BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

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

Appearances:

For Appellant: Joseph A. Vinatieri
Attorney at Law

For Respondent: Jon Jensen
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 Powerine Oil Company against proposed assessments of additional franchise tax in the amounts of $37,724 and $69,831 for the income years ended January 31, 1976, and January 31, 1977, respectively.

The sole issue presented by the appeal is whether appellant has established error in respondent's determination that a joint venture in which appellant held an ownership interest did not constitute part of its unitary business operations during the income years at issue.

Appellant, a California corporation, is engaged in the oil refining and distribution business in California and several other western states, Appellant operates an oil refinery at its headquarters in Santa Fe Springs, California, gas terminals in the States of California, Washington, and Hawaii, and service stations in the States of Washington, Hawaii, Arizona, and New Mexico. The parties agree that during the years at issue, these business activities constituted a unitary business. During the appeal years,, appellant also was engaged in a joint venture which is the focal point of this appeal.

In late 1974, appellant was approached by Dr. Paul Johnson who offered appellant an opportunity to diversify into copper mining., Dr. Johnson had discovered a new approach for exploiting what had heretofore been noncommercial bodies of copper-bearing ore, In addition, Dr. Johnson owned an option to lease a mine in Inyo County known as the Lorrettp Wine which contained substantial amounts of copper-bearing rock. Dr. Johnson believed that the Lorretto Mine would be an ideal location for verifying the commercial feasibility of his concept. Appellant, likewise, believed that its experience in the oil industry might be utilized in the field of copper extraction. Appellant felt that its staff of chemists, chemical engineers, and process engineers would be able to design and perfect the necessary process equipment and that its trucking division, accounting, and computers could provide various support functions.

In late 1974, appellant incorporated a wholly owned subsidiary named Powerine Copper Company, Inc. (hereinafter "Powerine"). On January 16, 1975, Powerine entered into a joint venture agreement with Paul H. Johnson and Associates (hereinafter "Associates"), a limited partnership formed by Dr. Johnson, in order to engage in the extraction and processing of copper ore at the Lorretto Mine. The name of the new venture was Bristlecone Copper Company (hereinafter "Bristlecone"). Pursuant to the terms of the joint venture agreement, Associates contributed the mine lease together with Dr. Johnson's rights to the copper extraction process

while appellant, through Powerine, provided an initial capitalization of $400,000. In return, appellant, through Powerine, received a **50-percent** interest in Bristlecone; while Associates received the other 50 percent.

The agreement provided that a management committee composed of two persons from each joint venturer be formed in order to set cash management, operation, and management policies. While the start-up process was to be commenced by Associates, appellant had the exclusive right to select Bristlecone's general manager. In addition, if Bristlecone's operations were not proceeding to its satisfaction, Powerine had the power to increase its presence in the management committee to a majority. A collateral agreement further'provided that the first $100,000 of mobile equipment needed for the operation was to be acquired by appellant and then leased to Bristlecone.

In mid-1975, after an investigation by Tom Jones, an executive of appellant on loan to Powerine, it was determined that the completion of the project would be delayed beyond its scheduled completion date. In addition, Jones concluded that the initial costs significantly exceeded the initial estimate and that improper mining equipment had been procured and utilized by Associates. As a result, appellant directed Jones to spend his full time at the site in an effort to control costs and to complete the project.

The record and testimony given at the oral hearing before us indicate that from the inception of the joint venture, each party had to approve major decisions such as substantial asset commitment and long-term objectives. When problems in Bristlecone's operations began to surface in mid-1975, appellant's involvement in the joint venture intensified. In September of 1975, William Burke, vice president of appellant, concluded that Dr. Johnson and his associates would have to be replaced as managers. Accordingly, it was agreed that Powerine would thereupon take direct control of all activities at the Lorretto Mine site. John Knaebel, appellant's independent mining consultant, took over active day-to-day management of the mine. In early October of 1975, all Bristlecone records were transferred to Powerine's control and a Bristlecone bank account was set up in Santa Fe Springs, appellant's headquarters, in order to control Bristlecone's expenditures and determine its cash flow requirements.

In addition, appellant made two separate $50,000 loans to Bristlecone. Upon further review by various executives of appellant in the fall of 1975, it was determined that a substantial additional capital contribution to Bristlecone of up to $175,000 would be required for efficient operation. Because Associates was not able to provide additional funds, and Powerine was forced to shoulder the entire burden, Powerine increased its ownership interest in Bristlecone from 50 percent to 67.5 percent. In spite of their efforts, in mid-1976 appellant's executives recommended that the copper operation be abandoned and appellant ultimately tdrmihated the Bristlecone venture.

For the years on appeal, appellant filed its California franchise tax returns on the basis of a combined report, including the income from the operations of its oil business and the loss from its share of the copper business in its apportionable income. Upon audit; respondent determined that the loss from the copper operations should be excluded, concluding that the copper operations were different from and consequently nonunitary with the oil operations.

