67-SBE-001

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
JACK HARRIS, INC.)

Appearances:

For Appellant: John H. Baker
Attorney at Law

For Respondent: Wilbur F. Lavelle
Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of Jack Harris, Inc., against proposed assessments of additional franchise tax in the amounts of $10,937.16 and $288.35 for the income years ended August 31, 1960, and 1961, respectively.

The issue presented by this appeal is whether appellant Jack Harris, Inc., and an Arizona joint venture known as Theba Farms were engaged in a unitary business requiring allocation of the combined income by the formula method rather than by separate accounting.

Appellant, a California corporation, farmed 15,000 acres in the Fresno area. Mr. Jack Harris was appellant's president, manager, and sole stockholder.

During the years in question, appellant owned a 15 percent interest in a joint venture, Theba Farms, which farmed 80,000 acres in Arizona. The other joint venturers were a syndicate of individual investors and Giffen, Inc., a large farming corporation in the Fresno area. Mr. Harris was manager and Mr. Price Giffen was assistant manager of Theba Farms.

There were periodic transfers of heavy farm equipment and workmen between appellant and Theba Farms., The transfers of farm equipment were made on a reciproc-al basis, without *any* intercompany charges. The workmen were. p aid by the particular company for. which they were working at a given time. On several occasions, fertilizer and seeds needed by Theba Farms were purchased throughappellant. Financing for Theba Farms was arranged by Jack Harris in his capacity as manager and he and other persons connected with -the joint venture personally guaranteed the repayment of loans. The joint venture incurred substantial losses while appellant operated at a profit,

In its franchise tax returns appellant reported *its* income attributable to California by the use of separate accounting and deducted from such income its share. of the Arizona joint venture losses, Based on its determination, that the California and. Arizona operations were separate rather than unitary, respondent excluded the Arizona losses from the computation of appellant's income,

Section 25101 of the Revenue and Taxation Code requires a taxpayer deriving income -from sources both within and without the -state to measure its California tax by the net income derived from or attributable to sources within this state, If a business is unitary in nature, the share of the combined net income attributable to California must be determined by a formula composed_ of property, payroll, *sales* or similar factors, (Butler Bros. v. McColgan, 17 Cal. 2 d 664 [111 P.2d 334], aff'd, 315 U.S. 501 [86 L. Ed, 991].)

In recent decisions) the California, Supreme Court reaffirmed the test-s to be' used in ascertaining- the existence of a unitary business, (Superior Oil Co. v. Franchise Tax Board, 60 Cal. 2d 406 [34 Cal. Rptr. 545, 386 P.2d 33]; Honolulu Oil Corp. v. Franchise Tax Board, 60 Cal. 2d 417 [34 Cal. Rptr. 552, 386 P.2d 40].) Under one test, a. business is unitary in nature if there is unity of ownership; unity of operation, and unity of use. Under another approach, a. unitary business exists when operation of the portion of the business done within the state is dependent upon or contributes to the operation of the *business*. without the state. Implicit in the latter test is a unity of ownership requirement,

The first ground for respondent's position that appellant and Theba Farms were not engaged. in a unitary business is that there was no unity cf ownership of the two companies. Appellant concedes that unity of ownership is a necessary element of a unitary business but argues that its 15 percent interest in Theba Farms meets the ownership requirement.

Appellant's argument is not supported by any authority that we have discovered. We are not aware of any case in which a court has found a unitary business to exist in the absence of an element of controlling ownership Over all parts of the business. As stated by authorities in this field: "separate ownership alone requires separation of treatment, no matter how closely the business activities are otherwise integrated," (Keesling & Warren., The Unitary Concept in the Allocation of Income (1960) 12 Hastings L. J. 42, 49); and "The essential prerequisite is that the various parts of the system are operated and ultimately controlled as a single enterprise with each part dependent upon and contributing to the whole." (Wilkie, Uniform Allocation of Income from Unitary Business (1959) 37 Taxes 437, 440.) Two companies may depend upon or contribute to each other as, for example, where one buys the products of the other but their operations would not properly be treated as unitary unless the element of controlling ownership were added, In the absence of controlling ownership, intercompany transactions and intercompany charges constitute arms l-length dealings which may be reflected adequate]_y by separate accounting,

Without determining the exact percentage of common ownership that is necessary to meet the unity of ownership requirement, we conclude that the requirement is not met in this case.

ORDER

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

Appeal of Jack Harris, Inc.

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 protests of Jack. Harris, Inc., against proposed assessments of additional franchise tax in the amounts of $10,937.16 and $288.35 for -the income years ended August 31, 1960, and 196%; respectively, be and the same is h-ereby sustained.

Done at Sacramento, California, this 3rd day of January, 1967, by the State Board of Equalization,

Paul R. Leake, Chairman

Geo. R. Reilly, Member

John W. Lynch, Member

Richard Nevins, Member

P m - - -, Member

ATTEST: Secretary