85-SBE-147

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
) NO. 81A-1249-MW
COACHMEN INDUSTRIES)
OF CALIFORNIA, INC.)

Appearances:

For Appellant: Dawn H. Cole
Attorney at Law

For Respondent: Paul D. Petrozzi
Counsel

O P I N I O N

This appeal is made pursuant to section 25666[1/] of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Coachmen Industries of California, Inc., against proposed assessments of additional franchise tax in the amounts of $5,875.27, $4,480.90, and $28,933.58 for the income years 1973, 1974, and 1975, respectively.

1/ Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as in effect for the income years in issue.

The primary question presented by this appeal is whether appellant was engaged in a single unitary business with its parent and its parent's other subsidiaries. If so, a second question must be addressed: whether the apportionment formula used allocates a disproportionate amount of income to California and, thus, does not fairly represent the extent of the taxpayer's business activity in this state.

Appellant was a California corporation with its offices and facilities in Vacaville, California. It was wholly owned by Coachmen Industries, Inc. (Coachmen Indiana), an Indiana corporation which manufactured and sold recreational vehicles. Coachmen Indiana had a number of divisions and subsidiaries during the appeal years, many of which also manufactured and sold recreational vehicles using the Coachmen name as well as several others. The remaining subsidiaries generally manufactured and sold parts or accessories for recreational vehicles, although one also manufactured boats, one made molds for rubber parts used by the automotive industry, and one also made precision machine parts.

During the appeal years., appellant manufactured and sold travel trailers and truck campers bearing the Coachmen name. It also sold trailers, campers, and motor homes manufactured by Coachmen Indiana. The items manufactured by appellant varied somewhat in design and decoration from those produced by Coachmen Indiana and its other subsidiaries.

Appellant purchased both finished products and production materials from its parent and the other subsidiaries. These intercompany.purchases amounted to 37.9 percent, 22.8 percent, and 29.6 percent of appellant's total purchases for the years 1973, 1974, and 1975, respectively. (Resp. Br. at 3; Resp. Ex. B at 3.) During the appeal years, appellant produced four or five different kinds of campers and trailers. Appellant purchased the same kinds of-campers and trailers from Coachmen Indiana for resale as well as two to four other kinds of recreational vehicles. Appellant apparently used the centralized purchasing facilities for production materials provided by the parent, but not to the same extent as other subsidiaries. Most production materials were obtained under contracts negotiated with West Coast suppliers by appellant's purchasing department. Appellant did not sell any of its products to Coachmen Indiana or the other subsidiaries, but a number of the other

subsidiaries made intercompany sales of finished vehicles and parts and furnishings for recreational vehicles.

Both of appellant's general managers who were employed during the appeal years came from Coachmen Indiana. In addition, a production manager, an assistant production manager, an engineer, a business manager, and an assistant vice president for sales came from Coachmen Indiana during these years. A secretary also came from another of Coachmen Indiana's subsidiaries.

Appellant and Coachmen Indiana had interlocking boards of directors and officers. Appellant's general manager made monthly reports to one of Coachmen Indiana's vice presidents. Product prices were reviewed by the parent, although appellant alleges that its general manager could change price and determine discounts without prior authorization from the parent. All capital expenditures had to be approved by the parent. Budgets were prepared by appellant's general manager, but had to be approved by the parent's executive committee in 1975. Salary increases for the general manager were approved by the parent, but salaries for appellant's other employees were approved 'by the general manager.

Appellant and two other subsidiaries each paid Coachmen Indiana an administrative fee of two percent of net sales each year. This amounted to $36,606, $27,142, and $70,686 for 1973, 1974, and 1975, respectively, for appellant. This fee was to cover services by the parent corporation such as warranty claims processing, engineering, purchasing, testing, printing payroll checks, and audits. It also apparently covered the salaries of the interlocking officers and directors. Appellant used the parent's administrative services only to a limited extent, while the other subsidiaries used them much more.

All financing for appellant was provided by the parent at approximately the market interest rate. Operating loans were made to appellant in both 1973 and 1974. Appellant was not authorized to obtain loans from any other source or to pay interest.

