

**FTB Legal Ruling No. 91-1, Unity of Ownership, Franchise Tax Board.,
November 12, 1991**

Corporation franchise (income)--Allocation and apportionment--Unitary business--Unity of ownership.-- Under Sec. 25101 of the Revenue and Taxation Code, corporations engaged in a single unitary business must compute their tax on a combined basis. One requirement for a finding that two or more corporations are engaged in a single unitary business is that such corporations share "unity of ownership." This Legal Ruling outlines the principles for determining whether unity of ownership exists.

General principles for determining unity of ownership: Sec. 25105 of the Revenue and Taxation Code is the governing section for determining unity of ownership. Sec. 25105 states that "direct or indirect ownership or control of more than 50% of the voting stock of the taxpayer shall constitute ownership or control . . ." for purposes of apportionment and allocation of corporate income, including the determination of the existence of a unitary business under Sec. 25101. The term "taxpayer," as used in Sec. 25101, refers to all of the members of a unitary group as an economic unit. The term "taxpayer" appearing in Sec. 25105 refers to all corporate members of a purported unitary group. Thus, more than 50% of the voting stock of all members of a purported unitary group must be owned or controlled by the same interests for the group to be unitary. In the absence of ownership or control of more than 50% of voting stock, evidence of "practical" or "economic" control or potential to control will not satisfy the requirements of Sec. 25105.

Voting stock: Sec. 25105 requires that only voting stock be considered in determining the requisite unity of ownership under Sec. 25105. "Voting stock" refers to shares of stock that have the power to elect the board of directors of the corporation. If there is more than one class of voting stock, the relative voting power of each class must be examined to determine whether the power to elect the membership of the board of directors is commonly held. If the power otherwise held in corporate stock to vote the membership of the board of directors is irrevocably transferred to another, whether by shareholder agreement, voting trust, or other legally binding agreement, the shareholder will not be considered as owning or controlling voting stock for the duration of the transfer, even if the shareholder otherwise holds legal or beneficial title to the stock. Instead, the recipient of the stock's voting power controls the voting stock for purposes of Sec. 25105.

Direct or indirect ownership: In general, a legal or beneficial owner of stock who does not have voting rights does not own voting stock, within the meaning of Sec. 25105, because such shareholder's voting power has been severed from the stock. If one individual or entity has direct ownership and control of the

voting rights of more than 50% of the voting stock of two or more corporations, unity of ownership exists among the corporations. This is called “direct ownership.” Direct ownership is also present when a widely held corporation owns and controls more than 50% of the voting stock of a subsidiary. In that case, the operations of both the parent and the subsidiary are under the ultimate control of the board of directors of the parent.

Indirect ownership exists when an individual or entity has direct ownership and control in excess of 50% of the voting stock of a corporation that in turn has direct ownership and control in excess of 50% of the voting stock of another corporation.

Direct or indirect control: When there is a binding legal transfer of voting rights of stock, that stock is directly controlled by the holder of the power to vote the stock. The holder of voting rights under a voting agreement, voting trust, or proxy agreement (other than a proxy for a limited term or with respect to a specific corporate event) controls the voting stock, if the holder of voting rights, as against the owner, can enforceably vote the stock.

If an individual or entity has direct or indirect ownership, or direct control, of a corporation and that corporation exercises direct control of a second corporation, the individual or entity exercises indirect control over the second corporation.

Control by a concerted group: According to a California Court of Appeal decision in the Rain Bird Sprinkler Mfg. Corp. decision (see ¶401-897), nothing in Sec. 25105 requires that ownership be held by a single individual or entity to meet the unity of ownership test. Thus, 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 Sec. 25105. In Rain Bird, the court held that unity of ownership existed when more than 50% of the stock of the corporations sought to be combined was owned or controlled by a shareholder group acting in concert.

If an individual or entity owns or controls over 50% of the voting stock of another corporation, concerted action generally does not exist with respect to unrelated minority shareholders. In that case, the power to vote the majority of the board of directors of the corporation, and thus control the corporation, does not depend upon concerted action with respect to the minority shareholders. An exception may apply when shareholders are members of the same family and one family member owns or controls over 50% of the voting stock of a corporation. In such cases, concerted action may exist with respect to family member shareholders, because the family is more likely to view itself as an economic unit than an unrelated shareholder group and to accept transfers of value at other than arm's length.

Inferences of concerted action: When family members cumulatively own or control over 50% of the voting stock of two or more corporations, there is an inference that the family members constitute a concerted group. Similarly, when minority shareholders cumulatively own or control more than 50% of the voting stock of two or more corporations and have common voting patterns and when the corporations share substantial contribution or dependency, there is an inference that such shareholders constitute a concerted group.

Application of IRC Sec. 482 to Sec. 25105: In interpreting the terms “direct . . .” or “indirect ownership or control” in Sec. 25105, cases that interpret IRC Sec. 482, concerning the allocation of income and deductions among related taxpayers, provide guidance. However, due deference must be given to the distinct requirement of Sec. 25105 that such ownership or control exist with respect to more than 50% of the voting stock. IRC Sec. 482 has no percentage ownership threshold. Furthermore, IRC Sec. 482 is remedial, and the IRS has discretion to make adjustments to income of commonly controlled taxpayers, while Sec. 25101, the general California provision authorizing unitary combination of corporations, requires mandatory combination whenever a unitary business exists between commonly owned entities.

Unrelated corporations holding minority interest in a third corporation: Although two or more corporate shareholders (themselves held by unrelated shareholders), each holding a minority interest in a third corporation, may act in concert to control the business of the third corporation, the corporate shareholders and the commonly held corporation do not together satisfy the conditions of Sec. 25105 for unity of ownership. This is because no shareholder or group of shareholders owns or controls more than 50% of the voting stock of any two or more of the corporations in question.

Control of stock through a partnership interest: With respect to stock held by a partnership, if the partnership agreement provides that a partner has voting power over voting stock held by the partnership, that partner will be treated as the only entity in control of the stock. Unless the partnership agreement provides otherwise, the following additional rules will apply. First, a partner in a general partnership will be considered to have control of the voting stock held by the partnership to the extent that such partner would receive such stock on dissolution of the partnership. Furthermore, such voting stock attributed to the partner will be aggregated with the partner's individual stock holdings for purposes of Sec. 25105. With respect to limited partnerships, a single general partner in a limited partnership will be considered to have control of the voting stock held by the partnership. Such voting stock will be aggregated with the partner's individual holdings for purposes of Sec. 25105. However, two or more general partners in a limited partnership will not be considered to control the voting stock of the limited partnership for purposes of allowing such stock to be aggregated with stock held directly by the general partners.

Partnerships as a concerted group: Generally, a limited or general partnership owning over 50% of the voting stock of two or more corporations will be considered a concerted group of its general partners for purposes of Sec. 25105. However, if a general partner holds more than a 50% interest in a partnership, and the partnership agreement does not provide otherwise, only that general partner will be considered in control of the stock held by the partnership, and the other partners will not be considered members of a concerted group. If a corporation holds more than a 50% interest in a general partnership, and the partnership agreement does not assign voting power to another partner, unity of ownership exists between the more than 50% corporate partner and the corporation held by the partnership.

