



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
REGAL OF CALIFORNIA, INC.)

For Appellant: Edward Gronner
Vice President

For Respondent: Bruce W. Walker
Chief Counsel

Brian W. Toman
Counsel

O P I N I O N

This appeal is made pursuant to section 26077 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying, to the extent of \$6,095.29 and \$1,823.03, the claims of Regal of California, Inc., for refund of franchise tax in the amounts of \$8,945.00 and \$17,776.00 for the income years 1972 and 1973, respectively.

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During the years on appeal, the president of Regal was Mr. Irving **Alpert**, its executive vice president was Mr. Barry Finn, its vice president and controller was Mr. Edward Gronner, **and** its secretary and, general counsel was Mr. Walter Margulies. Mr. **Alpert**, Mr. **Finn**, and Mr. Margulies also served on the board of directors of Regal. During the same period, Mr. Margulies served as secretary and general counsel of **appellant**, and **both** he and Mr. **Alpert** served on appellant's board of directors. Appellant and Regal employed Mr. Harmon Shidlofsky **during** **this** period as their principal buyer in the Orient. Mr. Shidlofsky's duties in this regard included selecting fabrics and styles of clothing that could be produced in the Orient and arranging for the purchase and importation of such clothing from the oriental manufacturers.

At the time of its acquisition by Regal in 1971, Dalmar operated solely in the Orient as a purchasing agent for various retail clothing stores located in the United States. After the acquisition, Mr. Finn **and** Mr. Margulies became members of Dalmar's board of directors. **Also**, Mr. Finn was elected president of Dalmar, Mr. Gronner **was** elected vice president., Mr. Margulies was elected secretary and appointed general counsel, and Mr. Shidlofsky was, appointed general manager of Dalmar. These men served in the positions indicated throughout 1972 and 1973,.

After the acquisition, Dalmar continued **its** operation in the Orient as a purchasing agent for domestic retail stores. However, at the direction of Regal, Dalmar did not order for its clients any items of **ladies'** sportswear which resembled the style or specifications of the clothing generally handled by appellant and Regal. The day to day operations of Dalmar during 1972 and 1973 were handled by its general manager, Mr. Shidlofsky. Mr. Shidlofsky chose the oriental manufacturers that produced clothing for Dalmar's clients, and he set the commission rates that Dalmar charged for its services.. Mr. **Alpert** assisted Mr. Shi'dlofsky in deciding which customers' Dalmar did business with and in selecting the **general** types of clothing that Dalmar ordered for its clients. Mr. Shidlofsky served as general manager of Dalmar **in** addition to serving as the principal buyer for **appellant** and Regal. Apparently, of the five purchasing agents employed by Dalmar, two or three also served as **buyers** for appellant and Regal. From 1971 to 1973 the number of Dalmar's clients who were also customers of appellant or Regal increased from 40 to 90 percent.

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During 1972 and 1973, Dalmar paid over **\$1,000,000** in fees to Regal for administrative services and managerial assistance. The fees represent almost 80 percent of Dalmar's total operating expense for the years in question. In addition to occupying space in Regal's New York offices and sharing Regal's showroom, Dalmar utilized computerized accounting services provided by Regal. Dalmar and Regal also shared a common medical plan for the benefit of their employees.

When a corporate taxpayer derives income from sources both within and without California, it is required to measure its California franchise tax liability by the net income derived from or attributable to sources within the state. (Rev. & Tax. Code, § 25101.) If the taxpayer is engaged in a unitary business with affiliated corporations, the income attributable to California sources 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 161 (1947)]; John Deere Plow Co. v. Franchise Tax Board, 38 Cal. 2d 214 [238 P.2d 569] (1951), app. dism., 343 U.S. 939 [96 L. Ed. 1345] (1952).)

The California Supreme Court has developed two general tests for determining whether a business is unitary. In Butler Bros. v. McColgan, 17 Cal. 2d 664 [111 P.2d 334] (1941), affd., 315 U.S. 501 [86 L. Ed. 991] (1942), the court held that the existence of a unitary business is clearly established by the presence of the three unities of ownership, operation, and use. Subsequently, in Edison California Stores, Inc. v. McColgan, supra, the court 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. More recent cases have reaffirmed these tests. (See, e.g., Superior Oil Co. v. Franchise Tax Board, 60 Cal. 2d 406 [34 Cal. Rptr. 545, 386 P.2d 33] (1963); Honolulu Oil Corp. v. Franchise Tax Board, 60 Cal. 2d 417 [34 Cal. Rptr. 552, 386 P.2d 40] (1963).)

Application of either of the above described tests to the facts presented by the instant appeal leads us to the conclusion that Dalmar was engaged in a single unitary business with appellant and Regal during 1972 and 1973.

