59-SBE-045

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )
)
HOLLY DEVELOPMENT COMPANY )

Appearances:

For Appellant: Harrison Harkins, Attorney at Law

For Respondent: Burl D. Lack, Chief Counsel;
John S. Warren, Associate Tax Counsel

## O P I N I O N

This appeal is made pursuant to Section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of Holly Development Company to proposed assessments of additional franchise tax in the amounts of $1,211.53, $2,065.48, $1,932.96, $1,106.64 and $1,398.77 for the income years 1947, 1948, 1949, 1950 and 1951, respectively.

Appellant is a California corporation with its headquarters in Los Angeles. During the years involved herein it was engaged in the business of acquiring and developing oil properties and producing crude oil. It sold the crude oil to companies having collection pipelines in the field.

Originally all of Appellant's activity was centered in California, but during the period involved herein it was also engaged in operations in Texas. It only drilled a few wells in California during this period while it drilled many in Texas. Appellant purchased the casings and pipe for its well-drilling operations through Youngstown Steel in Los Angeles and then had the shipment made from the mill to the field where the wells were being drilled. The actual drilling of each well was done by a local, independent driller who drilled the well for an interest in the lease.

Appellant's officers were all stationed in Los Angeles. Appellant employed a man named Rife who maintained an office in San Antonio, Texas. Acting for Appellant, Rife secured oil leases and then contracted with local drillers to attempt to find oil. Commencing in 1949 Appellant also employed a geologist and engineer and two pumpers in Texas.

All of Appellant's operations were directed from the Los Angeles office. Leases and contracts made by Rife were sent to the home office for approval. The officers of Appellant made frequent trips to Texas to oversee the operations there. Financing for the Texas operations was procured in California and legal, tax and auditing services were centralized here. All insurance was obtained by the Los Angeles office, including Workmen's Compensation and group life insurance which covered both the California and Texas employees. All salaries were paid from the California office.

During the years in question Appellant filed California franchise tax returns in which it allocated its income to sources within and without the State by use of the standard allocation formula of property, payroll and sales. The Franchise Tax Board determined that Appellant was not engaged in a unitary business and it assigned income to California on the basis of separate accounting. The only issue presented is whether or not Appellant was engaged in a unitary business.

The Franchise Tax Board's Regulation 24301 (now 25101), Title 18, California Administrative Code, provided:

> "Basically, if the operation of a business within the State is dependent on or contributes to the operation of the business outside the State, the entire operation is unitary in character ..."

This regulation embodied the test enunciated in Butler Brothers v. McColgan, 17 Cal. 2d 664, 668, affirmed 315 U. S. 501; and Edison California Stores, Inc. v. McColgan, 30 Cal. 2d 472, 481.

The evidence before us clearly indicates the interdependency of Appellant's California and Texas operations. There was centralized management, centralized accounting, centralized financing and centralized purchasing of casings and pipe. The importance of these factors was considered at length by the California Supreme Court in the Butler Brothers case, supra, where the court pointed out that enlarging the scope of operations "permits better as well as more costly services of accounting and management to be available to each [segment of the operation], whereas if each were separately operated, services of such quality in all probability would be too expensive to be practicable." The modus operandi employed by Appellant allowed it to minimize its expenses while securing high quality service thereby materially increasing the income over what it would have been had the operations in each state been truly separate.

The Franchise Tax Board cites State ex rel Attorney General v. Lyon Oil Refining Co., 284 S. W. 33 (Ark. 1926) and Edward Hines Lumber Co. v. Galloway, 154 P. 2d 539 (Ore., 1944)

as authority for the proposition that extractive businesses carried on in several states are not unitary businesses. The Lyon case involved a property tax. The court there stated that it was "apparent from the reasoning of the Supreme Court of the United States that the unit system of taxation can only be applied to public carriers and other like public corporations and that the rule is not applicable to corporations like the oil refining company." The California Supreme Court and the United States Supreme Court do not subscribe to the restrictive rule set forth in the Lyon case in so far as the California franchise tax is concerned. (See Butler Brothers v. McColgan, supra.)

The Hines case arose on a demurrer filed by the Tax Commissioner of Oregon. The taxpayer sought to set aside the Commissioner's determination that stock of a coal company which it owned should not be considered part of its unitary lumber business. The court felt that it could be inferred from the complaint filed by the taxpayer that the coal company stock was held merely as an investment and therefore concluded that the trial court was correct in sustaining the demurrer of the Commissioner. The case does not hold or imply that the extractive nature of a business precludes it from being considered unitary.

## 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 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protests of Holly Development Company to proposed assessments of additional franchise tax in the amounts of $1,211.53, $2,065.48, $1,932.96, $1,106.64 and

$1,398.77 for the income years 1947, 1948, 1949, 1950 and 1951, respectively, be and the same is hereby reversed.

Done at Sacramento, California, this 20th day of May, 1959, by the State Board of Equalization.

Paul R. Leake, Chairman

John W. Lynch, Member

Richard Nevins, Member

Geo. R. Reilly, Member

_____, Member

ATTEST: Dixwell L. Pierce, Secretary

ORDER DENYING RESPONDENT'S PETITION FOR REHEARING

EXCERPT FROM THE MINUTES OF THE BOARD OF EQUALIZATION

MAY 23, 1961

Upon consideration of the petition for rehearing filed and oral argument presented in support thereof by the Franchise Tax Board in the Appeal of Holly Development Company from the action of the Franchise Tax Board on protests to proposed assessments of additional franchise tax in the amounts of $1,211.53, $2,065.48, $1,932.96, $1,106.64 and $1,398.77 for the income years 1947, 1948, 1949, 1950 and 1951, respectively, upon motion of Mr. Leake, seconded by Mr. Reilly, and carried by Mr. Lynch (Mr. Nevins voting no and Mr. Cranston absent), it is hereby ordered that the petition for rehearing be denied.