BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of)
)
SANTA ANITA CONSOLIDATED, INC., ET AL.)

Appearances:

For Appellants: James H. Knecht
Attorney at Law

For Respondent: Jean Ogrod
Counsel

O P I N I ON

These appeals are made pursuant to section 26075, subdivision (a), of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claims of Santa Anita Consolidated, Inc., for refund of franchise tax in the amounts of $19,610, $57,748, and $171,689 for the income years ended October 31, 1970, October 31, 1971, and October 31, 1973, respectively, and pursuant to section 25666 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of Santa Anita Consolidated, Inc.; Los Angeles Turf Club, Inc.: Hadley Auto Transport, Inc.; Robert H. Grant Corporation; and Santa Anita Development Corporation against proposed assessments of additional franchise tax in the amounts and for the years as follows:

Appellant	Income Years Ended	Amounts
Santa Anita Consolidated, Inc.	10/31/70	778.00
	10/31/71	1,416.00
	10/31/73	61,305.00
	6/30/74	214,777.15
	6/30/75	151,026.19
Los Angeles Turf Club, Inc.	10/31/70	1,891.00
	10/31/71	875.00
	10/31/72	2,478.72
	10/31/73	10,416.37
	6/30/74	225,606.94
	6/30/75	167,911.54
Hadley Auto Transport, Inc.	10/31/70	2,587.57
	10/31/71	2,747.00
	10/31/72	575.55
	10/31/73	2,196.62
	6/30/74	8,677.32
	6/30/75	15,642.52
Robert H. Grant Corporation	10/31/71	67,841.75
	10/31/72	13,052.15
Santa Anita Development Corp.	10/31/72	9,522.78
	10/31/73	293.09
	6/30/75	7,744.17

Although a number of issues were originally presented, all but one have been resolved during the course of this appeal. The sole remaining issue is whether Santa Anita Consolidated, Inc., was engaged in a single unitary business with various subsidiaries during the years on appeal. Santa Anita Consolidated, Inc., will hereinafter be referred to as "SAC."

SAC was incorporated in California in 1934 as the Los Angeles Turf Club to promote horse racing and operate a Thoroughbred racetrack. In 1964, the company changed its name to Santa.Anita Consolidated, Inc., and transferred the racing business and leased the related facilities to its wholly owned subsidiary, Los Angeles Turf Club, Inc. (LATC). SAC, always had headquarters in or near Los Angeles, and all of its activities were in California. Its stock was widely held and traded on the over-the-counter market.

LATC operated a large and profitable Thoroughbred racetrack in Arcadia, California. The racetrack business generated substantial cash beyond that needed in the business, and SAC used this excess cash to acquire various companies engaged in diverse businesses.

Hadley Auto Transport, Inc. (HAT), was acquired by SAC in 1968. Before SAC bought 100 percent of the stock, HAT was a closely held corporation run by members of the Hadley family. The Hadleys continued to operate HAT after the acquisition, and, in 1976, SAC sold HAT back to its former owners. HAT was engaged in the transportation and delivery of automobiles. Most of HAT's income came from contracts with the Ford Motor Company, and HAT's home office was on property rented from Ford next to Ford's principal California assembly plant. HAT operated in fifteen western states, including California.

In June 1970, SAC acquired all the stock of another closely held company, Robert H. Grant Corporation (RHG). RHG's former owners continued to serve as chief executive officers and to run RHG after the acquisition until 1975, when they resigned and RHG's business was wound down. RHG was engaged primarily in the construction of single family homes and townhouses but also did some planned community and commercial development and land sales. At the time of its acquisition, it was one of the most successful housing developers in the West. Its home office was in California, but through a number of subsidiaries it engaged in housing construction in Hawaii, Arizona, Nevada, and Florida, as well as in California. For a time, two of its subsidiaries manufactured mobile homes in California.

Santa Anita Development Corporation (SDC) was acquired by SAC in April 1972. Two of its chief executives continued to operate the company after the acquisition. SDC specialized in the development of small neighborhood shopping centers, often using joint ventures in which SDC would do the development and the other joint venturers would provide the cash. It was headquartered in California and operated both within and without the state.

For their income years ended October 1970 through October 1973, appellants initially filed separate returns. They later filed claims for refund for the income years ended in 1970, 1972, and 1973, based on tax computations using combined report and apportionment of income procedures. Appellants' returns for the income years ended in 1974 and 1975 were filed using combined

report procedures. A claim for refund was filed by SAC for the income year ended in 1971, but it was based on an adjustment to income; SAC did not contend that it was engaged in a unitary business during that year.

Respondent reviewed appellants' returns and refund claims for all years, issued proposed assessments and, after two hearings, affirmed the proposed assessments and denied the'claims for refund. These appeals followed.

