BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
) NO. 82A-1611-KP
MANCHESTER TANK & EQUIPMENT)
COMPANY)

Appearances:

For Appellant: Gordon B. Cutler
Attorney at Law

For Respondent: David Lew
Counsel

OPINION

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 Manchester Tank & Equipment Company against proposed assessments of additional franchise tax in the amounts of $12,179.50, $23,200.08, and $22,997.93 for the income years ended June 30, 1976, June 30, 1977, and June 30, 1978, 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.

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The issue on appeal is whether appellant and its three wholly owned subsidiaries were engaged in a single unitary business during the income years at issue.

Appellant, a closely held corporation, was organized and began doing business in California in 1953. Its principal shareholders are members of the Reifschneider family and an individual named John Snapp. Appellant formed its Georgia subsidiary in 1966. Appellant acquired the stock of its Indiana subsidiary by purchasing the company from unrelated parties in 1973. Finally, appellant purchased the stock of its Texas subsidiary in 1971. The Texas subsidiary was originally organized and run by Alfred 0. Costanzo, who remained as president of that company after the stock purchase and who became a member of each of the boards of directors of the other subsidiaries as well as the parent corporation. All four of the corporations were engaged in the manufacture and sale of pressurized and nonpressurized tanks.

During the income years at issue, all four companies operated under a common name and common advertising. Each corporation paid a pro rata share of the advertising costs. The officers and directors of the corporations were the same individuals with the exception of Mr. Costanzo's presidency of the Texas corporation. The boards of directors held consolidated annual meetings as well as interim special meetings at irregular intervals. There were intercompany loans between the corporations at irregular intervals at market interest rates. Intercompany purchases occurred on an irregular basis. There was a limited amount of purchases from common suppliers. Capital expenditures over $10,000 for any of the corporations required its board's approval. Common data processing services were supplied by appellant for ledger processing and accounts payable. A common accounting firm prepared the corporate tax returns and performed all necessary audits. There was one products liability insurance policy with each company paying its pro rata share of the premiums. There was a common profit-sharing plan and a common retirement plan. Finally, on rare occasions, the sales force for one corporation would make sales for the other corporations.

For the income years at issue, appellant filed its franchise tax returns on a separate basis. Respondent audited those returns and determined that appellant was unitary with each of its subsidiaries and that it

should have filed the returns on a combined basis. Respondent issued its assessments, appellant's subsequent protest was denied, and this appeal followed.

A taxpayer which derives income from sources both within and without California is required to measure its California franchise tax liability by its net income derived from or attributable to California sources. (Rev. & Tax. Code, § 25101.) Even if a taxpayer does business solely in California, its income is derived from or attributable to sources both within and without California when that taxpayer is engaged in a unitary business with affiliated corporations doing business outside of California. (Appeal of Kikkoman International, Inc., Cal. St. Bd. of Equal., June 29, 1982.) In such a case, 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 corporations. (See Edison California Stores, Inc. v. McColgan, 30 Cal.2d 472 [183 P.2d 16] (1947).)

In 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 California Supreme Court determined that the existence of a unitary business had been 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. In a subsequent decision, the court stated that a business is unitary when 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.) The existence of a unitary business is established if either of these tests is met. (Appeal of F. W. Woolworth Co., Cal. St. Bd. of Equal., July 31, 1972.)

Respondent's determination that appellant is engaged in a unitary business with its affiliates is presumptively correct, and the burden is on the appellant to show that such determination is erroneous. (Appeal of John Deere Plow Co. of Moline, Cal. St. Bd. of Equal., Dec. 13, 1961.) While none of the factors relied on by respondent is sufficient, by itself, to compel a finding of unity, in the aggregate these factors establish the existence of a "flow of value" (Container Corp. v. Franchise Tax Board, 463 U.S. 159, 178 [77 L.Ed.2d 545]

(1983)) sufficient to sustain the Franchise Tax Board's determination. Appellant must, therefore, prove by a preponderance of the evidence that, in the aggregate, the unitary connections relied on by respondent are so lacking in substance as to compel the conclusion that a single integrated economic enterprise did not exist. (Appeal of Saga Corporation, Cal. St. Bd. of Equal., June 29, 1982.)

While appellant has done a commendable job in presenting its case, we find that it has not met its burden. Due to the nature of the relationship between the companies, appellant has chosen the only method of attack available. Appellant has presented this board with well-reasoned arguments that the factors relied upon by respondent may be interpreted in a manner other than the interpretation given them by the Franchise Tax Board. Whether each factor may be interpreted in another fashion, however, does not change the overall impression that the companies were unitary in their operation. In order to attack the evident "flow of value" between the companies, a taxpayer must be able to present concrete evidence of the separate nature of the corporations; it cannot merely argue that respondent has put too much emphasis on several factors which indicate that the companies were unitary. (See Appeal of Saga Corporation, supra.)

For the foregoing reasons, respondent's action in this matter will be sustained.

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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 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Manchester Tank and Equipment Company against proposed assessments of additional franchise tax in the amounts of **$12,179.50, $23,200.08,** and **$22,997.93** for the income years ended June **30, 1976,** June **30, 1977,** and June **30, 1978, be** and the same is hereby sustained.

Done at Sacramento, California, this 6th day of January , 1987, by the State Board of Equalization, with Board-Kenbers **Mr.** Collis, **Mr. Dronenburg,** Mr. Bennett, **Mr.** Carpenter and Ms. Raker **present.**

Conway H. Collis , Chairman .

Ernest J. Dronenburg, Jr. , Member

William M. Bennett , Member

Paul Carpenter , Member

Anne Baker* , Member

*For Gray Davis, per Governnent Code section 7.9