



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
WYNN OIL COMPANY)

Appearances:

For Appellant: John W. Welch and
Frederick A. **Richman**
Attorneys at Law

For Respondent: David M. Hinman
Counsel

O P I N I O N

This appeal is made pursuant to section 26075, subdivision (a), of the Revenue and Taxation Code from the action of the Franchise Tax Board in partially denying, to the extent of **\$13,108.67** for the income

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year 1966 and **\$22,302.15** for the income year 1967, the claims of Wynn Oil Company for refund of franchise tax in the amounts of **\$29,450.00** and **\$47,708.22** for the income years 1966 and 1967, respectively.

The sole issue for determination is whether appellant's 80 percent owned subsidiary, Student Residence, Inc. (SRI), was engaged in a unitary business with appellant and properly **includible** in the California combined report.

Some of the following facts were stipulated, others were established by oral testimony or by means of documents submitted by appellant. We commend both appellant and its counsel for developing an excellent record.

For many years appellant, a California corporation, was involved solely in the manufacture and distribution of petrochemical products such as Wynn's Friction Proofing and other automotive additives and car-care products. Appellant owned several subsidiaries which were primarily involved in the distribution of its petrochemical products both in the United States and in many foreign countries. During the early or mid-1960's, Wynn was experiencing difficulties in further expanding its petrochemical business. However, possessing a strong balance sheet and confident in the abilities of its management, Wynn formed a committee to investigate various opportunities for the expansion and diversification of the business. As a result of the committee's deliberations, two main diversification efforts were undertaken in 1965. 'In that year Wynn acquired Robert Skeels and Company, which manufactured and distributed locks and other builders' hardware products. Although the marketing of Skeels' hardware products was totally different from the marketing of Wynn's petrochemical products, respondent agreed that Skeels was unitary with appellant during the appeal years.

In 1965 Wynn also entered the student residence business through SRI. Originally, SRI was Beekar Corporation which had been organized in the 1950's and was wholly owned by Carl and Beatrice **Wynn**, the controlling **officers** and directors of Wynn. In 1965 Beekar was inactive and had no substantial assets although it was in good **standing and** continued to file

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tax returns annually. In 1965 the name Beekar was changed to SRI and Carl and Beatrice Wynn sold **80** percent of their stock to Wynn for \$4,000 and 20 percent to Ronald E. White for **\$1,000.**^{1/} Appellant and White contributed an additional \$20,000 and \$5,000, respectively, as paid-in capital. SRI's purpose was to engage in the construction, management, promotion and operation of student dormitories on college campuses. During the appeal years two facilities were put into operation: Northridge Hall near San Fernando Valley State College and Yosemite Hall near Stanislaus State College. Depending on the success of these operations, Wynn planned to build others.

Ronald E. White, the minority shareholder of SRI, was originally employed by Wynn's accounting firm and was acquainted with Wynn's financial position as well as with Wynn's top management. In 1964 White left the accounting firm and joined the financial department of a real estate development firm engaged in the construction of residential communities and apartment complexes. Although White was interested in financing real estate developments, he had no particular expertise in the student residence area, particularly with respect to the actual operation of the dormitories, public relations, advertising and research. Nevertheless, it was White who first suggested that diversification into the student residence area might be profitable for Wynn.

From SRI's inception until July 26, 1967, when he was relieved, White was the president of SRI. During the appeal years, most of the officers and directors of Wynn and SRI were the same. Carl E. Wynn

^{1/} According to Wynn, the reason SRI was operated as a separate subsidiary rather than as a division, was to take advantage of the limited liability afforded by the separate corporate existence. Wynn also suggests a second reason was to require White to purchase an interest in the new venture as an added assurance of his performance.

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served both corporations as chairman of the board. Three of the five SRI directors were also three of the five Wynn directors for all of 1966 and part of 1967. Beatrice E. Wynn served as vice president of SRI and as a director and vice president of Wynn. Wesley E. Bellwood, president of Wynn, was secretary of SRI in 1966. SRI's assistant secretary in 1966 and Secretary in 1967 was **Elizabeth** Pollack, who was also secretary of Wynn during the same years. Alfred A. Michaud was the vice president of marketing at Wynn and also a vice president of **SRI** and one of its directors in 1967. Mary Wengert was the assistant secretary of both corporations in 1967. Of all the officers or directors of SRI, only White was not an officer of Wynn. After July 26, 1976, Donald E. Smith was elected president of SRI. Smith was also treasurer of Wynn, treasurer of SRI and a director of SRI during both years.

