87-SBE-070

B&FORE THE STATE BOARD OF EQUALIZATION

OF THE **STATE OF CALIFORNIA**

In the **Matter of'** the Appeal of QUAKER STATE OIL REFINING CORPORATION	))))	**No. 80A-106-LB**

For Appellant: Hilmar Trost
Certified Public Accountant

For Respondent: **Timothy W.** Boyer
Supervising 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 Quaker State Oil **Refining Corporation** against a proposed assessment of additional franchise tax in the amount of **$76,488.88** for the income year 1977.

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

The sole issue for determination is whether Valley Camp Coal Company (Valley Camp) was part of appellant's unitary business during the income year 1977.

During the appeal year, appellant was in the business of purchasing, producing and refining crude oil and manufacturing and marketing petroleum products. At the same time, Valley Camp mined and sold bituminous coal. In May 1976, appellant acquired all of the stock of Valley Camp. Appellant treated Valley Camp as part of its unitary business and included it in its combined report for the appeal year. After an audit, respondent concluded that Valley Camp was not unitary with appellant and excluded it from the combined report. After appellant's protest was denied this appeal was instituted.

A taxpayer which derives income from sources both within and without this state is required to measure its California franchise tax liability by it net income derived from or attributable to sources within this state. (Rev. & Tax. Code, § 25101.) The California-source income of such a taxpayer must be computed in accordance with the provisions of the Uniform Division of Income for Tax Purposes Act (UDITPA) contained in sections 25120-25139. (Reb. & Tax. Code, § 25101.) If the taxpayer is engaged in a unitary business with an affiliated corporation, 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 5691 (1951), app. dism., 343 U.S. 939 (96 L.Ed. 1345) (1952).) Where truly separate businesses are involved, however, the separate accounting method is used to determine the income of each separate business. (Edison California Stores, Inc. v. McColgan, supra.)

A unitary business may exist when there is unity of ownership, unity of operation; and unity of use (Butler Bros. v. McColgan, 17 Cal.2d 664, 678 [111 P.2d 334] (1941), affd., 315 U.S. 501 [86 L.Ed. 9911 (1942)) or when the operation of the business within California contributes to or is dependent upon the operation of the business outside this state (Edison California Stores, Inc. v. McColgan, supra, 30 Cal.2d at 481). Respondent's determination-is presumptively correct, and the burden is on appellant to show such determination is erroneous. (Cf. Appeal of John Deere Plow Co. of Moline, Cal. St.

Bd. of Equal., Dec. 13, 1961.) Where, as here, the taxpayer contends that it is engaged in a unitary business, it must prove that, in the aggregate, the unitary connections it relies on are of such substance as to compel the conclusion that a single integrated economic enterprise existed. (Cf. Appeal of Saga Corporation, Cal. St. Bd. of Equal., June 29, 1982).)

Initially, respondent maintains that appellant and Valley Camp were engaged in different businesses; appellant was engaged, primarily, in refining oil and marketing petroleum products while Valley Camp mined and sold coal to utilities and industrial companies. Appellant, on the other hand, contends that both were engaged in the same business, fossil fuel energy.

More specifically, respondent contends that the factors which normally establish contribution or dependency as well as unity of use and operation were not present. Some of the factors which respondent maintains were absent include: a strong centralized executive force and common management which would result in intercompany exchange of technical know-how and expertise; intercompany product flow; intercompany transfer of employees; use of a common name or trademark: common advertising; intercompany financing: use of common facilities; and centralized services. In the absence of sufficient unitary factors, respondent concludes that appellant and Valley Camp were not functionally integrated during 1977 and that Valley Camp was simply an unrelated investment.

Appellant, on the other hand, contends that sufficient unitary factors are present to establish the existence of a single integrated economic enterprise. Specifically, appellant argues that it has established the existence of: unity of ownership: unity of operation as evidenced by intercompany sales and financing and common accounting, tax and legal services; and unity of use as indicated by a centralized executive force.

We agree with respondent.