Warranty and dealer agreement forms were provided by Coachmen Indiana. Appellant handled its own warranty claims processing, although Coachmen Indiana apparently handled this for its other subsidiaries. A division of Coachmen Indiana, Hoosier House, acted as an advertising agency for appellant, the parent, and other subsidiaries. Hoosier House created "dealer co-op"

advertising and promotional campaigns for appellant and the dealers which distributed Coachmen Indiana's products. Appellant prepared the photographic work for advertising brochures for its own products and Hoosier House arranged for the preparation and printing of the brochures by West Coast printing companies. Appellant was apparently not required to use Hoosier House for its own advertising and alleges that it used other advertising agencies as well.

Appellant participated in the parent's group health and life insurance plans. Coachmen Indiana also purchased all general liability insurance for the subsidiaries. Other insurance was arranged by appellant. Coachmen Indiana's qualified stock option plan also covered appellant's key employees. Appellant did not participate in the parent's incentive bonus compensation plan, but had its own.

Appellant filed its franchise tax returns for the appeal years on a separate accounting basis. Respondent determined that appellant was engaged in a unitary business with its parent and its parent's other subsidiaries and that appellant's income attributable to California sources should have been determined by formula apportionment of the unitary business income.

When a taxpayer derives income from sources both within and without this state, its franchise tax liability is 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. McColgan, 30 Cal.2d 472 [183 P.2d 16] [illegible]947).)

The existence of a unitary business may be established under either of two tests set forth by the California Supreme Court. In Butler Bros. v. McColgan, 17 Cal.2d 664 [111 P.2d 334] (1941), affd., 315 U.S. S01 [86 L.Ed. 991] (1942), the court held that a unitary business was-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. Later, the court stated that a business is unitary if the operation of the portion 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 is presumptively correct and appellant bears the burden of proving that it is incorrect. (Appeal of John Deere Plow Company 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. (Container Corp. of America v. Franchise Tax Board, 117 Cal.App.3d 988 [173 Cal.Rptr. 121] (1981), affd., 463 U.S. 159 [77 L.Ed.2d 545] (1983).) Where, as here, the appellant is contesting respondent's determination of unity, it must prove by a preponderance of the evidence that, in the aggregate, the unitary connections relied on by respondent were so lacking in substance as to compel the conclusion that a single integrated economic enterprise did not exist.

Unity of ownership is clearly present, since Coachmen Indiana owned all of the shares of appellant. Appellant, however, contends that the remaining connections between appellant, Coachmen Indiana, and Coachmen Indiana's other subsidiaries were insufficient to demonstrate the existence of either the unities of use and operation or contribution or dependency.

We must disagree with appellant, since we find that sufficient contribution and dependency existed among these corporations to demonstrate that they were engaged in a single unitary business during the appeal years. In spite of appellant's emphasis on its autonomy, there were a number of connections which, in the aggregate, indicate that the corporations were sufficiently integrated to be considered parts of a single economic enterprise for purposes of taxation.

There was significant product flow from Coachmen Indiana to appellant of finished goods and some production materials. Intercompany product flow, while insufficient by itself to support a finding of unity, is clearly a significant demonstration of contribution or dependency. (Container Corp. of America v. Franchise Tax Board, supra, 463 U.S. at 179.) Although the product flow was apparently only-one way, the "flow of value" (Container Corp. of America v. Franchise Tax Board, supra, 463 U.S. at 178) went both ways: appellant received products to sell and Coachmen Indiana had an additional market for the goods it produced. The fact that the sales were made to appellant at the same prices charged to other distributors

does not make the sales less significant as a unitary indicator,. (Appeal of Arkla Industries, Inc., Cal. St. Bd. of Equal., Aug. 16, 1977.) In fact, it points up the manufacturer/distributor aspect of the relationship between Coachmen Indiana and appellant, a relationship which is an example of a classic vertically integrated unitary business.

