

BEFORE THE STATE BOARD OF EQUALIZATION
OF **THE** STATE OF CALIFORNIA

In the Matter of the Appeal of)
J. B.. TORRANCE, INC.)

For Appellant: Gregory W. Goff
Attorney at Law

For Respondent: Paul J. Petrozzi
Counsel

O P I N I O N

This appeal is made pursuant to section 25666 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of J. B. **Torrance, Inc.**, against proposed assessments of additional **franchise** tax in the amounts of \$19,530, \$15,024, \$14,173, and \$21,106 for the income years ended June **30**, 1976, June 30, 1977, June 30, 1978, and June 30, 1979, respectively.

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The issue presented for our resolution is whether appellant's California and out-of-state business activities constituted a single unitary business during **the years** in question.

Formed in 1970, appellant is a California corporation whose stock is wholly owned by **Jerry B. Torrance** and his spouse. The principal business of this closely held corporation is the ownership and management of three mobilehome parks **in San Diego, California**, and the operation of a cattle ranch on 17,000 acres of Oregon land leased from the Torrance family.

As **president** and chief executive-officer, **Jerry B. Torrance personally** directed the daily affairs of the company during the appeal years. His fall and winter months were generally spent in San Diego managing the mobilehome parks which he planned and constructed in the **1960's**. In the spring and summer, he relocated to Oregon to oversee the development of the cattle ranch acquired in 1972. An engineer by education and profession, Mr. Torrance nevertheless performed the sundry tasks of a cattle rancher while in Oregon. He obtained grazing permits, negotiated water **rights and** cattle purchases, hired ranch personnel, repaired equipment, supervised the installation of fences, redesigned the irrigation system, and oversaw the production of hay and pasture lands.

In general, any important decision or expenditure related to either business of the company required the approval of Jerry B. Torrance. Thus, company policy dictated that any expense exceeding \$100 had to be first discussed and authorized by him. When he was not available for meetings, Mr. Torrance kept in daily telephone contact with employees in California and Oregon to facilitate his supervision of the company business activities.

While its chief executive officer **traveled up** and down the west coast, the administration of appellant's financial affairs was based in San Diego where the Torrance family maintained their principal residence. A **San Diego-based accountant**, who was also an officer and general manager for the corporation, provided financial advice for corporate investments and prepared the tax returns for the company. A bookkeeper employed by the **accountant kept** the corporate books and records, performed budget and -accounting **services**, and prepared payroll and expense disbursements for both businesses.

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Even though it maintained Oregon bank accounts to pay the expenses of the cattle ranch, appellant's primary bank accounts were with San Diego banks and the income from both businesses was comingled. However, the rental income derived from the operation of the mobilehome parks constituted the major source of revenue for the company and was used to pay the expenses of the cattle ranch.

In addition, the same attorneys handled the legal matters of the corporation whether arising from the operation of the California mobilehome parks or the Oregon cattle ranch. Employees in both locales were covered under the same health plan. Finally, liability **insurance for** the cattle ranch was obtained at a reduced premium based upon the experience rating of the **more-**established mobilehome parks business.

On the theory that the San Diego mobilehome parks and **the Oregon** cattle ranch were a single unitary business, appellant filed its California franchise tax return on the basis of a combined report for its 1976 through 1979 income years. Respondent determined that the two business activities were not unitary and recomputed **appellant's franchise** tax liability for the four income years on a separate accounting basis without regard to the income from the cattle ranch. Appellant has appealed the **resultant** proposed assessments of additional franchise tax.

When a taxpayer derives **income** from sources both within and without this state, 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 sources 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. Morgan~~, 30 Cal.2d 472 [183 P.2d 16] (1947).) If, on the other hand, the business within this state is truly separate and distinct from the business without the state so that the segregation of income may be made clearly and accurately, the separate accounting method may properly be used. (Butler Bros. v. **McColgan**, 17 Cal.2d 664, 667 [111 P.2d 334] (1941), **affd.**, 315 U.S. 501 [86 L.Ed. 991] (1942); Superior Oil co. v. Franchise Tax Board, 60 Cal.2d 406 [34 Cal.Rptr. 545, 386 P.2d 33] (1963).)

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The California Supreme Court has set forth two tests to determine whether a business is unitary. In Butler Bros. v. McColgan, supra, the court held that the unitary nature of a business is definitely established by the presence of unity of ownership; unity of operation as evidenced by central purchasing, advertising, accounting, and management divisions; and unity of use in a centralized executive force and general system of operation. The court subsequently added that a business is unitary if the operation of the business done within this state 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 is presumptively correct and appellant bears the burden of proving that it is erroneous. (Appeal of John Deere Plow Co. of Moline, Cal. St. Bd. of Equal., Dec. 13, 1961.)

Appellant contends that its California mobile-home parks and Oregon cattle ranch were a single unitary business whether scrutinized under the three unities or the contribution or dependency test. Since appellant owns both enterprises, unity of ownership was present. Appellant argues that unity of operation is demonstrated by the centralization of its administrative functions and intracompany financing and that unity of use is shown by the employment of a sole executive manager and shared financial and insurance values. Finally, appellant reasons that a substantial degree of contribution or dependency existed in that both the mobilehome parks segment and the cattle ranch business relied upon the management abilities of a single executive officer, the financial services of one accounting office, and a common source of revenue.

