

✓

TAX APPEAL BOARD OF THE STATE OF DELAWARE

FOOD FAIR STORES, INC.,)	
)	
Petitioner,)	
)	Docket No. 531
v.)	
)	
DIVISION OF REVENUE,)	
)	
Respondent.)	

Before: Joseph S. Yucht, Esquire, Vice-Chairman; Cyric W. Cain, Jr., Rhett McGriff, and Nettie C. Reilly, Members.

Jack B. Jacobs, Esquire, Attorney for Petitioner.

A. Gary Wilson, Esquire, Assistant Attorney General for Respondent.

DECISION AND ORDER

Joseph S. Yucht, Esquire: Petitioner, Food Fair, sells at retail, through its retail outlets, many products. Some of these products it manufactures through its various divisions or through its wholly owned subsidiary, Hernig Milk Company. These various divisions and subsidiary are operated independently from Petitioner and the operations of each division and subsidiary are accounted for separately. These divisions and subsidiary not only sell their products to Petitioner, but they also sell to other entities not related to nor affiliated with Petitioner.

These sales are made at current wholesale prices and are the same for all purchasers.

In order to ascertain objectively the profitability of each of said divisions and subsidiary, the accounting method adopted by Petitioner to determine the "wholesale cost" excluded, inter alia, the following items: (a) wholesale profit, (b) overhead, and (c) warehouse charges. Petitioner defined said terms as follows:

(a) Wholesale profit - "'Wholesale profit' means Food Fair's gross sales of food items at wholesale prices, less the 'overhead' and 'cost of manufacturing' incurred with respect to the items sold. Wholesale profit does not include an expense related to activity which occurs after the food products arrive at Food Fair's retail branch outlets."

(b) Overhead - "'Overhead' means all expenses of Food Fair's manufacturing divisions which are not directly related to the manufacturing process. Specifically, 'overhead' includes:

- (a) the salaries paid to division office personnel and salesmen;
- (b) payroll taxes with respect to division office and personnel salaries;
- (c) freight charges on items shipped from the division to the warehouse;
- (d) office and office utility expenses for a division;
- and (e) health and welfare benefits for division office

and sales staff. For this purpose 'office personnel' includes clerical help, secretaries, typists, buyers, accounting personnel and office manager."

(c) Warehouse charges - "Not included in the wholesale price paid by Food Fair to its divisions are 'warehouse charges' incurred by Food Fair's retail outlets. 'Warehouse charges' represent the expense of storage of refrigerated meat and produce. Such storage expenses are charged for bookkeeping purposes by a Food Fair warehouse to the given retail store which ultimately receives the stored product. 'Warehouse charges' are not included in 'wholesale profit', 'overhead', 'cost of manufacturing' or gross sales at wholesale level. In fact, 'warehouse charges' are not expenses incurred at the wholesale level at all. Rather they are expenses 'incurred' only by retail stores at the retail level, and are reflected on Food Fair's books in order to determine the profitability of Food Fair's retail stores, as opposed to the profitability of its divisions and other parts of its wholesale operation."

Based on the aforesaid definitions, Petitioner computed its mercantile license tax for the years 1969-1970, 1970-1971 and the 1971-1972, and did not include them in/computation as required by the then 30 Del. C. §§2901(4) and 2905(b). Respondent issued a

Notice of Assessment alleging a deficiency for mercantile taxes for said years in the amount of \$148,542, including interest and penalty. From this Notice of Assessment, Petitioner filed a Notice of Appeal with the Tax Appeal Board. By agreement between the parties, the issues presented to the Board were:

1. Whether or not the amount attributed by Petitioner to "wholesale profit", "overhead", and "warehouse charges" should be included within the "purchase price" as that term was used in 30 Delaware Code §§2901(4) and 2905(b)?

2. Whether or not the Hernig Milk Company, a wholly owned subsidiary corporation, should be treated as an operating division of Petitioner or as a separate entity in determining "purchase price" pursuant to the then 30 Delaware Code §2901(4)?