Holding in “Hugo Neu-Proler” to apply only in situations with substantially identical facts: The holding of a California Court of Appeal in Hugo Neu-Proler (see ¶401-583) will apply only in situations with substantially identical facts. In that case, two corporations were equal partners in a partnership, and the partnership formed a domestic international sales corporation (DISC). The court held that unity of ownership existed between the DISC and the two corporate partners on the basis that the DISC was owned and controlled by the partnership. The court also noted that, together, both corporate partners had “absolute sovereignty” over the DISC.

However, while a partnership can own stock, as an entity, the partnership cannot control it; only the partners can control the voting stock held by the partnership. Under the general principle that when control is severed from ownership, only the entity in control of voting stock is counted in the application of Sec. 25105. On this basis, the partnership's ownership of the stock is disregarded. Furthermore, because Sec. 25105 does not expressly incorporate the attribution-of-ownership principles of IRC Sec. 318 or any other provision, attribution of stock ownership between partners is not properly applied to Sec. 25105.

In addition, the court's observation that, together, the two corporate partners had “absolute sovereignty” over the DISC, if intended as a test, cannot be reconciled with the requirements of Sec. 25105, particularly when read together with Sec. 25101. Under those provisions, all components of a unitary business must be under common control by the same interest, in excess of 50% of the voting stock of each. To view that test as satisfied by the observation that, together, the two corporate partners held all of the stock of the DISC through partnership, without also examining whether the corporate shareholders themselves were also held more than 50% by the same shareholders holding the DISC, ignored the important rationale of the unity of ownership test that members of a purported unitary group be under effective common control. Such an interpretation would nullify Sec. 25105 as a test for unity of ownership. Accordingly, the holding of Hugo Neu-Proler will apply only in situations with substantially identical facts.

Trustees and other fiduciaries: A trustee will be considered to be exercising voting control of stock over which he or she has exclusive voting power. Stock held by the trustee in his or her own right will generally be aggregated with the stock controlled by the trustee in trust for purposes of meeting the more than 50% test of Sec. 25105. However, stock held by independent cotrustees will not be aggregated with stock controlled by the cotrustees in their individual capacities, because neither cotrustee can independently exercise control with respect to the stock held in trust.

Voting stock held by guardians, administrators, executors, etc., will be considered controlled by those fiduciaries in accordance with the principles applicable to trustees, if the fiduciary relationship prevents the title owner from exercising voting rights.

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Section 1: Introduction

Under Revenue and Taxation Code Section 25101, corporations engaged in a single unitary business must compute their tax on a combined basis, Edison California Stores v. McColgan (1947) 30 Cal.2d 472, Superior Oil v. Franchise Tax Board (1963) 60 Cal.2d 417. One of the requirements for a finding that two or more corporations are engaged in a single unitary business is that such corporations share “unity of ownership.” (Butler Bros. v. McColgan (1941) 17 Cal.2d 664, aff’d, 315 U.S. 501.) In Rain Bird Sprinkler Mfg. Corp. v. Franchise Tax Board (1991) 229 Cal.App.3d 784, the court held that Section 25105, Revenue and Taxation Code, was the governing section with respect to the determination of unity of ownership under Section 25101.

This Legal Ruling examines the requirements for unity of ownership under Section 25105. This ruling also examines the holding of Hugo Neu-Proler International Sales Corp. v. Franchise Tax Board (1987) 195 Cal.App.3d 326, in light of the requirements of that section.

Section 2: General Principles

The principle underlying the unity of ownership requirement is that in order for two entities to be unitary, there must be “some bond of ownership or control” uniting the purported unitary entities. (See Container Corp. v. Franchise Tax Board (1983) 463 U.S. 159, 166, 77 L.Ed.2d 545, enunciating this constitutional standard.) When unity of ownership exists, corporations can be commonly controlled in a manner where the interests of a single corporation can be made subservient to the interests of the entire economic unit represented by all of the corporations in the purported unitary group.

While, for constitutional purposes, the bond of ownership or control required for unitary combination under Container Corp. v. Franchise Tax Board, supra, 463 U.S. 159, 166, is relatively broad, the applicable California statutory standard is narrower. That standard is found in Section 25105, Rain Bird Sprinkler Mfg. Corp. v. Franchise Tax Board, supra, 229 Cal.App.3d 784, 789, 791. Section 25105 states that “direct or indirect ownership or control of more than 50% of the voting stock of the taxpayer shall constitute ownership or control for purposes of this article.” Section 25105 thus defines ownership or control for purposes of Article 1 of Chapter 17 of Part 11 of the Revenue and Taxation Code, the general provisions relating to apportionment and allocation of corporate income, including the determination of the existence of a unitary business under Section 25101.

As used in Section 25101, for the specific purpose of the determination of members of a unitary group, the term “taxpayer” refers to all of the members of a unitary group as an economic unit, Edison California Stores v. McColgan (1947) 30 Cal.2d 472, 480 (applying Section 10 of the Bank and Corporation

Franchise Tax Act of 1929, predecessor to Section 25101). Because the ownership or control provisions of Section 25105 have no direct application outside of the article in which that section appears, the term “taxpayer” appearing in Section 25105 has the same scope as the term “taxpayer” under Section 25101, referring to all corporate members of a purported unitary group. This means that more than 50% of the voting stock of all such members must be owned or controlled by the same interests. That all members of a purported unitary group must be under common ownership or control is also implicit in the word “unity” in the phrase “unity of ownership.”

Section 3: Voting Stock

Holdings

“Voting stock” refers to those shares of stock which have the power to elect the board of directors of the corporation.

If there exists more than one class of voting stock, the relative voting power of each class must be examined to determine whether the power to elect the membership of the board of directors is commonly held.

If the power otherwise held in corporate stock to vote the membership of the board of directors is transferred to another, the holder of that power controls the voting stock for purposes of Section 25105, to the exclusion of the transferor. As to the transferor, its interest in such stock is not an interest in voting stock.

Discussion

Voting stock. Section 25105 requires that only voting stock be considered in determining the requisite unity of ownership under Section 25101. As noted above, the principal objective of the unity of ownership test is to determine whether corporations which are purportedly members of a unitary group are commonly controlled in a manner where the interests of one corporation can be made subservient to the interests of the entire economic unit. The power to control the business affairs of a corporation is resident in the corporation's board of directors (see, e.g., Cal. Corp. Code Section 300). Although all stock gives the owner the right to share in the profits of a corporation, the power to control the operations of the corporation, through election of the board of directors, is conferred only by voting stock. Accordingly, for purposes of Section 25105, “voting stock” refers to those shares of stock, under the applicable law, corporate charter, articles of incorporation, or shareholder agreements, which have the power to elect the board of directors of the corporation (see, e.g., Cal. Corp. Code Section 194.5, defining “voting power”; see also *Rudolph Wurlitzer Co., et. al. v. Comm.* (1933) 29 BTA 443, *aff'd* 81 F.2d 971, cert. den. 298 U.S. 676). Thus, for example, preferred stock which has voting power limited to

approval of liquidation of the corporation will not be considered voting stock for purposes of Section 25105.