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 entity, 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. dism., 343 U.S. 939 [96 L.Ed. 1345] (1952).) On the other hand, where truly separate businesses are involved, the separate accounting method is used to determine the income of each separate business. (Appeal of Amwalt Group, Inc., Cal. St. Bd. of Equal., July 28, 1983.)

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 operations. (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, 545, 386 P.2d 333 (1963); Honolulu Oil Corp. v. Franchise Tax Board, 60 Cal.2d 417 [34 Cal.Rptr. 552, 386 P.2d 403 (1963).) 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.) Respondent's determination is presumptively correct, and appellant bears the burden of proving that it is incorrect. (Appeal of John Deere Plow Co. of Moline, Cal. St. Bd. of Equal., Dec. 13, 1961.) Each appeal must be decided on its own particular facts, and no one factor is controlling. (Appeal of Triangle Publications, Inc., Cal. St. Bd. of Equal., June 27, 1984.)

Respondent has argued that appellant is engaged in a different business from that of Bristlecone. Respondent contends that the appellant's oil operations are unlike the copper extraction operations of Bristlecone, and this alleged diversity dictates the conclusion that the operations are nonunitary. The identical contention was directly confronted in our decision in the Appeal of Wynn Oil Company, decided February 6, 1980, wherein we held that the mere fact that two business entities are engaged in diverse lines of business does not, standing alone, preclude a finding that such businesses are unitary. Moreover, in our recent decision of Appeal of Pittsburgh-Des Moines Steel Company,, decided June 21, 1983, which appellant relies on, we found that a single unitary business existed between diverse lines of businesses where one was a real estate project leasing space to business clients while the other fabricated and erected steel structures.

In the Pittsburgh-Des Moines Steel Company appeal we noted that the Franchise Tax Board relied upon the following factors to conclude that the contribution or dependency test established a unitary business: (1) taxpayer contributed part of the materials used to construct the joint venture; (2) taxpayer contributed management skills on a major policy-making level; (3) taxpayer contributed know-how in the construction

of the project; (4) taxpayer supplied labor and supervision during the project's construction; and (5) the project was dependent upon the taxpayer for financial support. We concluded that these features compelled the conclusion that a unitary business existed in that case.

Based on the facts, as outlined above, we find that these same unitary factors are present in the instant case and, therefore, the relationship between appellant and Bristlecone is one requiring unitary treatment. In the instant case, appellant contributed the first $100,000 of equipment needed for the project. This contribution amounted to approximately 20 percent of the project's initial cost. Secondly, from the beginning of operations, integration of executive forces was manifested with two officers of appellant (i.e., Peter B. Rothschild, executive vice president and William Burke, vice president) serving on Bristlecone's management committee. As such, these men made up two of the four members of the committee that was in charge of the general policies, cash management, and business operations of the venture. Additionally, by late 1975, appellant exercised its prerogative and actually took over full control of the mining and processing operations. Furthermore, when Bristlecone's operations failed to run smoothly during the first six months of the project, appellant took over direct control and responsibility for the day-to-day operations. Appellant also ensured that the necessary engineering and economic feasibility studies were performed, and provided supervision during the construction phase. In addition, during this period appellant provided the required accounting and financial analysis services for Bristlecone. Appellant also possessed knowledge and expertise involving the production phase of resource extraction and supplied Bristlecone with technical expertise through its process and consulting engineers and an outside metallurgical engineer during the developmental phase. Lastly, the project's ability to turn to appellant for necessary financial aid is also an indication of unity. In addition to $400,000 in start-up financing, appellant made additional financial contributions to Bristlecone, including two separate $50,000 loans and a $175,000 contribution to capital.

The foregoing factors in the aggregate show a degree of contribution and dependency between appellant and Bristlecone which fully satisfies us that a finding of unity is appropriate. Respondent's action, therefore, must be reversed.

Appeal of Powerine Oil Company

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 protest of Powerine Oil Company against proposed assessments of additional franchise tax in the amounts of $37,724 and $69,831 for the income years ended January 31, 1976, and January 31, 1977, respectively, be and the same is hereby reversed.

Done at Sacramento, California, this 26th day of June , 1985, by the State Board of Equalization, with Board Members Mr. Dronenburg, Mr. Collis, Mr. Bennett Mr. Nevins and Mr. Cory present.

Ernest J. Dronenburg, Jr., Chairman

Conway H. Collis', Member

William M. Bennett, Member

Kenneth Cory*, Member

_____, Member

*Kenneth Cory abstaining

STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
1020 N STREET, SACRAMENTO, CALIFORNIA
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September 10, 1985

Mr. Joseph A. Vinatieri
Bewley, Lassleben & Miller
13215 East Penn Street
Suite 510 Whittier Square
Whittier, CA 90602

Dear Mr. Vinatieri:

Appeal of Powerine Oil Company
81A-1252

Income Years Ended	Proposed Assessments by Franchise Tax Board
1-31-76	**$37,724.00**
1-31-77	**69,831.00**

This is to inform you that on September 10, 1985, pursuant to the request of the respondent, the Board of Equalization ordered that the petition for rehearing be withdrawn.

ATTEST: Douglas D. Bell
Executive Secretary