that the parent and the subsidiary share centralized management. Similarly, the CEO of a corporation can sell assets of its business divisions, but that does not mean that all the corporation's business divisions are necessarily part of the same unitary business.

As to WDC's core business operations, there do not appear to have been substantial intercompany purchases between Western Beverage and other divisions of WDC. Western Beverage occasionally hired Western Transportation, at Western Transportation's standard rates, to transport goods to Western Beverage's warehouse.[14] In 2009, the last full tax year preceding the tax year at issue, amounts paid by Western Beverage constituted less than one percent of Western Transportation's revenue and less than one percent of the volume of beverages distributed by Western Beverage. As these transactions were minimal and conducted at arm's length, they are not a significant indicator of unity of operations.[15]

The intercompany transactions here appear similar to the intercompany transactions that *Tenneco* found to be insubstantial and not indicative of unity. (*Tenneco*, *supra*, at pp. 1523, 1528.) They are far less than the intercompany transactions present in *Chase Brass*. In *Chase*

[14] However, FTB correctly notes that arm's-length pricing does not preclude a unitary analysis, citing *Exxon Corp. v. Dept. of Revenue* (1980) 447 U.S. 207, 221-225. More broadly, *Container Corp. of America v. Franchise Tax Bd.*, *supra*, observed that a "substantial flow of goods" is not necessary to establish a unitary relationship. (*Container Corp. of America v. Franchise Tax Bd.*, *supra*, 463 U.S. 159, 178-179.)

[15] FTB argues that Western Transportation's purpose was to serve Western Beverage and that it continued to serve this function. At least in part, FTB bases this argument on VG's declaration, which states that when WDC initially acquired long-haul trucks, in 1977, it intended to use them to ship Western Beverage's inventory. As noted above, the record suggests that, in the tax year at issue, any services provided were minimal and at market rates. The fact that WDC had a different intent, approximately 48 years ago, is of little relevance.

Brass, Chase obtained at least 80 percent of its copper from its parent and a sister subsidiary. (*Chase Brass*, *supra*, at p. 501.)

In sum, the record shows that WDC's divisions were not centrally managed and did not engage in substantial intercompany transactions. Accordingly, the record indicates that unity of use did not exist between WDC, Western Transportation, and Western Division.

D. Conclusion as to the Three Unities Test

Unity of ownership is unquestionably present. Whether or not unity of operations existed is a close issue, but appellants have not shown error in FTB's determination that there was unity of operations. However, appellants have shown that unity of use is not present.

These facts are more similar to the facts of *Tenneco*, in which unity was not found, than to the facts of *Chase Brass*, in which unity was found. As all three unities must be present to establish a unitary business, the three unities test is not satisfied. (See *Dental Ins.*, *supra*, at p. 348.)

However, the three unities test and the dependency or contribution test are alternative tests. The satisfaction of either test is sufficient to establish the existence of a unitary business. (*A.M. Castle*, *supra*, 36 Cal.App.4th 1794, 1802-1806.) Accordingly, OTA next considers whether appellants have shown error in FTB's determination that the dependency or contribution test establishes unity.

III. Dependency or Contribution Test

As noted previously, the dependency or contribution test evaluates whether the activities under consideration are "dependent upon or contribute to each other and the operations of the taxpayer as a whole." (*A.M. Castle*, *supra*, at pp. 1803-1804.) The dependency or contribution test and the three unities test are alternative tests, and the satisfaction of either test is sufficient to establish unity. (*Id*. at pp. 1802-1806.) In *A.M. Castle*, the court described the dependency or contribution test as "more general" than the three unities test. (*Id*. at p. 1804.) However, the application of either test "should result in the same conclusion." (*Dental Ins.*, *supra*, at p. 348.)

FTB cites *Chase Brass* to support its determination that unity is established under the dependency or contribution test, while appellants point to *Tenneco* to support their conclusion

that unity is lacking.[16] As indicated previously, the facts here appear more similar to the facts of *Tenneco*, in which unity was found to be lacking, than the facts of *Chase Brass*, in which unity was found.

Chase Brass found that a subsidiary, Chase Brass and Copper Co., Inc. (Chase), was unitary with its parent (Kennecott Copper Corporation) where there were material intercompany sales, centralized control over major policy decisions, significant intercompany loan financing, some minor common purchasing, a common retirement plan, and centralized preparation of consolidated tax accounts. Here, there were no significant loans from WDC to Western Beverage, and WDC's divisions appear to have operated with more independence than Chase.

