BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
) No. 85A-448-MW
MEADOWS REALTY COMPANY, ET AL.)

Appearances:

For Appellant: Daniel J. Cooper
Attorney at Law

For Respondent: Paul 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 Meadows Realty Company, et al., against proposed assessments of additional franchise tax in the amounts and for the income years as follows:

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 Meadows Realty Company, et al.

Appellants	Income Years Ended	Proposed Assessments
Meadows Realty Company	4/30/75	$272,676
	4/30/75	200
	4/30/75	6,911
	4/30/76	107,284
	4/30/76	200
	4/30/77	20,345
	4/30/78	18,288
	4/30/78	200
Diversified Communities, Inc.	4/30/75	200
	4/30/76	7,945
	4/30/77	200
	4/30/78	7,947
Claraben Mobile Homes, Inc.	4/30/76	7,029
	4/30/77	25,983
Azimuth Equities, Inc.	4/30/75	200
	4/30/76	13,295
	4/30/77	24,669
	4/30/78	14,550

The question presented by this appeal is whether the appellants were engaged in a single unitary business with their parent corporation, San Joaquin Oil Refining Co. (San Joaquin), during the appeal years.2/

The appellants were all owned, directly or indirectly, by San Joaquin. San Joaquin, which was solely owned by Mr. Newell Fait (Fait), was principally engaged in oil refining. San Joaquin generated excess funds which were available to expend on other lines of business and, in 1974, it formed Meadows Realty Co. (Meadows) for that purpose. Meadows was a holding company, the sole function of which was to hold the stock and notes of Azimuth Equities, Inc. (Azimuth). Azimuth owned Diversified Communities, Inc. (DCI), and Azimuth Development Co. (ADC). DCI was a holding company which owned two other companies, Diversified Communities of Summit, Inc. (DCS), and Diversified Communities of Ohio, Inc. (DCO). Azimuth developed and managed mobile home parks. ADC, DCS, and DCO developed and sold residential condominiums. A diagram of the corporate structure follows.

2/ Claraben Mobile Homes, acquired in 1975 and sold in 1977, sold mobile homes. It appears that appellants have conceded that Claraben was not part of any unitary business.