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Our conclusion is based on the presence of the following major factors which indicate the existence of a unitary business under the established tests: (1) ownership by Regal of all of the stock of appellant and Dalmar; (2) interlocking directors and an integrated executive force; (3) common employment of key employees; (4) Regal's exercise of, control over major policy decisions affecting the affiliated corporations; (5) centralized, accounting, administrative, and other overhead functions; (6) sharing of common facilities; (7) shared expertise in connection with the oriental clothing market; and, (8) common customers or clients of the basically similar service provided by the affiliated corporations.

We are particularly impressed with the mutual benefits which the affiliated corporations derived through the use of an integrated purchasing force. Although Dalmar, at the direction of Regal, handled a line of merchandise somewhat different than that handled by appellant and Regal, a major aspect of the business of each of the corporations involved the purchase of clothing from oriental manufacturers. Because of the similarity in this phase of their respective businesses, appellant, Regal, and Dalmar were able to integrate their purchasing activities to a considerable extent. In this connection, there was a transfer of key personnel, between the companies, a sharing of the expertise of the common buyers, and greater centralized control over the purchasing activities of the corporations.

It is also significant that the integrated executive force of the affiliated corporations controlled the types of clothing which Dalmar was permitted to order for its clients. On the one hand, this control allowed the unitary group to cover a broader range of the imported clothing market than might have been possible if each of the corporations operated independently. On the other hand, it seems likely that such control allowed appellant and Regal to avoid or eliminate competition which Dalmar might have presented had it not become a member of the unitary group.

Finally, we believe the integrated, purchasing and executive forces of the affiliated corporations substantially contributed to the success of the unitary group by virtue of the fact that the companies had inside knowledge of each other's customers and competitors. It seems

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apparent that the increase in the number of customers which Dalmar shared with appellant and Regal is directly attributable to these factors. It seems equally apparent that these factors enabled appellant and Regal to keep close tabs on the types of clothing that their competitors ordered through Dalmar.

In light of the factors listed above, we must conclude that respondent's decision to include **Dalmar** as a member of the unitary business conducted by appellant and Regal is amply supported by the evidence contained in the record before **us**. (See Appeal of Automated Building Components, Inc., Cal. St. Bd. of Equal., June 22, 1976; Appeal of Grolier Society, Inc., Cal. St. Bd. of Equal., Aug. 19, 1975; Appeal of F.W. Woolworth Co., Cal. St. Bd. of Equal., July 31, 1972; Appeals of the Anaconda Company, et al., Cal. St. Bd. of Equal., May 11, 1972; Appeal of Hunt Foods and Industries, Inc., et al., Cal. St. Bd. of Equal., April 5, 1965.) Appellant's **primary** contention on appeal appears to be that the facts and circumstances surrounding Dalmar's affiliation with the business of appellant and Regal did not significantly change during the period from 1971, through 1973 and, therefore, respondent's determination that Dalmar was not a member of the unitary group during 1971 should control with respect to the years 1972 and 1973. However, the only evidence submitted by appellant in support of its contention consists of various correspondence between appellant and respondent concerning the 1971 audit. Appellant has failed to submit any direct evidence showing that Dalmar's business during the years on appeal was truly separate and distinct from the unitary business conducted by appellant and Regal.

Appellant also appears to argue that the unitary business concept should not be applied in this case because the operation of Dalmar during the years on appeal had no direct relationship to the California business activity of appellant. However, a determination that a business is unitary does not require an interdependence between one segment of that business and every other segment of the business. All that need be shown is that during the appeal years Dalmar formed an inseparable part of the unitary business conducted by appellant and Regal. (See Appeal of Monsanto Co., Cal. St. Bd. of Equal., Nov. 6, 1970.) As we have indicated, the record on appeal contains ample evidence to support such a conclusion and very little evidence to the contrary. Accordingly, respondent's action in this matter must be sustained.

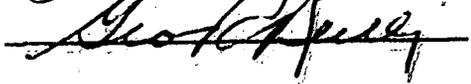
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O R D E R

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

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to, section 26077 of the Revenue and Taxation Code,, that the action of the Franchise Tax Board in deny- ing, to the, extent of. \$6,095.29 and \$1,823.03, the claims of Regal of California, Inc., for refund, of franchise tax in the amounts of \$8,945.00 and \$17,776.00 for. the income years 1972 and 19 73, respectively, be and the same is hereby modified in accordance with respondent's conces- sion that Far East Was not a member of the unitary group. In all other respects the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this 18th day of October , 1977, by the State Board of Equalization.

 Chairman
 Member
 Member
 Member
 Member