Initially, we reject appellant's contention that it is in the same business with Valley Camp. While, in broad terms, it may be true, as appellant alleges, that an oil-refining company and a coal-mining company are both engaged in the fossil fuel energy industry, it does not follow that they are engaged in the same business. (See, e.g., Keesling & Warren, The Unitary Concept

in the Allocation of Income, 12 Hast. L.J. 42, 48-49 (1960).) Appellant, who purchases most of its oil from independent operators, was engaged, primarily, in the business of refining oil. Valley Camp was engaged in the underground mining and sale of bituminous coal which was used to generate steam, an entirely separate and distinct business. There is not a scintilla of evidence in the record even suggesting any commonality of operations or transferability of technology between appellant's oil refining business and Valley Camp's coal mining business.

In contending that both the three unities and the contribution or dependency test are satisfied, appellant maintains that it has established the existence of centralized management, intercompany sales and financing, and common accounting, tax and legal services.[2/]

Appellant's vague generalized allegations of centralized management and integrated executive forces are simply insufficient to carry its burden of proof. Furthermore, the executive assistance alluded to by appellant lacks unitary significance because it does not demonstrate any integration between the corporations. (See Appeals of Santa Anita Consolidated, Inc., Cal. St. Bd. of Equal., Apr. 5, 1984.)

Next, appellant contends that a $4,000,000 loan from appellant to Valley Camp is substantial evidence of operational unity and contribution or dependency. Again, we must reject this argument. In order for intercompany financing to constitute a significant unitary characteristic, there must be evidence that the financing contributed to the operational integration of the group. (Container Corp. v. Franchise Tax Board, 463 U.S. 159 [77 L.Ed.2d 545], reh. den., 464 U.S. 909 [78 L.Ed.2d 248] (1983); Appeals of Santa Anita Consolidated, Inc., supra.) In this appeal, there is no such evidence.

Although appellant argues otherwise, one of the more important indications of unity, intercompany product flow, is almost absent in this appeal. In 1977, appellant purchased only six-tenths of one percent of Valley Camp's coal. During the same year, Valley Camp's purchases from appellant constituted only six one-hundredths of one percent of appellant's gross sales.

2/ The parties, of course, agree that the requirement for unity of ownership is sseisfied.

These are simply not significant intercompany transactions and lend no support to a finding that a unitary business existed. (See, e.g., Appeal of Daniel Industries, Inc., Cal. St. Bd. of Equal., June 30, 1980.)

Finally, appellant maintains that the presence of centralized administrative services establishes unity of operation and helps to satisfy the contribution or dependency test. Specifically, appellant asserts that some accounting, legal and tax services were performed. However, the mere presence of some centralized administrative functions neither establishes unity of operation nor satisfies the contribution or dependency test. Appellant has not shown that its centralized services resulted in operational integration of the two businesses. There is no suggestion. that the services were used for any common business activity or that either appellant or Valley Camp gained any substantial mutual advantage from them. (See, e.g., Appeal of the Amwalt Group, Inc., Cal. St. Bd. of Equal., July 28, 1983.)

To demonstrate the existence of a single unitary business, it is necessary to do more than simply list circumstances which are labeled "unitary factors" as appellant has done in this appeal. Such factors are distinguishing features of a unitary business only when they establish functional integration between the corporations involved. We must distinguish between cases such as this one 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 significant interrelationship among the related entities that they all must be considered to be parts of a single integrated economic enterprise. (Appeal of Saga Corporation, Cal. St. Bd. of Equal., supra.)

For the reasons discussed above, we conclude that respondent's action must be sustained.

Appeal of Quaker State Oil Refining Corporation

ORDER

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 Quaker State Oil Refining Corporation against a proposed assessment of additional franchise tax in the amount of $76,488.88 for the income year 1977, be and the same is hereby sustained.

Done at Sacramento, California, this 6th day of October, 1987, by the State Board of Equalization, with Board Members Mr. Collis, Mr. Dronenburg, Mr. Carpenter and Ms. Baker present.

Conway H. Collis, Chairman

Ernest J. Dronenburg, Jr., Member

Paul Carpenter, Member

Anne Baker*, Member

_____, Member

*For Gray Davis, per Government Code section 7.9