If a taxpayer derives income from sources both within and without California, its franchise tax liability is required to be measured by its net income derived from or attributable to sources within this state. (Rev. & Tax. Code, § 25101.) If the taxpayer is engaged in a single unitary business with affiliated corporations, the income attributable to California must be determined by applying an apportionment formula to the total income derived from the combined unitary operations of the affiliated companies. (Edison California Stores, Inc. v. McColgan, 30 Cal.2d 472 [183 P.2d 16] (1947).)

There are two alternative tests used to determine whether a business is unitary. The California Supreme Court has held that the'existence of a unitary business is definitely established by the presence of unity of ownership; unity of operation as evidenced by central accounting, purchasing, advertising, and management divisions; and unity of use in a centralized executive force and general system of operation. (Butler Bros. v. McColgan, 17 Cal.2d 664 [111 P.2d 334] (1941); affd., 315 U.S. 501 [86 L.Ed. 991] (1942).) It has also stated that a business is unitary if the operation of the business done within California is dependent upon or contributes to the operation of the business outside California. (Edison California Stores, Inc. v. McColgan, supra, 30 Cal.2d at.481.) Respondent's determination regarding the existence of a unitary business is presumptively correct, and appellants bear the burden of showing that it is incorrect.

Appellants contend that the following factors demonstrate that they were engaged in a single unitary business: 'SAC's ownership of its subsidiaries: interlocking officers and directors; major policies and activities of the corporate group being directed by SAC's board of directors and management committee; intercompany financing; SAC's requirements of financial accountability and uniformity; centralized legal services: SAC's requirement of long range planning by the subsidiaries; transfers of

several executives among SAC and its subsidiaries; common stock option and thrift plans for qualified employees; and control of executive compensation. Respondent argues that, although unity of ownership existed, SAC and its subsidiaries were engaged in diverse types of activities which were insufficiently integrated to be considered a single unitary business under either the three unities test or the contribution or dependency test.

To demonstrate the existence of a single unitary business, it is necessary to do more than simply list circumstances which are labeled "unitary factors." Such "factors" are distinguishing features of a unitary business only when they show that there was functional integration between the corporations or divisions involved. We must distinguish

> between those cases in which unitary labels are applied to transactions and circumstances which, upon examination, have no real substance, and those in which the factors involved show such a significant interrelationship among the related entities that they all must be considered to be parts of a single integrated economic enterprise.

(Appeal of Saga Corporation, Cal. St. Bd. of Equal., June 29, 1982.)

When one corporation invests in subsidiaries which operate within and without the state, it does not automatically create a single unitary business. There must be evidence that the affiliated corporations form a "functionally integrated enterprise'" (Container Corp. v. Franchise Tax Bd. -- U.S. --, -- [77 L.Ed.2d 545, 562] (1983), quoting Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425, 448 [63 L.Ed.2d 510] (1986)) rather than a group of mere investments whose operations are unrelated. The type of business enterprise in which a subsidiary engages may provide the starting point in determining whether a functionally integrated enterprise has been created.

> Investment in a business enterprise truly "distinct' from a corporation's main line of business often serves the primary function of diversifying the corporate portfolio and reducing the risks inherent in being tied to one industry's business cycle. When a corporation invests in a subsidiary that engages in the same line of work as itself, it becomes much,

> more likely that one function of the investment is to make better use--either through economies of scale or through operational integration or sharing of expertise--of the parent's existing business-related resources.

(Container Corp. v. Franchise Tax Bd., supra, -- U.S. at -- [77 L.Ed.2d at 561].)1/

SAC has invested in various distinct business enterprises and, in order to carry their burden of proof, appellants must show that the factors on which they rely resulted in a functionally integrated enterprise rather than merely a group of unrelated investments.

Appellants have emphasized the substantial interlocking of officers and directors among the corporations, the control of major policy by SAC's executives, and the financial guidance which was provided by these executives. High level executive assistance is considered an important element of unity of use. (Chase Brass & Copper Co. v. Franchise Tax Board, 10 Cal.App.3d 496, 504 [87 Cal.Rptr. 239], app. dism. and cert. den., 440 U.S. 961 [27 L.Ed.2d 381] (1970).) However, we find that the executive assistance described by appellants lacks unitary significance because it did not result in any integration among the corporations. With only a few exceptions, the executive assistance was in the area of financial control and approval and was apparently provided merely to make each independent subsidiary a more productive asset for SAC. Such financial guidance reveals nothing more than an owner's interest in overseeing its investments and does nothing to distinguish the group as a unitary business. (See Appeal of Mole-Richardson Company, Cal. St.