In *Tenneco*, the taxpayer had minimal common advertising, no substantial intercompany sales, minimal centralized departments, weak central management, and the subsidiaries at issue "had a history of separateness and were of a diverse unrelated nature." Also, in *Tenneco*, the parent borrowed funds for use by its subsidiaries, but *Tenneco*, found that this financing served an investment function, rather than an operational function. Here, there was no significant intercompany financing, although WDC had a line of credit that assisted Western Beverage and was secured by Western Beverage's assets.

FTB notes that WDC did not report any separate unitary businesses and included Western Beverage's deductions in the calculation of its unitary business income. FTB argues that these representations indicate that Western Beverage was a part of the unitary business. However, WDC's tax reporting is not reliable. The unreliability of WDC's tax reporting is shown by the fact that WDC erroneously reported that the sale of Western Beverage's assets generated nonbusiness income. As WDC did not properly report income from the sale, OTA does not have confidence that WDC properly reported whether it had separate unitary businesses. As WDC's tax reporting is unreliable, OTA gives it little weight.[17]

---

[16] Appellants also contrast the facts here with those present in *Superior Oil Co. v. Franchise Tax Bd.* (1963) 60 Cal.2d 406. In that case, the court found California business operations "contributed substantially" to the out-of-state portion of its business "in areas relating to executive policy making, administrative control, coordination of exploration activities, well production and land acquisition, training of technical personnel, specific scientific and technical development and testing laboratories, drilling operations and drilling equipment, manufacturing and sales, accounting, tax returns, personnel, insurance and purchasing." (*Id.* at p. 412.) It further found that the California operations were "substantially dependent" on out-of-state operations in areas such as borrowing, supplies, and the transfer of personnel. (*Id.* at pp. 412 – 413.)

[17] Appellants argue that the tax reporting was not correct. The testimony of VG was that he was not involved in the preparation of WDC's tax returns; that they were prepared by a Colorado accounting firm, which also prepared the shareholders' K-1s. The declarations and testimony appear to be consistent and reliable. While WDC's tax reporting is concerning, a preponderance of the evidence indicates that Western Beverage and Western Transportation were not a part of a single unitary business.

In sum, while WDC's divisions shared some common administrative services, they lacked common advertising, significant intercompany sales, centralized management, or other indicators of dependency or contribution. Appellants have met their burden of showing that the dependency or contribution test is not satisfied.

IV. Conclusion as to Unity

Appellants have demonstrated that neither the three unities test nor the dependency or contribution test is satisfied. The record indicates that the alleged unitary connections between Western Beverage and WDC's other divisions were sufficiently weak to compel the conclusion that Western Beverage and the other divisions of WDC did not constitute a single integrated economic enterprise.

Issue 2: Whether the tax benefit rule requires the inclusion of additional income based on deductions reported by WDC.

As an alternative argument, FTB contends that, if Western Beverage is viewed as conducting a separate trade or business, Western Beverage's deductions from WDC's unitary trade or business should be recovered under the tax benefit rule because characterizing the sale of the assets as a sale of nonbusiness assets or assets of a separate trade or business would be inconsistent with WDC's original characterization of the assets as part of a single unitary business. FTB states that, between 2007 and 2010, WDC deducted $5,320,801 of "Damaged/Dated Beer Expense" and that, as of the 2009 tax year, WDC reported $4,425,055 of accumulated amortization related to beer distribution rights.

It is a well-settled principle that each tax year stands on its own and must be separately considered. (See, e.g., *Appeal of Kwon et al.*, 2021-OTA-296P; *Appeal of Laude* (76-SBE-096) 1976 WL 4112.) However, where the tax benefit rule applies, it requires "the inclusion of income when events occur that are fundamentally inconsistent with an earlier deduction." (*Hillsboro Nat'l Bank v. Commissioner* (1983) 460 U.S. 370, 372.) The basic purpose of the rule "is to achieve rough transactional parity . . . and to protect the Government and the taxpayer from the adverse effects of reporting a transaction on the basis of assumptions that an event in a subsequent year proves to have been erroneous." (*Id*. at p. 384.)