More than one class of voting stock. Section 25105 does not address the situation where a corporation has more than one class of voting stock. When more than one class of voting stock exists, it is necessary to examine the relative voting power of such stock, to determine whether or not the power to elect the membership of the board of directors of the purported unitary entities is commonly held.

For example, assume that an individual X holds all of the stock of Corporation M and holds 500 shares of Class A voting stock in Corporation N, entitled to elect just two of five members of the board of directors. Unrelated individual Y holds 300 shares of Class B voting stock in Corporation N, entitled to elect three of the five members. Corporation N has issued no other shares. Unity of ownership does not exist under Section 25105 between Corporations M and N, because individual X cannot commonly control the operations of the respective corporations through the election of the board of directors of both corporations, and individual Y has no power to control the election of the board of directors of Corporation M. (Individuals X and Y will also not be considered a concerted group with respect to Corporations M and N, see Section 8, below.)

Transfer of voting power. If the power otherwise held in corporate stock to vote the membership of the board of directors is irrevocably transferred to another (by shareholder agreement, voting trust, or otherwise legally binding agreement), even if the shareholder otherwise holds legal or beneficial title to such stock, such shareholder will not be considered as owning or controlling voting stock for the duration of the transfer. This is because, as to such shareholder, such interest in stock is no longer an interest in voting stock, because such shareholder no longer can participate in the election of the board of directors. That shareholder's stock interest is analogous to nonvoting common stock, which would not qualify as voting stock under Section 25105.

The position that ownership of stock, in the absence of voting power, is insufficient to satisfy the condition of Section 25105 is consistent with the holding of *Edison California Stores v. McColgan*, supra, 30 Cal.2d 472, 480, that the unity of ownership criterion requires controlling ownership, and not merely ownership, of voting stock: “[I]n the present case there is a parent corporation owning and controlling as units of one system fifteen different branches organized as corporations in as many states (emphasis added).”

That position is also supported by the language of *Rain Bird*, supra, which stated:

It cannot be disputed that an important rationale for the unity of ownership requirement is the need for the existence of effective common control over a

functionally integrated business entity. It is the reality of control, not its form or mode, that should be determinative (emphasis added). Rain Bird, supra, 229 Cal.App.3d 784, 790.

If an individual or entity receives voting power in stock from another, although such individual or entity does not own such stock, that individual or entity controls the voting stock, and will therefore satisfy the condition of control of voting stock for purposes of Section 25105.

Additional support for disregarding ownership of stock where the owner has no voting power, in favor of the holder of such power, is the fact that such disregard avoids double counting of a share of voting stock under Section 25105, once with respect to the nonvoting stock owner, and again with respect to the individual who controls the voting rights of such stock.

Section 4: Direct Ownership

Holdings

Direct ownership exists if an individual or entity has direct ownership and control of more than 50% of the voting stock of two or more corporations.

Direct ownership also is present when a widely held corporation owns and controls more than 50% of the stock of a subsidiary.

Discussion

Ownership by individual or entity. If one individual or entity has direct ownership and control of the voting rights of more than 50% of the voting stock of two or more corporations, unity of ownership exists among the corporations under Section 25105. Thus, for example, if individual X holds more than 50% of the voting stock of Corporations A and B, X can control the election of the board of directors of both corporations and therefore control the operations of each.

Stock of subsidiary of widely held corporation. When the voting stock of a parent corporation is widely held, and that parent corporation directly owns and controls more than 50% of the voting stock of a subsidiary, the operations of both parent and subsidiary are under the ultimate control of the board of directors of the parent. Thus, both the parent and its subsidiary share unity of ownership, Edison California Stores, supra, 30 Cal.2d 472, 479-480.

Section 5: Indirect Ownership

Holdings

Indirect ownership exists when an individual or entity has direct ownership and control in excess of 50% of the voting stock of a corporation which in turn has direct ownership and control in excess of 50% of the voting stock of another corporation.

If indirect ownership exists within the meaning of Section 25105, such as where a parent corporation owns a chain of corporations, the fact that an intervening corporation in that chain is not a member of a unitary group, for reasons other than unity of ownership, will not prevent the unitary combination of lower tier members with other corporations higher in the chain.

Discussion

Indirect ownership. If one individual or entity has direct ownership and control in excess of 50% of the voting stock of a corporation, which in turn has direct ownership and control in excess of 50% of the voting stock of a second corporation, the individual or entity has indirect ownership of the second corporation. Because both corporations are owned directly or indirectly by the same individual or entity, unity of ownership exists between both corporations under Section 25105.

A determination of indirect ownership in this context requires application of the excess of 50% voting stock threshold at each level of the organizational structure to determine which entity ultimately controls the entire group sought to be combined in a unitary group. This is because power to elect the members of the boards of directors is controlled at each successive level under the ultimate control of the first corporation in the chain. For example: Corporation A owns 60% of the voting stock of Corporation C and 60% of the voting stock of Corporation D. Corporation B owns 40% of the voting stock of C and 40% of the voting stock of D. C and D each own 30% of the voting stock of Corporation E. B also directly owns the remaining 40% of the voting stock of E. Unity of ownership exists among A, C, D and E (but not B) because one entity, A, acting indirectly through its control of C and D, can elect the membership of E's board of directors.

Intervening nonunitary entity. Legal Ruling 410, 1/16/79, holds that unity of ownership may exist among unitary corporations where the voting stock of each corporation sought to be combined is owned and controlled by a corporation which is not a member of the unitary group. Legal Ruling 411, 1/16/79, holds that unity of ownership exists where the voting stock is owned and controlled by an entity even when such entity is not subject to the corporate franchise tax.

Accordingly, if indirect ownership or control exists within the meaning of Section 25105, such as where a parent corporation owns a chain of corporations (i.e., where a parent owns a subsidiary, and that subsidiary owns another subsidiary, etc.), the fact that an intervening corporation in that chain is not a member of a

unitary group, for reasons other than unity of ownership, will not prevent the unitary combination of lower tier members with other corporations higher in the chain.

For example, Corporation P owns all of the stock of S, which in turn owns all of the stock of T. The operation of Corporation P contributes to or depends upon the operation of Corporation T, within the meaning of those terms in Edison California Stores, supra, 30 Cal.2d 472, 481. However, the operation of Corporation S does not sufficiently contribute to or depend upon the operation of Corporations P or T to properly include the income and apportionment factors of Corporation S in a unitary group. Corporations P and T are members of a unitary group, notwithstanding the fact that S is not properly included in the unitary group, because the board of directors of P can direct, through control of S, the operations of T.

Section 6: Direct Control

Holdings

When there is a binding legal transfer of voting rights of stock, that stock is “controlled” within the meaning of Section 25105 by the holder of the power to vote the stock. The holder of voting rights under a voting agreement, voting trust, or proxy agreement (other than a proxy for a limited term or with respect to a specific corporate event) controls the voting stock, if the holder of voting rights can enforceably vote the stock as against the owner.