Wynn was **instrumental** in securing start-up financing for the construction phase of SRI's operation. In 1966 Wynn attempted to interest the Bank of America in **financing SRI's** operation on a guaranteed basis. When the Bank of America refused, Wynn approached United California Bank (UCB) with the same proposal. When UCB agreed to make the loans on the terms presented, Wynn switched all of its banking activities to UCB. Initial financing which was guaranteed by Wynn included a \$500,000 real estate and commercial loan from UCB. Wynn's guarantee was required by UCB because of the single purpose use of the dormitories and the inadequate asset position of SRI. Similarly, Wynn provided the required guarantee when permanent financing for SRI's two dormitories was obtained from Massachusetts Mutual Life Insurance Company in the amount of **\$3,000,000**. Wynn also provided a blanket guarantee to UCB for any additional short term loans to SRI. These guarantees were substantial, limiting Wynn's own credit line and affecting Wynn's policies and capacities regarding its other credit arrangements. As SRI continued to experience cash shortfalls during the appeal years, Wynn loaned SRI additional amounts which in total, exceeded **\$1,000,000**.

Mr. White's initial duties as president of SRI involved the investigation and proposal of appropriate sites for the dormitories. However, the actual selection and approval of the final site acquisitions were made by Carl Wynn and Wesley **Bellwood** after their

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personal inspection. Although Mr. White was directly involved with the purchase negotiations and with reviewing the building plans and supervision of the building contractors, final approval of his actions rested with Mr. Wynn and Mr. Bellwood. They personally approved the architect and reviewed the architect's plans.

During the construction phase, Mr. White was responsible for the supervision of day-to-day construction activity at the dormitories. He reported personally to Mr. **Bellwood** and other Wynn executives on a weekly basis, and was advised on day-to-day decisions through telephone contact with Wynn executives. Mr. White had no authority to make any policy decisions or bind SRI to any contracts without the approval of Wynn's management. Once construction was completed, Mr. White's participation became very limited since he was not involved in the management phase of the operation. After the construction phase, Mr. White became involved in another dormitory project with which neither Wynn nor SRI were concerned. Mr. White's preoccupation with the unrelated project ultimately resulted in his removal as president of SRI in 1967 by Wynn as the majority shareholder of SRI.

All facets of SRI's operations were **closely** supervised by Wynn management, particularly Mr. **Bellwood** and Mr. Smith. **Wynn's** management was actively involved in matters concerning **SRI's** substantial financial needs including budgetary review, approval and control, as well as final salary determinations. No SRI checks could be issued without a co-signature of a Wynn officer. Not only was the power to make operational and managerial decisions exercised by Wynn, but also the day-to-day operations of SRI were closely monitored and directed by Wynn officers. For example, Mr. Smith personally supervised all personnel and operations at the student residences, including the selection of dormitory managers. Mr. **Bellwood** personally controlled the occupancy situation which was vital to SRI's success. **He** was also directly involved with the hiring of SRI's key employees. Both Mr. Wynn, chairman of the board of both corporations, and Mr. **Bellwood** made regular trips to the two facilities and personally established working relationships with the college presidents and other campus officials whose support was essential to SRI's success. Stephen A. Smith, a vice president of

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Wynn during 1966 and part of **1967**, was also responsible for supervising, certain aspects of SRI's operations. His responsibilities included reviewing the promotional campaigns and security services at both locations, working with the local college officials, and approval of all of SRI's advertising expenses.