30 Delaware Code §2901(4) which was repealed on April 1, 1975, but effective as of the time in question provided:

"'Purchase price' includes the value of any cash or other consideration paid or agreed to be paid by a retailer for the goods purchased by him for sale in the course of business; where a retailer has manufactured a product in whole or in part, his purchase price of a product includes the price of the component parts and the cost of manufacturing such product;...."

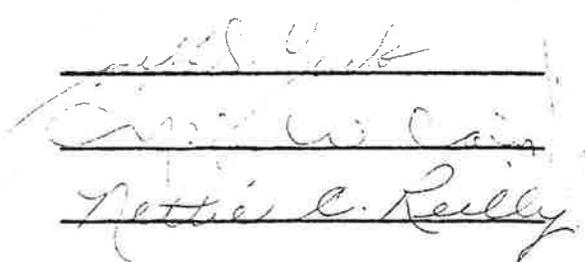
Petitioner contends that certain costs incurred by its various manufacturing divisions, which are included in Petitioner's definition of wholesale profit and overhead, are not part of the

cost of manufacturing and thus not included in purchase price. In addition, Petitioner contends that certain warehouse charges, such as refrigeration expense, should not be included in purchase price, since this is a cost of selling, even though it was incurred prior to the item reaching the retail outlet. The Board does not agree with Petitioner. Mr. Barnes, a witness for Petitioner clearly stated that the method of bookkeeping employed by Petitioner was used to determine "profitability of retail stores" and not for any other purpose. In addition, the Board found that the accounting system used by Petitioner was contrary to sound accounting and business practices. Accordingly, these items of "wholesale profit", "overhead", and "warehouse charges" are deemed to be part of the cost of manufacturing and thus included in "Purchase Price" as that term is defined in the then 30 Delaware Code §2901(4). We hold that the term "cost of manufacturing" as used in said §2901(4) includes all costs incurred by the retailer prior to his getting the product for retail use. The effect of this is to equate a retailer who buys from a second party with the retailer who also manufactures the product. If the costs are the same, then the purchase price paid by them is the same. The only difference to be reflected is the difference in costs.

As to the question as to whether or not Hernig Milk Company should be treated as an operating division or as a separate entity, we find that it is a separate entity and not an operating division. The fact that it is a wholly owned subsidiary is not controlling and the fact that Petitioner treats it as an operating division for accounting purposes is not persuasive. The first part of said §2901(4) clearly defines "purchase price" to include "...the value of any cash or other consideration paid or agreed to be paid by a retailer for the goods purchased by him for sale in the course of business;....". Hernig clearly is the seller and Petitioner is the retailer. Accordingly, we hold that Hernig Milk Company should be treated as a separate entity in determining "purchase price" pursuant to the then 30 Delaware Code §2901(4).

For the foregoing reasons the Board holds in favor of the Respondent.

IT IS SO ORDERED.



Rethia C. Reilly

Dated: May 11, 1977

SYNOPSIS

DOCKET NO. 531

TAX SEGMENT: LICENSE TAX (Retailer)

ISSUE: The question is whether the Respondent is correct in that transactions between related corporations should be treated at arms length in determining the purchase price (cost) to be used for the retailer license tax where purchase price was the basis of the tax.

Petitioner claimed excluded the following items (a) wholesale profit, (b) overhead and (c) warehouse charges.

Based on the above exclusion petitioner computed its mercantile license tax by excluding these costs on transactions from a wholly owned corporation "Hernig" to Food Fair.

The second question is whether or not the Hernig Milk Company, a wholly owned subsidiary corporation should be treated as an operating division of petitioner or a separate entity in determining the purchase price.

TAB DECISION: The Tax Appeal Board held that all amounts should be treated as cost and included in the purchase price.

The Tax Appeal Board also held that the Hernig Milk Company was a separate entity and not an operating division.

DECISION: For Respondent

DECISION DATE: May 11, 1977