Discussion

Direct control. Direct control of voting of stock will generally satisfy control requirements for purposes of applying the more than 50% test of Section 25105. When there is a binding legal transfer of voting rights of stock, that stock is controlled within the meaning of Section 25105 by the person or entity which has the power to vote the stock. As noted above, a legal or beneficial owner of stock who does not have voting rights does not own voting stock, within the meaning of Section 25105, because such shareholder has severed his or her voting power from the stock.

In determining which individual or entity directly controls the power to vote the stock, the provisions of Title 1, Division 1, Chapter 7 (commencing with Section 700) of the California Corporations Code will generally apply to California corporations. Where it is shown that state law other than California law applies to the entities in question, the law of the other state will determine the legal rights and obligations of the entities.

Voting agreements. If a voting agreement, such as that described by Cal. Corp. Code Section 706(a), is enforceable against the beneficial owner of the shares,

the party with the voting rights will be treated as controlling the stock for purposes of Section 25105.

Voting trusts. If a shareholder transfers its shares to trustees in a voting trust, such as that described under Cal. Corp. Code Section 706(b), and the trustee's powers are enforceable against the beneficial owner, the trustee, and not the original shareholder, will be the controlling entity of the shares under Section 25105.

Proxies. A proxy allows a shareholder holding voting stock to authorize another person or persons to act on its behalf with respect to voting of its stock (see, e.g., Cal. Corp. Code Section 705). Proxies are generally revocable and are valid for a specific period or for a specific act. For example, under California law, such proxies are valid for only 11 months unless the specific irrevocability requirements of Section 705(c) are met. An irrevocable proxy is generally allowed only if it is given to secure the performance of a duty or to protect a title, and becomes revocable by operation of law when such duty is performed.

Therefore, because a proxy (as opposed to a voting agreement or trust) is generally of limited duration, and may be revoked, a proxy holder will generally not be treated as controlling voting stock for purposes of Section 25105 merely by virtue of a single grant of proxy for a specific corporate event. However, where, under the laws of this or another state, a grant of proxy is for a period of one year or more and the proxy holder has unfettered control to vote the membership of the board of directors of the corporation without regard to the direction of proxy grantor, the proxy holder will be treated as controlling the voting stock of the corporation to the extent of the voting stock subject to such powers. In addition, a regular and consistent pattern of granting proxies to the same proxy holder(s) may provide some evidence of control. (For further discussion, see Section 9, below.)

Section 7: Indirect Control

Holding

Control exercisable through ownership or control of another corporation is indirect control under Section 25105.

Discussion

If an individual or entity has direct or indirect ownership, or direct control, of a corporation, and that corporation exercises direct control of a second corporation, the individual or entity exercises indirect control over the second corporation. Power to vote the membership of the board of directors of the second corporation can be accomplished through the control of the membership of the board of directors of the first corporation.

For example, if Corporation A owns 100% of the voting stock of Corporation B, and Corporation B directly controls the voting stock of Corporation C by a shareholder agreement, Corporation A indirectly controls Corporation C.

Section 8: Control by a Concerted Group

Holdings

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.

When an individual or entity owns or controls over 50% of the voting stock of another corporation, concerted action does not exist with respect to unrelated minority shareholders, as the exercise of power to vote the majority of the board of directors of the corporation, and thus control the corporation, does not depend upon concerted action with respect to the minority shareholders.

This principle does not apply, however, when a member of a family owns or controls over 50% of the voting stock of another corporation. In such cases, concerted action may exist with respect to family member shareholders, because the family is more likely to view itself as an economic unit than an unrelated shareholder group, and accept transfer of value at other than arm's length.

Discussion

Common control through concerted action. In *Rain Bird*, supra, 229 Cal.App.3d 784, 789-91, 793, the court found that the term "indirect," which appears in Section 25105, was sufficient to support unitary combination when there existed effective common control by a group of minority shareholders, acting in concert, over a functionally integrated business entity. The court held that, "nothing in the language of Section 25105 requires that ownership be held by a single individual or entity to meet the unity of ownership test," *Rain Bird*, supra, 229 Cal.App.3d 784, 791. The court thus held, under authority of Section 25105, unity of ownership existed when more than 50% of the stock of the corporations sought to be combined was owned or controlled by a shareholder group acting in concert. (*Rain Bird* 229 Cal.App.3d 784, 789, 790, 793.) Thus, relying on the term "indirect," the Court read Section 25105 as if it contained the phrase "by the same interests," holding:

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 (*Rain Bird*, supra, 229 Cal.App.3d 784, 793).

While the holding of the court in *Rain Bird*, supra, 229 Cal.App.3d 784, involved family members acting as a concerted group, there is nothing in the above statement of principle or in the language of Section 25105, which limits the principle of concerted ownership or control to members of the same family. Accordingly, in circumstances where there is concerted ownership or control of voting stock of two or more corporations by the same interests, whether or not members of the same family, the conditions of Section 25105 are satisfied.

Evidence of concerted ownership or control of voting stock by a group of shareholders will require examination of all of the facts and circumstances, including the business relationships of the corporations sought to be combined, the relationships between the shareholders, the degree of common ownership, common voting patterns, and the relative percentage of ownership or control held by each shareholder.

No concerted action if ownership or control is otherwise present. If more than 50% of voting stock of one corporation is directly owned or controlled, or indirectly owned or controlled through another corporation within the meaning of sections 5 and 7 of this ruling, concerted action does not exist with respect to unrelated minority shareholders. This is because the exercise of power to vote the majority of the board of directors of the corporation, and thus control the corporation, does not depend upon concerted action with respect to the minority shareholders.

For example, assume Corporation A owns 51% of the voting stock of Corporation X and 50% of the voting stock of Corporation Y. Corporation B owns 49% of the voting stock of Corporation X and 50% of the voting stock of Corporation Y. Because Corporation A can exercise control over Corporation X without regard to Corporation B, Corporations A and X share unity of ownership. Corporations A and B cannot be considered a concerted group of shareholders with respect to Corporations X and Y which would allow X and Y to be combined, because Corporation A does not require the concerted action of Corporation B to exercise control over Corporation X.

Assuming the same facts as in the previous example, if Corporations A, X, and B own 25%, 25% and 50% of the voting stock of Corporation Z, respectively, Corporations A (by controlling the stock held by X) and B can constitute a concerted group with respect to Corporations Y and Z, which would allow Corporations Y and Z to be included in a unitary group, if other additional unitary attributes are present.

Exception for concerted action within a family. However, if the shareholders of one or more corporations are members of the same family (see discussion of family relationships in section 9 of this ruling), the shareholders may constitute a concerted group with respect to the corporations so held, where demonstrated by the evidence, notwithstanding the fact that a member of the family holds more

than 50% of the voting stock of one or more corporations. This is because members of the same family are more likely to view the family as an economic unit and have less concern regarding the accuracy of accounting for shifts of value between corporations held by members of the family. This analysis is supported by the holding in the Rain Bird case, wherein some of the family members held more than 50% of the voting stock of some of the corporations there sought to be combined (see Appeal of Rain Bird Sprinkler Mfg. Corp., et al., Cal. St. Bd. of Equal, June 27, 1984, rev. by Rain Bird v. Franchise Tax Board, supra, 229 Cal.App.3d 784, for further discussion of the family relationships involved in that case).