Many staff services were provided by Wynn to SRI. Wynn's accountants, under the direction of Mr. Martinez, Wynn's controller, handled all of SRI's accounting and payroll. Publicity material, press conferences, contacts with university and high school officials and other marketing services were provided to SRI by Wynn's public relations and marketing departments. These activities were coordinated by Lauren Lord, Wynn's public relations manager, Kenneth Lovgren, Wynn's advertising manager, and Nissen **Davis**, Wynn's assistant advertising manager. SRI's contracts for food services and food supplies, an integral part of its overall operations, were negotiated exclusively by **Wynn employees**. Wynn's general corporate counsel and tax counsel were designated by Wynn's board of directors to represent both Wynn and SRI. Wynn negotiated and arranged for all of SRI's insurance policies, treating SRI as an integral part of the Wynn operation, thereby obtaining the benefits of Wynn's established liability experience records and ratings. SRI benefited from volume purchases of office supplies and used the Wynn letterhead. All of these services were provided by Wynn to SRI without charge.

There was a substantial identity of facilities used by Wynn and SRI. Wynn's headquarters were used as the headquarters for SRI's operations. All board meetings and shareholder meetings were held at the same location for both corporations. The president of SRI used office space at Wynn's.

During the years in issue, all of SRI's employees were subject to the same uniform rules and conditions of employment as were the employees of **Wynn**. All employees were covered by the same health **i**nsurance and group life insurance plans and received other similar employee benefits. The only exception was that SRI employees did not participate in Wynn's profit sharing **p**lan. Wynn management dictated when certain SRI employees were to be terminated. Some of Wynn's employees were assigned to work full-time, and others part-time, on the staff of SRI.

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For the appeal years Wynn and SRI filed separate returns.' Subsequently, Wynn filed claims for refund on the basis that it was operating a unitary business with all of its affiliates, including SRI, and was required to file a combined report with all of its affiliates. Respondent determined that, although Wynn should file a combined report with all **its** other affiliates, domestic and foreign, it could not include SRI, since the business of SRI was separate and distinct from the unitary business of Wynn and its other affiliates. Respondent's action in partially denying Wynn's claim for refund led to this appeal.

When a taxpayer derives income from sources both within and without California, it is **required** to measure its California franchise tax liability by its net income derived from or attributable to sources within this state. (Rev. & Tax. Code, § 25101.) If the taxpayer is engaged in a unitary business with an affiliated corporation, the amount of 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 16] (1947); John Deere Plow Co. v. Franchise Tax Board, 38 Cal. 2d 214 [238 P.2d 569] (1951), app. dismissed 343 U.S. 939 [96 L. Ed. 1345] (1952).)

The California Supreme Court has determined that a unitary business is definitely established by the existence of: (1) unity of ownership; (2) unity of operation as evidenced by central purchasing, advertising, accounting and management divisions; and (3) unity of use in a centralized executive force and general system of operation. (Butler Bros. v. McColgan, 17 Cal. 2d 664, 678 [111 P.2d 334] (1941), affd., 315 U.S. 501 [86 L. Ed. 991] (1942).) The court has also 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. (Edison California Stores, Inc. v. McColgan, supra, 30 Cal. 2d at 481.) These principles have been reaffirmed in more recent cases. (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 407] (1963).)

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The existence of a unitary business may be established **if either** the three unities or the contribution or dependency **test** is satisfied. (Appeal of F. W. Woolworth Co., Cal. St. Bd. of Equal., July 31, 1972.) Implicit in either test, of course, is the requirement of quantitative substantiality. (Appeal of Beatrice Foods Co., Cal. St. Bd. of Equal., Nov. 19, 1958; Appeal of Public Finance Co., Cal. St. Bd. of Equal., Dec. 29, 1958; see also Superior Oil Co. v. Franchise Tax Board, supra.) In other words, corporations are engaged in a unitary business within the scope of either test if, because of the unitary features, the earnings of the group are materially different from what they would have been if each corporation had operated without the benefit of **its** unitary connections with the other corporations.

During the appeal years, respondent's regulations, which offer further guidance for determining whether a taxpayer is engaged in a single trade or business or more than one trade or business, provided:

The determination of whether the activities of the taxpayer constitute a single trade or business or more than one trade or **business** will turn on the **facts** of each case. In **general**, the activities of the taxpayer will be considered a single business if there is evidence to indicate that the divisions under consideration are integrated with, dependent upon or contribute to each other and the operations of the taxpayer as a whole. The following factors are considered to be good indicia of a single trade or business; and the presence of any of these factors creates a strong **presumption that** the activities of the taxpayer constitute a single trade or business:

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(3) Strong centralized management: A taxpayer which might **otherwise** be considered as engaged in more than one trade or business is properly considered as engaged in one trade or business when there is a strong central management,

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coupled with the existence of centralized departments for such functions as financing, advertising, research, and purchasing. Thus, some conglomerates may properly be considered as engaged in only one trade or business when the central executive officers are involved in the day-to-day operations of the various divisions and there are centralized offices which perform for the divisions the normal matters which a truly independent business would perform for itself, such as accounting, personnel, insurance, legal, purchasing, advertising, and financing, (Cal. Admin. Code, tit. 18, reg. 25120, subd. (b) (art. 2).)