The tax benefit rule consists of an "inclusionary component" and an "exclusionary component." (*Frederick v. Commissioner* (1993) 101 T.C. 35, 40.) Where the rule applies, the inclusionary component requires the recognition of additional income, but the exclusionary component limits the amount of additional recognized income "to the amount of the tax benefit that resulted from the deduction." (*Id.* at p. 41.) The exclusionary component is reflected in

Internal Revenue Code (IRC) section 111(a), which provides that "[g]ross income does not include income attributable to the recovery during the taxable year of any amount deducted in any prior taxable year to the extent such amount did not reduce the amount of tax imposed ....."[18]

FTB raised this argument for the first time on appeal and it requires new evidence. Specifically, FTB's argument requires a determination of whether WDC received a tax benefit from reporting the deductions as amounts deductible from the income of a single unitary business rather than as amounts deductible from a separate trade or business conducted by Western Beverage. As a result, FTB bears the burden of proof on this issue. (See *Appeal of Mendelsohn* (85-SBE-141) 1985 WL 15923; *Appeal of Praxair*, 2019-OTA-301P.)

The record shows that WDC apportioned a net loss to California for the 2007 to 2009 tax years. It does not show whether WDC would have reported a net gain to California if it had reported Western Beverage's business activities as a separate trade or business. Therefore, it does not show whether WDC's reporting of the deductions as part of a single unitary business provided a tax benefit for those tax years. As FTB has the burden of proof on this issue, its argument fails as to deductions taken for the 2007 to 2009 tax years.

For the 2010 tax year, WDC reported a total of $248,618 of deductions for amortization of distribution rights and damaged/dated beer. It reported these expenses as part of a single unitary business, erroneously treated gain from the sale of Western Beverage assets as nonbusiness income, and, applying an apportionment percentage of 4.9339 percent, apportioned a net loss of $157,000 to California. Based on its reported apportionment percentage of 4.9339 percent, this apportioned $157,000 loss only included $12,666 of deductions from the amortization of distribution rights and damaged/dated beer. If this $12,666 of apportioned deductions were eliminated, it appears likely that WDC still would have apportioned a net loss to California, and there would be no change in its tax.[19] Thus, FTB has not shown that WDC received a tax benefit from the deductions.[20]

---

[18] California generally conforms to IRC section 111 pursuant to R&TC sections 17131 and 24310.

[19] As Western Beverage operated a separate trade or business, none of its business income is taxable by California, and it still receives no tax benefit from the deductions. The deductions did not provide a tax benefit to WDC when it reported them as part of a single unitary business operated by WDC, and they do not provide a tax benefit when Western Beverage is treated as a separate trade or business.

[20] The more general rule of the duty of consistency similarly requires as one of its elements that inconsistent reporting or treatment in subsequent tax years results in a harm to FTB, e.g., loss of actual tax revenue. (See *Appeal of Chen and Chi*, 2020-OTA-021P.)

Docusign Envelope ID: 07C5E64F-E118-82CC-831A-E757A7FFC613

For this reason, the tax benefit rule does not apply to require the recapture of deductions claimed by WDC. As a result of this conclusion, it is not necessary to address whether the deductions and the treatment of Western Beverage as a separate trade or business constitute a single, integrated transaction or whether the tax benefit rule applies when challenged deductions occurred in the same tax year in which the deductions are sought to be recovered.[21]

In light of the conclusions as to Issues 1 and 2 above, there is no need to consider the additional issues.

HOLDINGS

1. Western Beverage did not operate as a unitary trade or business with WDC's other divisions.
2. The tax benefit rule does not require the inclusion of additional income based on deductions reported by WDC.

DISPOSITION

FTB's actions are reversed.

DocuSigned by:
Sara A. Hosey
6D3FE4A0CA514E7...

Sara A. Hosey
Administrative Law Judge

We concur:

Signed by:
Veronica I. Long
32D46B0C49C949F...

Veronica I. Long
Administrative Law Judge

DocuSigned by:
John O Johnson
873D9797B9E64E1...

John O. Johnson
Administrative Law Judge

Date Issued: 6/18/2026

[21] See *Appeal of H.V. Management Corporation, et al.* (81-SBE-081) 1981 WL 11807 [requiring a "single, integrated transaction" for application of the tax benefit rule]; *Appeal of Centennial Equities Corporation* (84-SBE-086) 1984 WL 16165 [requiring a "single, integrated transaction"]; *Spitalny v. U.S.* (9th Cir. 1970) 430 F.2d 195, 198 [stating that "tax benefit principles would seem to apply with even greater force" where deductions were taken in the same tax year as the year at issue].)