Section 9: Inference of Concerted Action

Holdings

When members of the same family, as described, cumulatively own or control in excess of 50% of the voting stock of two or more corporations, there is an inference that the family members constitute a concerted group.

When minority shareholders cumulatively own or control more than 50% of the voting stock of two or more corporations and have common voting patterns, and the corporations share substantial contribution or dependency, there is an inference that such shareholders constitute a concerted group.

When the voting stock of two or more corporations, sharing substantial contribution or dependency, are cumulatively owned or controlled by the same minority shareholders in excess of 50% of voting stock, a regular grant of proxies to a select group of individuals will give rise to an inference of concerted action.

Discussion

Inference defined. Concerted action by a group will be inferred in the circumstances described below. As used herein, the term “inference” means “a deduction of fact that may logically and reasonably be drawn from another fact or group of facts found or otherwise established.” Evidence Code Section 600(b).

Same family. If two or more shareholders, cumulatively owning or controlling in excess of 50% of the voting stock of two or more corporations, are members of the same family, there is an inference that the family members constitute a concerted group with respect to the corporations so held. The inference is stronger for spouses and minor children, less strong for adult members of the same family. For this purpose, “family” includes parents, children and grandchildren, brothers and sisters, and their respective spouses. No inference exists for more remote family relationships.

Concerted action between unrelated minority shareholders. If two or more unrelated minority shareholders cumulatively own or control in excess of 50% of the voting stock of two or more corporations, concerted action will generally be inferred to exist between such shareholders if (1) the shareholders have the same voting pattern with respect to the stock of the corporations, and (2) the corporations share substantial contribution and/or dependency.

The inference of concerted action between minority shareholders is strongest when the shareholders hold substantially equal percentages in the voting stock of the corporations. In such cases, shareholders have no particular economic incentive to insure that transfers of value between the corporations are properly stated at arm's length, because every dollar of income understated by one corporation will be overstated by the same amount in the other. However, such shareholders could, by acting in concert and without economic detriment, shift income from one corporation to another for tax motivated reasons.

Example--Shareholders A, B, C and D own 35%, 30%, 25% and 10% of the voting stock of Corporation X, respectively. These same individuals own the same respective percentage of voting stock of Corporation Y. The shareholders have the same voting patterns with respect to both corporations and the operations of both corporations share substantial contribution or dependency. Unity of ownership under Section 25105 is inferred.

The inference of concerted action diminishes as the relative percentage of ownership of voting stock held by the minority shareholders in the corporations sought to be combined becomes more unequal, because, at the extremes, a shareholder will tend to maximize its investment in the corporation in which it has the greater interest, making it more likely that valuation of transactions between the corporations will be properly stated. Nevertheless, such shareholders may be willing to accept transfers of value at other than arm's-length value to obtain the benefits of operating as an integrated business enterprise.

Example--A owns 40% of Corporation X and 15% of Corporation Y. B owns 15% of Corporation X and 40% of Corporation Y. A and B are unrelated and the rest of the stock of both corporations is held by other unrelated persons. While A and B could exercise common voting control over Corporations X and Y to exceed 50% of the voting stock, the likelihood that they would do so is less than if their interests were substantially equal, reducing the force of the inference of concerted action.

There is no inference of concerted action in the circumstances described above, if the primary purpose for the acquisition and/or disposition of such stock is the reduction of California income or franchise tax.

Proxies as inference of concerted control. When voting stock in two or more corporations is cumulatively owned or controlled by minority shareholders in

excess of 50%, a regular and consistent pattern of granting proxies to a select group of proxy holders may give rise to an inference that concerted group control in fact exists, where the facts indicate that there is a substantial contribution or dependency relationship between the corporations sought to be combined.

Example: Voting stock in Corporations A and B are cumulatively held in excess of 50% by the same shareholders. Proxies with respect to Corporations A and B sufficient to exceed the 50% threshold of Section 25105 are routinely granted to a small group (e.g., corporate management) over a pattern of two or more years, and the corporations sought to be combined have substantial contribution or dependency relationships. The regular grant of such proxies gives rise to an inference of concerted group control.

Section 10: Application of Internal Revenue Code Section 482 to Section 25105

Holding

With respect to the terms “direct or indirect ownership or control” appearing in Section 25105, cases interpreting Section 482 of the Internal Revenue Code provide guidance, with due deference to the distinct requirement of Section 25105 that such ownership or control exist with respect to more than 50% of the voting stock.

Discussion

Hugo Neu-Proler, supra, 195 Cal.App.3d, (see discussion infra) and to a certain extent Rain Bird, supra, 229 Cal.App.3d 784, relied on the “direct or indirect ownership or control” principles of Internal Revenue Code Section 482 and B. Forman Company v. Comm. (2d Cir. 1972) 453 F.2d 1144 in support of their respective holdings, on the basis that section was “analogous” to Section 25105. Section 482, relating to allocation of income and deductions among related taxpayers, applies only when the taxpayers are “owned or controlled directly or indirectly by the same interests.”

The analogy of Section 482 to Section 25105 is imperfect, however. Section 482 is a remedial section, and only the Commissioner of the Internal Revenue Service (and the Franchise Tax Board under Revenue and Taxation Code Section 24725) has the discretion to make adjustments to the income of commonly controlled taxpayers (Treas. Reg. Section 1.482-1(b)). In contrast, Section 25101, the general section authorizing unitary combination of corporations under Edison California Stores, supra, 30 Cal.2d 472, was found to require mandatory combination, binding on the taxpayer and the Franchise Tax Board alike, whenever a unitary business exists between commonly owned entities. Superior Oil, supra, 60 Cal.2d 417.

More importantly, Section 25105, by its terms, requires that there exists “control of more than 50 percent of the voting stock.” “Control,” then, relates to the control of voting stock, and not practical or economic control of the business in general, and that control must extend to more than 50% of such voting stock. In contrast, Section 482 has no percentage ownership threshold, *B. Forman v. Comm.* (2d Cir. 1972) 453 F.2d 1144, 1152-3, and “control,” as the term is used in Section 482, includes “any kind of control . . . however exercisable or exercised.” [Treas. Reg. Section 1.482-1(a)(3)] (hereinafter described as “practical or economic control,” where not accompanied by actual control of more than 50% of voting stock). Accordingly, cases decided under Section 482, such as *B. Forman v. Comm.*, *supra*, to the extent they rely on the practical or economic control principles of that section and without regard to the control of more than 50% of the voting stock, are distinguishable in the application of Section 25105.

Section 11: Practical Control Not Sufficient

Holding

In the absence of ownership or control of more than 50% of voting stock, evidence of practical or economic control, or potential to control will not satisfy the requirements of Section 25105.