In general, 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.) However, where the businesses are distinct in nature, as here, the mere recital of a number of centralized functions is not sufficient to establish unity under either test. (Appeal of Allied Properties, Inc., Cal. St. Bd. of Equal., March 17, 1964.) We must be careful to 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

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significant interrelationship among the related entities that they all must be considered to be parts of a single integrated enterprise.

(Appeal of Saga Corporation, Cal. St. Bd. of Equal., June 29, 1982; see also Appeal of Hollywood Film Enterprises, Inc., Cal. St. Bd. of Equal., March 31, 1982.)

In other words, where a corporate taxpayer has invested in distinct business enterprises and seeks to prove the existence of a single unitary business, it must present sufficient **evidence** that the unitary factors relied upon resulted in a functionally integrated enterprise rather than merely a group of investments whose operations are unrelated. (Appeals of Santa Anita Consolidated, Inc., et al., Cal. St. Bd. of Equal., April 5, 1984; see also Container Corp. v. Franchise Tax Board, 117 Cal.App.3d 988 [173 Cal.Rptr. 121] (1981), affd., -- U.S. -- [77 L.Ed.2d 545, 562] (1983).)

The taxpayer in the instant appeal has **high-**lighted three aspects of its operations in an attempt to demonstrate that the mobilehome parks business in California was unitary with its out-of-state cattle ranch. First, appellant has emphasized the strong centralized control exerted by Jerry B. Torrance-over the daily and seasonal **operations** of the cattle ranch as well as **over** the financial and policy-making decisions of the company. Appellant has also underscored how valuable Mr. Torrance's **engineering** background and his experience in constructing the mobilehome parks were to the development of the cattle ranch. Generally, 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, 564 [87 Cal.Rptr. 2391, app. dism. and cert. den., 400 U.S. 961 [27 L.Ed. 381] (1970).) The type of executive management and close supervision described by appellant is expected, however, of the **chief** executive officer and principal stockholder of **a closely held corporation** that operates more than one enterprise. (Appeal of Jaresa Farms, Inc., Cal. St. Bd. of Equal., Dec. 15, 1966.) It reveals **nothing** more than an owner's interest in overseeing its assets.- (Appeal of Mole-Richardson Company, Cal. St. Bd. of Equal., Oct. 26, 1983; see Appeal of Hollywood Film Enterprises, Inc., supra.) An owner's interest in managing its **assets** is insufficient to demonstrate unity of use and certainly does nothing to distinguish the holdings as a unitary business. (Appeal of C. H. Stuart, Inc., Cal. St. Bd. of

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Equal., Nov. 14, 1984; Appeals of Santa Anita Consolidated, Inc., et al., supra.)

Second, the existence of centralized services, such as bookkeeping, budgeting, payroll, and **tax preparation**, is offered by appellant as evidence of operational unity and dependency. In prior cases, we have held that an operation of distinct businesses is not unitary merely because accounting records are kept at a principal office. (See Appeal of Simco, Inc., Cal. St. Bd. of Equal, Oct. 27, 1964; Appeal of Industrial Management Corp., Cal. St. Bd. of Equal., June 9, 1959.)' In the instant matter, we observe that appellant did not perform these financial service functions itself through a central office. Rather, these duties were essentially contracted out and provided by the separate business **office of** an accountant, albeit an officer of the **corporation**. We fail to see how appellant's employ of an outside accounting office **to handle** the books and **records** of its mobilehome parks and cattle **ranch resulted** in any substantial mutual advantage (Appeal of -Hollywood Film Enterprises, Inc., supra; Appeal of Allied Properties, Inc., supra) or integration **between** the two segments. (Appeal of Mole-Richardson Company, supra.) Operational unity or contribution or dependency thus did not **'exist** to any meaningful degree by virtue of appellant's delegation of its fiscal responsibilities.

Third, we find no particular **unitary** significance to appellant's comingled bank accounts or its use of rent receipts from the San Diego mobilehome parks to cover the expenses of the Oregon cattle ranch. In order to establish unity, appellant must demonstrate that its financing practices contributed to the operational integration of its two segments. (Appeals of Santa Anita Consolidated, Inc., et al., supra; Appeal of C. H. Stuart, Inc., supra.) Companies which conduct more than one business, however, often use their credit and the profits from one undertaking to aid their other enterprises, but such financing does not create a unitary business out of unrelated activities. (Appeal of Simco, Inc., supra.) The record in this appeal convinces us **that** appellant merely used funds from the mobilehome parks business to first develop the cattle ranch and then to secure its financial position as an independent asset.

Based upon the record in this appeal, we conclude that appellant has not proven its two businesses to have been sufficiently integrated in their operations

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during the years under review to be considered a single unitary business. In short, the various managerial and financial attributes relied upon by appellant demonstrate nothing more than the ordinary oversight expected of a closely held corporation operating unrelated and distinct investments. Accordingly, respondent's action in this matter must be sustained.

