BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter af the Appeal of)
) No. 82A-1826-DB
HOOKER INDUSTRIES, INC.)

Appearances:

Far Appellant: Walter Tribbey
Attorney at Law

For Respondent: Donald C. McKenzie
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 Hooker Industries, Inc., against proposed assessments of additional franchise tax in the amounts of $15,062 and $2,245 for the income years ended June 30, 1973, and June 30, 1974, 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.

Appeal of Booker Lndustries, Inc.

The issue in this appeal is whether appellant and its wholly owned subsidiary, Superior Plastics, Inc., were engaged in a single unitary business during the appeal years.

Appellant was incorporated in California in 1966 for the purpose of manufacturing and selling high performance exhaust systems for racing cars. Thereafter, appellant expanded its product line to include additional parts and accessories for automobiles, motorcycles, and snowmobiles. In t972, appellant decided to broaden its activities further in order to facilitate a planned initial public offering of its stock. Aspart of this plan, appellant bought the assets of a water ski manufacturing business in January 1973 and the stock of Superior Plastics, Inc., an Oregon boat manufacturer, in February 1973. For its income years ended June 30, 1973, and June 30, 1974, appellant filed its franchise tax returns on a combined report basis with Superior, After auditing those returns, however, respondent determined that appellant and Superior were not engaged in a single unitary business during this period, and it issued the proposed assessments now before-us.

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 where the taxpayer is engaged in a multistate unitary business with one or more affiliated corporations. In such a case, the amount of income attributable to California sources must he determined by applying an ⁂ppartfonment formula to the total income derived from the combined unitary operations of the af filiated corporations. (See Edison California Stores, Inc. v. McColgan, 30 Cal.2d 472 [183 P.2d 16] (1947).)

Respondent's determination is presumptively correct, and appellant bears the burden of proving that it is incorrect; i.e., that the two companies did constitute a unitary business. The existence of a unitary business is established if either of two tests is met. (Appeal of P. W. Woolworth Co., Cal. St. Bd. Of Equal., July 31, 1972.) The California Supreme Court has determined that the existence of a uaitary business is definitely established by the presence 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 operation. (Butler Bros. v. McColgan, 17 Cal.2d 664, 678 [111 P.2d 3341 (1941), affd., 315 U.S. 501 [86 L.Ed. 991] (1942).) The court has also 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 appellant seems to base its case on the contribution or dependency test. In support of its position, appellant places particular emphasis on the executive and managerial control which it exercised over Superior at all times after Superior was acquired. The record reveals that, with the exception of James Lloyd, Superior's founder, all of Superior's officers and directors were replaced by appellant's officers and directors as soon as the acquisition was completed, Appellant also took steps to assume financial control of Superior's affairs. Employees of appellant, for example, supervised the collection of Superior's past-due accounts, and all of Superior's purchases above a nominal amount had to be approved by appellant's executives. Appellant also states that its production and inventory control manager took over all such functions for Superior soon after the acquisition.

Other examples of alleged contribution and dependency include loan guarantees of up to $2 million which appellant undertook in support of Superior's line of credit with its Oregon bank. By December 20, 1973, appellant had guranteed bank loans to Superior in the total amount of $644,000. Sometime in 1973, appellant also took over Superior's advertising and brought samples of Superior's boats to appellant's Ontario, California, headquarters for study by appellant's engineers. These engineers began to redesign and reengineer all of Superior's boats, as well as to prepare new manufacturing specifications for the boats. They also conducted research into the development of an ocean-racing boat, a product not then included in Superior's product line. Finally, appellant notes that Superior's employees were added to appellant's profit-sharing plan and that Superior was added to appellant's insurance policies. These actions, however, were taken just three days before the end of the appeal period, in the case of the profit-sharing plan, and one month after the end of the last appeal year, in the case of the insurance policies.

When a corporate taxpayer invests in distinct business operations and seeks to prove the existence of a single unitary business, it must produce sufficient evidence to show that the unitary factors relied upon resulted in a functionally integrated enterprise rather than merely a group of investments whose business operations are unrelated. (Appeal of J.B. Torrance, Inc., Cal. St. Bd. of Equal., May 8, 1985; Appeals of Santa Anita Consolidated, Inc., et al., Cal. St. Bd. of Equal., Apr. 5, 1984.) The evidence appellant has offered falls short of proving the existence of a functionally integrated enterprise, The executive and managerial control mentioned by appellant, for example, related primarily to financial controls over Superior's operation rather than to any operational integration between the two corporations. This sort of managerial control lacks unitary significance because it reveals nothing more than the owner's interest in overseeing its assets. (Appeal of Mole-Richardson Co., Cal. St. Bd. of Equal., Oct. 26, 1983; Appeal of Hollywood Film Enterprises, Inc., Cal. St. Bd. of Equal., Mar. 31, 1982.) Indeed, appellant's own corporate minutes show that appellant's directors were primarily concerned with protecting appellant's investment in Superior in the face of quickly deteriorating business conditions which led to substantial operating losses and then to Superior's bankruptcy in 1975.

The other allegedly unitary connections relied upon by appellant similarly lack any tendency to prove the existence of a single integrated economic enterprise. (See Appeal of Saga Corporation, Cal. St. Bd, of Equal., June 29, 1982.) Most of them, such as the collection, purchasing, loan guarantee, and inventory control items, fall into the category of financial-type controls, which do nothing to distinguish the operation of a unitary business from the mere management of one's assets. (See Appeal of C. H. Stuart, Inc., Cal. St. Ed. of Equal., Nov. 14, 1984.) Other items, such as the additions of Superior to appellant's insurance policies and profit-sharing plan, occurred either after the end of the appeal period or very close to the end and, thus, have little or no relevance to the existence of a unitary business during the years at issue. (Appeal of Hollywood Film Enterprises, Inc., supra.) The one item which had the potential to establish a significant unitary connection, the engineering research and development conducted for Superior by appellant's engineers, has not been developed sufficiently to show precisely when this work was done or whether it actually led to an operational interrelation-

ship of any substance between the two companies. Even if this one item had been developed, however, it would not have been sufficient, by itself, to establish the existence of a functionally integrated enterprise.

For the above reasons, we conclude that appellant has not established that it was engaged in a single unitary business with Superior. Respondent's action in this matter, therefore, will be sustained.

Appeal of Hooker Industries, Inc.

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 Hooker Industries, Inc., against proposed assessments of additional franchise tax in the amounts of $15,062 and $2,245 for the income years ended June 30, 1973, and June 30, 1974, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 7th day of May, 1987, by the State Board of Equalization, with Board Members Mr. Collis, Mr. Dronenburg, Mr. Bennett, Mr. Carpenter and Ms. Baker present.

Conway H. Collis, Chairman

Ernest J. Dronenburg, Jr., Member

William M. Bennett, Member

Paul Carpenter, Member

Anne Baker*, Member

*For Gray Davis, per Government Code section 7.9