For the reasons which will be discussed below, we believe that SRI was unitary with Wynn under either of the two tests and properly **includible** in the combined report.

It is conceded that the ownership requirement is satisfied since Wynn owned 80 percent of the stock of SRI.

Initially, respondent argues that SRI's operations do not contribute to or depend upon the operation of Wynn to a degree which is substantial enough to warrant their classification as a unitary business.

Respondent first contends that, because of Wynn's excessive investment capital, SRI was a mere passive investment, while Wynn's position was only that of an interested and active investor managing its investment. Respondent's allegation that Wynn had excessive investment capital is not supported by the record. Mr. **Bellwood** testified that, in developing its diversification plans, one of Wynn's main strengths was its strong balance sheet. However, he testified further that such strength was found, not in its excessive cash position, but in its ability to borrow significant sums at favorable interest rates. In fact, except for start-up costs and interim advances, SRI was entirely **debt** financed by obligations guaranteed by Wynn. Contrary to respondent's assertion, there is nothing in the record to indicate that Wynn entered the student residence business and its other diversification efforts as other than active business ventures.

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Next, respondent contends that, since SRI was engaged in a different type of business from that of Wynn and **Wynn's** other affiliates, the contribution or dependency test is not satisfied and SRI cannot be part of Wynn's unitary business. In support of this proposition respondent cites numerous prior appeals decided by this board. (See-Appeal of Lear Siegler, Inc., Cal. St. Bd. of Equal., April 24, 1967; Appeal of Jaresa Farms, Inc., Cal. St. Bd. of Equal., June 15, 1966; Appeal of Simco, Inc., Cal. St. Bd. of Equal., Oct. 27, 1964; Appeal of Allied Properties, Cal. St. Bd. of Equal., March 17, 1964; Appeal of Industrial Management Corp., Cal. St. Bd. of Equal., May 20, 1959; Appeal of Highland Corp., Cal. St. Bd. of Equal., May 20, 1959.) **Appellant, on the other hand**, has marshalled an equal number of decisions which, **it** contends, support the proposition that merely because corporations conduct different types of businesses does not, per se, require a determination that **the businesses** are not unitary. (See Appeal of I-T-E Circuit Breaker Co., Cal. St. Bd. Of Equal., Sept. 23, 1974; Appeal of Williams Furnace Co., Cal. St. Bd. of Equal., Aug. 7, 1969; Appeal of The GeCompany of California, Cal. St. Bd. of Equal., March 7, 1967; Appeal of Hunt Foods and Industries, Inc., Cal. St. Bd. of Equal., April 5, 1965; Appeal of Beatrice Foods Co., Cal. St. Bd. of Equal., Nov. 19, 1958; see also North American Cement Corp. v. Graves, 299 U.S. 517 [81 L. Ed. 381] (1936) **commented on** with approval in Butler Bros. v. McColgan, supra, 17 Cal. 2d at 674; Cal. Admin. Code, tit. 18, reg. 25120, subd. (b) (art. 2).)

We believe appellant has the better of this battle of authorities. The thrust of the decisions cited by both parties is that the mere fact corporations are engaged in diverse lines of businesses, standing alone, does not preclude a finding that such businesses are unitary. However, the cited decisions also indicate that, in some instances involving diverse lines of businesses, the factual basis for a finding of unity may require a stronger evidentiary showing than would be required in situations involving vertical or horizontal integration, since, in diversification situations, the advantages to be gained by centralization may be less than they are in the more typical vertically or **horizontally** integrated unitary business. Even respondent's own regulations do not suggest a different approach. (See Cal. Admin. Code, tit. 18, reg. 25120, subd. (b) (art. 2).)