Discussion

Economic or practical control not sufficient. While economic or practical control of the business in general is relevant in determining whether unity of use or unity of operations exists (see *Butler Brothers*, *supra*, 17 Cal.2d 664), unless that control is control with respect to voting stock, such as a voting agreement with a legally binding transfer of voting power, economic or practical control of the business will not be adequate to meet the more than 50% voting stock test of Section 25105.

Example: An automaker owns 20% of the voting stock of a seat fabric manufacturer. The seat fabric manufacturer sells 100% of its fabric to the automaker, resulting in the seat fabric manufacturer's substantial economic dependence on the automaker. While the automaker's 20% voting power coupled with the current economic dependence of the seat fabric manufacturer on the business of the automaker may provide the automaker with a degree of practical control, the more than 50% voting stock test of Section 25105 is not met, and no unity of ownership exists.

Stock warrants, options, convertible stock or other potential to control voting stock not

sufficient. Stock warrants and options generally give the holder the right to purchase shares of stock upon exercise. Convertible stock includes stock which carries a power to convert from nonvoting stock to voting stock. Until and unless

the option, warrant, or conversion privilege is exercised, the holder of the right does not have voting control of stock. Therefore, unexercised warrants, options, and conversion privileges will not constitute ownership or control under Section 25105.

Example: A 45% shareholder holds warrants, which, if exercised, would be sufficient for the shareholder's holdings to exceed 50% of the voting stock. The conditions of Section 25105 are not satisfied, because of the absence of ownership or control of over 50% of the voting stock under Section 25105. Potential ownership or control is not sufficient, even if some economic control is present. Indeed, a corporation could potentially control another corporation by mere purchase of available stock. (See also, generally, *F.W. Woolworth Co. v. Taxation and Revenue Dept.* (1982) 458 U.S. 354, 73 L.Ed. 2d 819, 827 (potential to operate a company as part of a unitary business is not dispositive to a unitary determination).)

Temporary loss of actual control, when taxpayer continuously in possession of practical control. In some circumstances, a taxpayer's actual voting control may temporarily fall below 50% of voting stock, but practical control is retained throughout the accounting period. This might happen, for example, as a result of an uneven exercise of conversion privileges, or temporary transfer of stock. In the alternative, taxpayers may seek to break unity of ownership as a tax planning device, while retaining practical control, by receiving warrants, options, etc. In such case, the Franchise Tax Board may, in the exercise of its discretion, find that, in substance, unity of ownership exists during the entire period.

Section 12: Unrelated Corporations Holding Minority Interests in a Third Corporation

Holding

Although two or more corporate shareholders (themselves held by unrelated shareholders), each holding a minority interest in a third corporation, may act in concert to control the business of the third corporation, the corporate shareholders and the commonly held corporation do not together satisfy the conditions of Section 25105.

Discussion

As applied in *Rain Bird, supra*, 229 Cal.App.3d 784, Section 25105 requires that more than 50% of the voting stock of all corporations in a purported unitary group be owned or controlled by the same interests (see discussion in section 8 of this ruling). Although two or more corporate shareholders (themselves held by unrelated shareholders), each holding a minority interest in a third corporation, may act in concert to control the election of the board of directors of the third corporation, the corporate shareholders and the commonly held corporation do not

together satisfy the conditions of Section 25105. This is because no shareholder or group of shareholders owns or controls more than 50% of the voting stock of any two or more of the corporations potentially to be combined.

For example, assume that Corporations A and B each own 50% of Corporation X. A and B are owned 100% by unrelated shareholders M and N, respectively. Corporation X does not share unity of ownership with A, and therefore cannot be included in a unitary group with respect to A because M does not own or control more than 50% of the stock of both Corporations A and X, as required by Section 25105.

This does not, however, prevent Corporations A and B from exercising concerted action with respect to two or more other corporations. Assume the same facts as in the preceding example, except that Corporations A and B also own 50% of Corporation Y. Corporations X and Y can share unity of ownership under Section 25105 if A and B act in concert to control them (see discussion in sections 8 and 9, above).

Section 13: Control of Stock Through a Partnership Interest

Holdings

When a partnership agreement provides that a partner has voting power over the voting stock held in partnership, that partner will be treated as the only entity in control of such stock.

Except when the partnership agreement provides to the contrary, a partner in a general partnership will be considered having control of the voting stock held by the partnership to the extent that such partner would receive such stock on dissolution of the partnership. Such stock shall be aggregated with the partner's individual holdings for purposes of Section 25105.

Except when the partnership agreement provides to the contrary, a single general partner in a limited partnership will be considered having control of the voting stock held by the partnership. Such stock shall be aggregated with the partner's individual holdings for purposes of Section 25105.

Except when the partnership agreement provides to the contrary, two or more general partners in a limited partnership will not be considered to control the voting stock of the limited partnership to allow such stock to be aggregated with the stock held directly by the general partners.

Limited partners will not be considered to control the voting stock of a limited partnership.

Discussion

Effect of voting arrangements in partnership agreements. When the partnership agreement provides that a partner has power to vote stock on behalf of the partnership, that partner is treated as controlling such stock to the exclusion of the other partners, in accordance with the terms of the agreement. Stock held or controlled directly by such partner in his or her own right shall be aggregated with the stock of the partnership so described for purposes of meeting the more than 50% test of Section 25105.

General partnerships. In the absence of provisions in the partnership agreement to the contrary, partners in a general partnership have equal rights in the management and conduct of the partnership business, Cal. Corp. Code Section 15018(e). However, in the event of a dispute among partners with respect to voting of stock held by a partnership, a general partner can normally force a dissolution of the partnership. See Cal. Corp. Code Section 15031, and the general provisions of Cal. Corp. Code Section 15001, et seq. (Uniform Partnership Act). Assets held by the partnership are considered co-owned by the partners as “tenants in partnership,” Cal. Corp. Code Section 15025. In the event of a dissolution, after satisfaction of liabilities, partnership property may be either sold and the proceeds distributed or the property may be distributed in kind to the former partners, 48 Cal.Jur. 3d Sections 146, 147. Generally, distribution in kind is favored over sale and distribution of proceeds of sale, *Logoluso v. Logoluso* (1965) 233 Cal.App.2d 523, 530, in such cases where the property is readily divisible, and such division can be equitably made between the partners (see *Jacoby v. Feldman* (1978) 81 Cal.App. 3d 432). Shares of stock are ordinarily readily divisible between the partners, by simple distribution of a proportionate number of shares, which makes such division likely in an action in dissolution of a partnership. Accordingly, in the absence of a provision in the partnership agreement to the contrary, or upon a showing that stock is not readily divisible by proportionate number of shares, partners in a general partnership will be considered as controlling the stock held by a partnership in proportion to their interest in the partnership.

Stock controlled by a partner through a partnership interest under the preceding paragraph shall be aggregated with the stock directly owned or controlled by such partner in his or her own right for purposes of meeting the more than 50% test of Section 25105.