1/ See also Appeal of Hollywood Film Enterprises, Inc., Cal. St. Bd. of Equal., March 31, 1982, in which we held that, when diverse businesses are involved, factors which are normally significant indicators of unity, such as intercompany product flow, often do not exist. Therefore, the factors which are present must be scrutinized "to see if they are really of such significance as to compel the conclusion that the . . . companies were engaged in a single unitary business."

Bd. of Equal., Oct. 26, 1983, Appeal of Hollywood Film Enterprises, Inc., Cal. St. Bd. of Equal., March 31, 1982.)[2/]

Intercompany financing, commonly considered an element of unity of operation, was present in the form of both direct loans to and from SAC's subsidiaries and SAC's guarantees of its subsidiaries' loans. However, this financing did not contribute in any way to the operational integration of the group. It served only to provide funds for the subsidiaries to further their independent operations.[3/]

2/ See also Container Corp. v. Franchise Tax Bd., supra, -- U.S. at -- (fn. 19) [77 L.Ed.2d at 563], where the United States Supreme Court stated:

> We made clear in F. W. Woolworth Co. [F. W. Woolworth Co. v. Taxation & Rev. Dept., 458 U.S. --, [73 L.Ed.2d 819] (1982)] that a unitary business finding could not be based merely on "the type of occasional oversight--with respect to capital structure, major debt, and dividends--that any parent gives to an investment in a subsidiary, ..." 458 US, at --, 73 L Ed 2d 819, 102 S Ct 3128. As exxon [Exxon Corp. v. Wisconsin Dept. of Revenue, 447 U.S. 207 [65 L.Ed.2d 66 (1980)] illustrates, however, mere decentralization of day-to-day management responsibility and accountability cannot defeat a unitary business finding. 447 US, at 224, 65 L Ed 2d 66, 100 S Ct 2109. The difference lies in whether the management role that the parent does play is grounded in its own operational expertise and its overall operational strategy.

3/ As the United States Supreme Court has noted with respect to loans and loan guarantees from a parent to its subsidiaries, "capital transactions can serve either an investment function or an operational function," (Container Corp. v. Franchise Tax Bd., supra, -- U.S. at -- n. 9) [77 L.Ed.2d at 563].) SAC's loans to its subsidiaries clearly served an investment function.

> When any entity conducts more than one business the profits from one activity are often used to aid its other enterprises. ... If such financing results in a unitary business virtually every business would be unitary no matter how unrelated were the various activities. Neither the courts of this state nor this board have so extended the unitary concept.

(Appeal of Simco, Incorporated, Cal. St. Bd. of Equal., Oct. 27, 1964.)

Some-centralized services, such as accounting, did exist, but there has been no showing that they resulted in any substantial mutual advantage. (Appeal of Hollywood Film Enterprises, Inc., supra.) Operational unity, therefore, cannot be said to have existed to any meaningful extent.

In the present case, each corporation is distinct, the operations of each business neither contributing to nor dependent upon the operations of any other. We are impressed by the fact that although there were opportunities for operational integration of the subsidiaries, given the related or complementary nature of some of their activities, no attempt was made to accomplish this. SAC acted rather as an investor overseeing the financial structure of unrelated investments.

The financial direction and control which SAC exercised over its subsidiaries, although pervasive, when unaccompanied by any significant operational integration, is simply insufficient to compel a finding of a single unitary business. (See Appeal of Mole-Richardson Company, supra; Appeal of Hollywood Film Enterprises, Inc., supra; see also fn. 2 of this opinion, supra.) We must, therefore, sustain the action of the Franchise Tax Board.

O R D ER

Pursuant to the views expressed in the opinion of the board on file in these proceedings, 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 denying the claims of Santa Anita Consolidated, Inc., for refund of franchise tax-in the amounts of $19,610, $57,748, and $171,689 for the income years ended October 31, 1970, October 31, 1971, and October 31, 1973, respectively, and, pursuant to section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protests of Santa Anita Consolidated, Inc.; Los Angeles Turf Club, Inc.; Hadley Auto Transport, Inc.; Robert H. Grant Corporation; and Santa Anita Development Corporation against proposed assessments of additional franchise tax in the amounts and for the years as follows:

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be and the same is hereby sustained.

Done at Sacramento, California, this 5th day of April, 1984, by the State Board of Equalization, with Board Members Mr. Nevins, Mr. Dronenburg, Mr. Be-nnctt and Mr. Harvey present.

Richard Nevins, Chairman

Ernest-J. Dronenhurg, Jr., Member

William M. Bennett, Member

Walter Harvey*, Member

, Member

*For Kenneth Cory, per Government Code section 7.9