Coachmen Indiana and appellant were, to a large extent, engaged in almost identical businesses and had interlocking officers and directors. Although appellant minimizes the importance of the common officers and directors, "it seems inevitable that this situation would lead to a mutually beneficial exchange of information and know-how . . . ." (Appeal of Anchor Hocking Glass Corporation, Cal. St. Bd. of Equal., Aug. 7, 1967.) The transfer of officers and management-level employees from Coachmen Indiana to appellant strengthens our belief that such an exchange of information and know-how took place. Although appellant's general managers may have been substantially autonomous in conducting the day-to-day operations, they brought with them a knowledge of the parent's operations and a perspective on the operations of the entire affiliated group which would have been invaluable in managing appellant. The other management-level personnel who were transferred from Coachmen Indiana brought expertise in their particular areas as well. We also note that appellant has not presented us with any evidence of the interlocking structure of directors and officers nor has it come forth with anything more than mere assertions to refute the proposition that major policy matters for the affiliated group *were* made by the interlocking officers and directors. Given this situation, we must conclude that the interlocking executive force and the transfer of management personnel contributed to the integration of the two companies.

Other factors also existed, to a greater or lesser extent, which support our conclusion that contribution and dependency existed between the companies. Financing was exclusively intercompany, common advertising by a common advertising agency was used for common products, a common trade name was used, some of the insurance and benefit plans were the same, and appellant paid a fee for some centralized services provided by Coachmen Indiana. Appellant has correctly pointed out that *no one* of these factors, by itself, is sufficient to support a finding of unity, but we find that, taken together with the intercompany product flow and the integrated executive force, they create a convincing picture

of a unitary business which appellant has **failed to** dispel. Although there are elements of independence present in this appeal which appellant has emphasized, they are simply insufficient to convince us that appellant, Coachmen Indiana, and the other subsidiaries were not engaged in a unitary business.

Appellant contends also that formula apportionment allocates a disproportionate amount of income to California and, therefore, it ought to be allowed to use separate accounting to report its California income. Deviations from the standard allocation and apportionment provisions may be allowed where those provisions "do not fairly represent the extent of the taxpayer's business activity in this state, . . ." (Rev. & Tax. Code, § 25137.) The party seeking to deviate from the standard formula bears the burden of proving that such exceptional circumstances exist. (Appeal of Donald M. Drake Company, Cal. St. Bd. of Equal., Feb. 3, 1977.)

Appellant argues that the formula is distortive because it does not take into account higher labor and real estate costs in California and because it apportions a positive taxable income to the California operations in years when they showed a loss under separate accounting. However, neither a variation in profitability nor separate accounting evidence that the activities resulted in a loss has-been held to preclude use of formula apportionment of the income of a unitary business. (Container Corp. of America v. Franchise Tax Board, supra, 117 Cal.App.3d at 1003; John Deere Plow Co. v. Franchise Tax Board, 38 Cal.2d 214, 224 [238 P.2d 569] (1951).) Appellant's argument that use of the apportionment formula has caused more income to be apportioned to California than the California operations could possibly earn is also without merit. This contention is based on treating appellant "as a separate and independent entity with a separate accounting system . . . . (and] disregards the basic concept of a unitary income--namely, that the unitary income is the result of the function of the entire unitary business to which each element contributes." (Chase Brass & Copper Co. v. Franchise Tax Board, 70 Cal.App.3d 457, 468-469 [138 Cal.Rptr. 901] (1977).)

Appellant's allegations of distortion, based on separate accounting principles, are simply insufficient to show that its business activity in California is not fairly represented by application of the standard formula.

For the reasons stated above, we must sustain respondent's action.

Appeal of Coachmen Industries of California, Inc.

ORDER

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS BEREBY 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 Coachmen Industries of California, Inc., against proposed assessments of additional franchise tax in the amounts of $5,875.27, $4,480.90, and $28,933.58 for the income years 1973, 1974, and 1975, respectively, be and the same-is hereby-sustained.

Done at Sacramento, California, this 3rd day of December, 1985, by the State Board of Equalization; with Board Members Mr. Collis, Mr. Nevins, and Mr. Harvey present.

______________________	, Chairman
Conway H. Collis	, Member
Richard Nevins	, Member
Walter Harvey*	, Member
______________________	Member

*For Kenneth Cory, per Government Code section 7.9