Limited partnerships. A single general partner in a limited partnership will be considered controlling the voting stock held by the partnership, on the basis that such general partner is the only entity which has actual voting control with respect to the stock, Cal. Corp. Code Section 15643 (Revised Uniform Limited Partnership Act).

When more than one general partner exists in a limited partnership, and the partnership agreement permits a general partner to exercise voting power over

some or all of the voting stock held by the partnership, the general partner will be considered to control such stock, to the extent the agreement so provides. Power to exercise voting control will be shown where, under the terms of the partnership agreement, a general partner has power to a) vote the stock held by the partnership without regard to the other partners, b) force a dissolution of the limited partnership and receive an interest in stock upon dissolution, or c) withdraw from the limited partnership and take such stock upon withdrawal.

In the absence of such a provision in the limited partnership agreement, however, if more than one general partner exists in such a partnership, no general partner will be treated as controlling the stock held by the limited partnership. This is because in the event of a dispute between two or more general partners with respect to voting stock, the general partners ordinarily cannot unilaterally force the dissolution of the partnership, Cal. Corp. Code Section 15681. In addition, unless otherwise provided in the partnership agreement, if a general partner withdraws from a limited partnership, the general partner's interest in the partnership becomes a limited partnership interest, Cal. Corp. Code Section 15662.

Limited partners will not be considered either owning or controlling stock because they do not own the stock directly, cannot exercise voting rights with respect to stock, cannot unilaterally force a dissolution of the limited partnership, Cal. Corp. Code Sections 15636(f) and 15632(b)(5), cannot withdraw from the partnership until six months after notice to the general partners, Cal. Corp. Code Section 15663, and cannot receive such stock upon withdrawal or in dissolution, Cal. Corp. Code Section 15636(d), absent a provision in the partnership agreement to the contrary.

Stock held directly by a single general partner in his or her own right shall be aggregated with the stock controlled by such general partner through a limited partnership under the preceding paragraph for purposes of meeting the more than 50% test of Section 25105. In the absence of a partnership agreement allowing a partner to control stock of the limited partnership to the exclusion of the other partners, the stock held by a limited partnership with two or more general partners cannot be aggregated with the stock held directly by the general partners.

Section 14: Partnerships as a Concerted Group

Holding

Generally, a partnership owning in excess of 50% of the voting stock of two or more corporations will constitute a concerted group of its partners.

Discussion

A limited or general partnership which owns more than 50% of the voting stock in two or more corporations will generally be considered a concerted group of its partners for purposes of Section 25105, unless a partner can exercise control of the voting stock without regard to the other partners.

For example, if a general partnership owns more than 50% of the voting stock of two corporations, and no partner's interest in the partnership exceeds 50%, the general partners will be considered a concerted group with respect to the corporate stock held by the partnership, absent a provision in the partnership agreement to the contrary.

However, if a general partner holds more than a 50% interest in a partnership, and the partnership agreement does not provide to the contrary, only that general partner will be considered in control of the stock held by the partnership, and the other partners will not be considered as members of a concerted group (see section 8 above, relating to more than 50% control held by a single entity preventing the presence of a concerted group). If a corporation holds a more than a 50% interest in a general partnership, and the partnership agreement does not assign voting power to another partner, unity of ownership exists between the more than 50% corporate partner and the corporation held by the partnership.

If a limited partnership with two or more general partners owns more than 50% of the voting stock of two or more corporations, the general partners will be considered a concerted group with respect to the corporate stock held by the partnership, absent a provision in the partnership agreement to the contrary.

Section 15: Application of Hugo Neu-Proler

Holding

Hugo Neu-Proler v. Franchise Tax Board shall apply only in situations with substantially identical facts.

Discussion

Hugo Neu-Proler v. Franchise Tax Board, supra, 195 Cal.App.3d 326, involved a partnership equally held by two corporations. In order to obtain favorable federal tax treatment, the partnership formed a Domestic International Sales Corporation (DISC) under Sections 991-997, Internal Revenue Code. The Court of Appeal held that unity of ownership existed between the DISC, the partnership, and the corporate partners because the DISC was owned and controlled by the partnership, and, alternatively, that if the stock was treated as held by the corporate partners, the ownership of stock of each of the partners was attributed to the other. The court also noted that together both corporate partners had “absolute sovereignty” over the DISC.

As noted above, however, while a partnership can own stock, it as an entity cannot control it; only the partners can control the voting stock held by the partnership. Under the general principle (Section 3 above) that when control is severed from ownership, only the entity in control of voting stock is counted in the application of Section 25105, the partnership's ownership of the stock is disregarded.

This principle is consistent with general tax law principles with respect to partners, under which a partnership is merely a reporting entity and not a taxpayer, and income of the partnership is treated as proportionately that of the partner in accordance with the partner's partnership interest (see Sections 701-761, Internal Revenue Code). It is also consistent with the principles of 18 Cal. Code Regs. Section 25137-1, which treats a proportionate amount of the partnership's payroll, property and sales as that of the partner for purposes of apportionment of partnership income, in accordance with the partner's interest in the partnership. In contrast, an ordinary corporation is a separate taxpaying entity, and there is no provision in the general tax law for treating income of one of such corporations as distributable to another.

“Attribution” is a statutory concept of constructive ownership designed to deal with specific statutory situations. The most common of these provisions is Section 318 of the Internal Revenue Code (incorporated by reference into the Revenue and Taxation Code, Section 24497). (With respect to partner and partnership attribution, see Sections 318(b)(2) and (3).) Other provisions for such attribution include Sections 544, 554, 1239, 1297, and 1563, Internal Revenue Code. Without exception, each of these principles of attribution applies only to the specific context to which the applicable section relates. For example, Section 318(a) states: “For purposes of this subchapter to which the rules contained in this section are expressly made applicable--(emphasis added).” Accordingly, unless specifically and expressly incorporated by reference, in a particular section, the attribution sections, by their terms, have no application in general tax law. As Section 25105 does not expressly incorporate the attribution principles of Section 318 or any other section, attribution of stock ownership between partners is not properly applied to Section 25105.

Finally, the observation by the court that together the two corporate partners had “absolute sovereignty” over the DISC, if intended as a test, cannot be reconciled with the requirements of Section 25105, particularly when read together with Section 25101. As noted above, all components of a unitary business must be under common control by the same interests, in excess of 50% of the voting stock of each. To view that test as satisfied by the observation that together the two corporate partners held all of the stock of the DISC through partnership, without also examining whether the corporate shareholders themselves were also held more than 50% by the same shareholders holding the DISC, ignores the “important rationale” of the unity of ownership test that members of a purported

unitary group be under “effective common control,” *Rain Bird, supra*, 229 Cal.App.3d 784, 790.

In addition, such an interpretation would nullify Section 25105 as a test for unity of ownership. The shareholders of any corporation together exercise “absolute sovereignty” over the corporation. Even if Section 25105 were read to require consensual agreement of such shareholders, any corporate act resulting from a vote of more than 50% of its shares would satisfy the requirements of Section 25105, regardless of the ownership and control relationships of the corporation and its corporate shareholders. This is so ordinary an event in corporate life as to render the requirements of Section 25105 meaningless as a test for unity of ownership.