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When we apply the traditional tests it is readily apparent that the record is replete with evidence establishing a most substantial degree of contribution **or** dependence.

Both Wynn and SRI had common officers and directors indicating that the companies shared a strong central management. These executive officers, and other high level Wynn employees, were involved not only in major policy decisions with respect to SRI, but also participated directly in SRI's day-to-day operations. Central executive officers such as Wesley Bellwood, president of Wynn, Donald Smith, treasurer, of Wynn, Alfred Michaud, vice president of marketing for Wynn, and numerous others were directly involved in all aspects of SRI's **day-to-day** operation. The financial support SRI received from Wynn, whether directly in the form of cash advances, or indirectly through **loans** obtained at favorable interest rates on the basis of Wynn guarantees, and the insurance which SRI was able to obtain because of Wynn's prior experience ratings are of particular significance. Wynn executives and employees developed, implemented, directed, supplied and controlled SRI's substantial advertising campaign and public relations efforts. It was also Wynn executives who negotiated and renegotiated the essential food service contracts for SRI's operations. In fact, it is evident that Wynn performed every conceivable normal line or staff function which SRI, had it been truly independent, could have been expected to perform for itself such as accounting, personnel, insurance, legal, purchasing, advertising and financing. On the other side of the coin, SRI provided a much needed outlet for Wynn's long-term diversification efforts.

For the above reasons we believe that during the appeal years a significant degree of substantial contribution or dependence existed between SRI and Wynn.

With respect to the three unities test respondent contends that unity of operation and unity of use were not **present since** there was no central executive force and because SRI's student residence business was not incorporated into Wynn's general system of **operations**. We disagree.

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Central to respondent's argument is its assertion that Ron White, rather than any of Wynn's executives, was the central force behind **SRI's** operations. 'This argument is not supported by the **facts.**

During the entire time White was president of SRI, his duties and responsibilities were clearly defined and limited. His specific responsibility was limited to supervising the day-to-day construction. He reported personally to Wynn officers on a weekly basis and was advised on day-to-day decisions through telephone and personal contact with Wynn executives. He had no authority to make any policy decisions without the approval of Wynn management. He could not write SRI checks or draw on SRI credit by himself. He had no control over SRI finances or budget. Once the construction phase was completed early in 1967, White's participation became even more attenuated. Due to his total involvement with unrelated projects, he was removed as president of SRI in July 1967. Of course, construction was only one phase of SRI's activities. Just as important to SRI's existence was the negotiation of financing, the procurement of insurance, public relations, promotional activities, the **negotiation** of food service contracts, and the provision for general corporate services such as accounting, payroll, and management. As related above, all these aspects of SRI's business were conducted in accordance with Wynn's general system of operation and were handled by Wynn executives and employees, not by White.

In view of the factors which we have discussed with respect to the contribution or dependency test, and to a more limited extent immediately above, it is evident that almost total integration of all line and staff functions existed between SRI and Wynn. **It** is also apparent that these functions were fully incorporated into Wynn's general system of operation. **Therefore,** we must conclude that unity of use and unity of operation existed to a degree sufficient to establish a unitary business.

For the reasons set out above it is our determination that SRI and Wynn were engaged in a unitary business during the appeal years. Accordingly, respondent's action in this matter must be reversed.

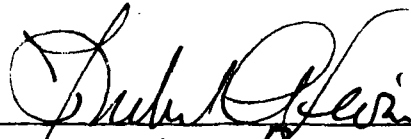
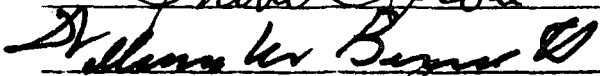

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O R D E R

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 partially denying, to the extent of **\$13,108.67** for the income year 1966 and **\$22,302.15** for the income year 1967, the claims of Wynn Oil Company for refund of franchise tax in the amounts, of **\$29,450.00** and **\$47,708.22** for the income years 1966 and 1967, respectively, be and the same is hereby reversed.

Done at Sacramento, California, this 6th day of February, 1980, by the State Board of Equalization.

 , Chairman
 , Member
 , Member
_____, Member
_____, Member