Accordingly, the holding of *Hugo Neu-Proler v. Franchise Tax Board, supra*, 195 Cal.App.3d 326, will apply only in situations with substantially identical facts.

Section 16: Trustee's Powers to Vote Stock

Holdings

A trustee will be considered as exercising voting control over the stock which he or she has exclusive voting power. Stock held by the trustee in his or her own right shall generally be aggregated with the stock controlled by such trustee in trust for purposes of meeting the more than 50% test of Section 25105.

Stock held by independent cotrustees shall not be aggregated with stock controlled by the trustees in their individual capacity, as neither trustee can independently exercise control with respect to such stock.

Discussion

Single independent trustee of a trust. A trustee will be considered as exercising voting control over the stock which he or she has exclusive voting power, because such trustee is the only entity which can participate in the election of the board of directors with respect to such stock. Except as described below, stock held by the trustee in his or her own right shall be aggregated with the stock controlled by such trustee in trust for purposes of meeting the more than 50% test of Section 25105.

This aggregation principle is not affected by fiduciary duties of the trustee to manage the trust assets for the benefit of the beneficiaries of the trust (see, e.g., California Civil Code Section 2228, et seq.). As a general observation, the fact that the holder of voting power has a fiduciary duty to others does not limit the application of Section 25105. For example, a member of the board of directors or an officer of a corporation has a fiduciary duty not to dissipate corporate

value as to minority shareholders (see, generally, 15 Cal. Jur. 3d (Rev.) Section 264-273).

Moreover, the trustee's fiduciary obligation does not mean that such trustee will necessarily make the same decisions regarding the election of the membership of the board of directors of the corporation that he or she would have made had that trustee not held such stock in his or her own right.

For example, the fiduciary may possess particular information regarding the business by virtue of his or her own voting stock interest in a corporation. The fiduciary may be willing to forego short-term gain on behalf of the beneficiaries in exchange for long-term advantage of a synergistic economic relationship with another corporation which he or she owns or controls. The fiduciary may be related to the beneficiary in a circumstance where challenge to the fiduciary's investment decisions is unlikely. Finally, the fiduciary might be motivated to shift more than a fair rate of return to the corporation whose stock is held in trust for related family members, retaining less return on his or her own stock investment, as an estate planning mechanism.

However, a consistently disparate voting pattern with respect to shares held by the trustee in his or her own right, and those controlled by the trustee on behalf of beneficiaries, may provide an evidentiary basis to conclude that unity of ownership does not exist.

Two or more independent trustees. Stock held in a trust with two or more independent cotrustees will not be considered controlled by the trustees in their individual capacity, because neither can act without consent of the other. Accordingly, stock held by the trust cannot be aggregated with stock held by such trustee in his or her own individual capacity. However, the trustees can otherwise constitute a concerted group with respect to two or more corporations held by the trust for purpose of meeting the unity of ownership test of Section 25105 under Section 8, above.

Example: Cotrustees A and B administer a common law trust which holds 60% of the stock of both Corporations X and Y. The stock held in trust will not be treated as controlled by either A or B in their individual capacity. Such cotrustees could, however, constitute a concerted group, with respect to X and Y, and allow unity of ownership to exist between such corporations under Section 25105.

Section 17: Transfer of Subsidiary Stock or Voting Power by Corporations to Trusts

Holdings

Irrevocable transfer by a corporation of voting stock or nominal voting power in a subsidiary to the control of a truly independent trustee, even if the corporation retains beneficial ownership of the stock, will terminate ownership or control for purposes of Section 25105.

Transfer of stock or voting power of a subsidiary to a trust or proxy holder, required by a government as a condition for that subsidiary to conduct a business enterprise, will terminate ownership or control for purposes of Section 25105, notwithstanding that the trust or proxy arrangement may be terminated by the transferor upon discontinuance of the business enterprise, if the transferor has no power to vote the membership of the board of directors of the subsidiary during the conduct of such business enterprise.

Discussion

True relinquishment of voting power and control. If a corporation irrevocably transfers stock or voting power of a subsidiary to a trust and the trustee has unfettered control of the voting power of stock so held, the corporation will be considered as not owning or controlling voting stock for purposes of Section 25105, for the duration of the transfer. As indicated in section 3 of this ruling, ownership of stock without voting power does not satisfy the conditions of Section 25105, because of the absence of controlling ownership.

Actual control of voting power retained. However, if a corporation transfers voting stock or nominal voting power of the stock of a subsidiary to a trust, but retains actual control of the voting power of stock held by the trust, or can revoke the trust, or retains the power to control the actions of or remove the trustee without cause, the corporation will be considered as owning or controlling the corporation for purposes of Section 25105. The determination of retained control will require an evaluation of all the facts and circumstances of the case, including whether there is an independent business reason for establishment of the trust, and the degree of influence that the grantor has over the actions of the trustee.

Voting trusts or proxy arrangements required by a government as a condition of conduct of a business enterprise. On occasion, a governmental entity will require a corporation to transfer stock in a subsidiary, or voting power with respect to stock in the subsidiary, to a trust or proxy holder as a condition for that subsidiary to conduct a particular business enterprise within the jurisdiction of the government's control. If, under all of the facts and circumstances of the case, the transferor truly relinquishes control to vote the membership of the board of directors while the subsidiary corporation continues to conduct the business enterprise, the transferor will not be considered to have controlling ownership or exercise control of voting stock of the subsidiary for purposes of Section 25105,

notwithstanding the fact that the transferor may terminate the trust or proxy arrangement upon discontinuance of the business enterprise.

Section 18: Shares Held by Guardians, Administrators, Executors, etc.

Holding

Voting stock held by an administrator, executor, guardian, etc. will be considered controlled by the fiduciary in accordance with the principles applicable to trustees, if the fiduciary relationship prevents the title owner from exercising voting rights.

Discussion

Under Cal. Corp. Code Section 702, shares held by an administrator, executor, guardian, conservator, or custodian acting in a fiduciary capacity on behalf of minors, estates, etc., may be voted by that fiduciary holder even though the shares are not actually transferred to the fiduciary holder's name. If the fiduciary relationship between the administrator, etc. under Section 702 prevents the title owner of the stock from exercising voting rights, the title owner will not be treated as the owner of voting stock under Section 25105. With respect to whether the stock is controlled by the fiduciary for purposes of Section 25105, the same principles with respect to trustees, above, shall apply to such fiduciaries.

Effect on Other Documents

Legal Rulings 410 and 411, 1/16/79, are followed and restated; Chief Counsel Letter to Tax Services dated February 3, 1987, "Unity of Ownership--Spouses, Partnerships and Trusts" is superseded.

Drafting Information

The principal authors of this ruling are Michael E. Brownell and Bruce R. Langston of the Franchise Tax Board Legal Division. For further information regarding this ruling, contact Mr. Brownell or Mr. Langston at the Franchise Tax Board Legal Division, P.O. Box 1468, Sacramento, CA 95812-1468.