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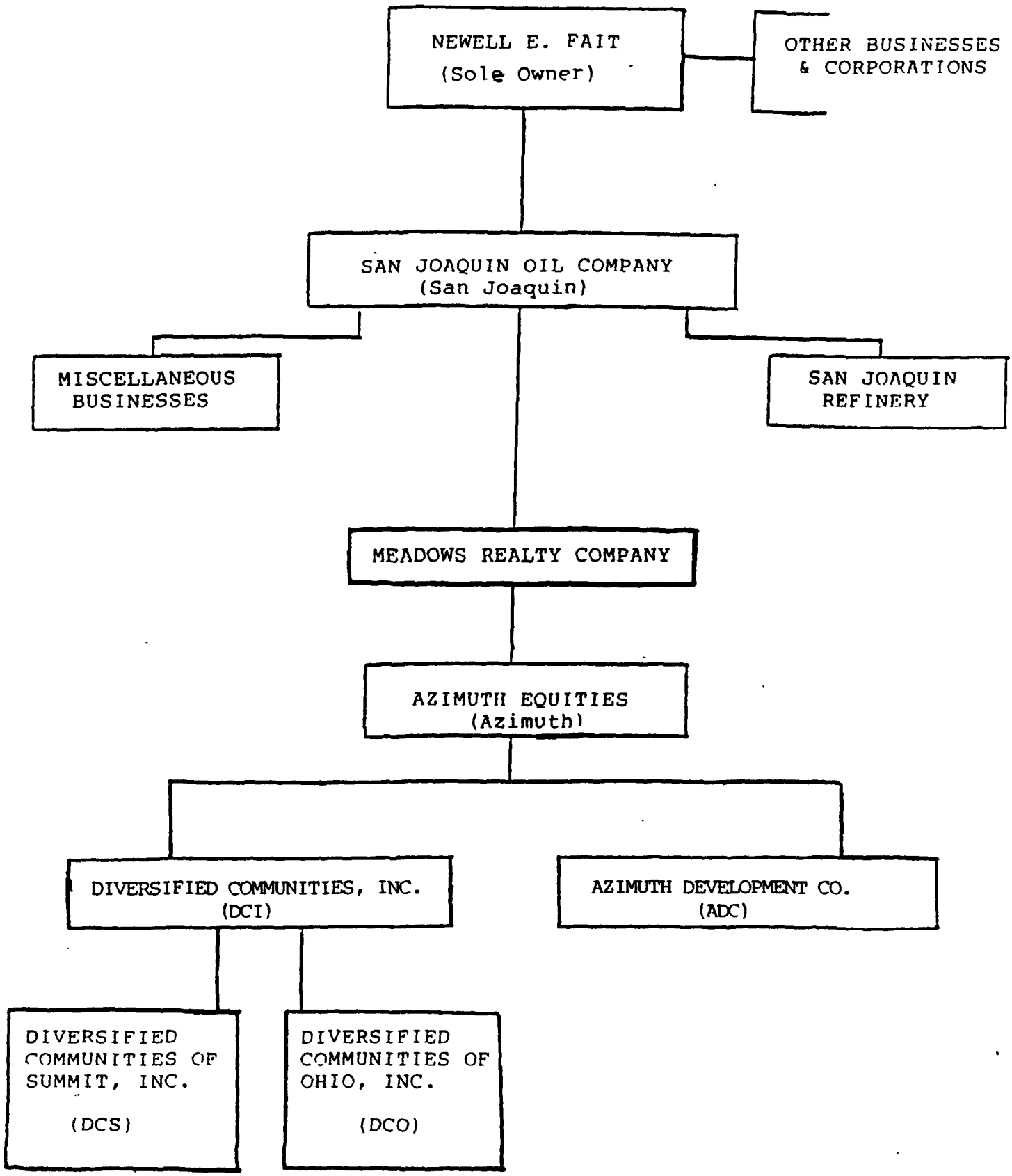

At the time San Joaquin acquired them, Azimuth and its subsidiaries were all insolvent and, apparently, had substantial net operating loss carryovers. After the acquisitions, Fait and his management team determined all major policies and arranged all major projects for the corporations in the group. The affiliated group apparently filed combined reports for the appeal years. The Franchise Tax Board (FTB) determined that they were not engaged in a unitary business and disallowed the use of combined reports. The appellants object to the determination that they were not engaged in a unitary business with San Joaquin, but do not argue that they constitute a unitary business themselves, without San Joaquin.

If a taxpayer derives income from sources both within and without California, its franchise tax liability is required to be 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 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] (1947).)

Respondent's determination regarding the existence of a unitary business is presumptively correct, and appellants bear the burden of showing that it is incorrect. (Appeal of Kikkoman International, Inc., Cal. St. Bd. of Equal., June 29, 1982.) The California Supreme Court has held that the existence of a unitary business may be established by the presence of unity of ownership; unity of operation as evidenced by central accounting, purchasing, advertising, and management divisions; and unity of use in a centralized executive force and general system of operation. (Butler Bros. v. McColgan, 17 Cal.2d 664 [111 P.2d 334] (1941), affd., 315 U.S. 501 [86 L.Ed. 991] (1942).) It has also stated that a business is unitary if the operation 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.) More recently, the United States Supreme Court has emphasized that a unitary business is a functionally integrated enterprise whose parts are characterized by substantial mutual interdependence and a flow of value. (Container Corp. v. Franchise Tax Board, 463 U.S. 159, 178-179 (77 L.Ed.2d 545), rehg. den., 464 U.S. 909 [78 L.Ed.2d 248] (1983)).

More is required to demonstrate the existence of a functionally integrated enterprise than the recitation of a number of so-called "unitary factors." One must be able to differentiate a unitary business from a group of commonly owned businesses or activities, the operations of which really have no effect upon one another. As we said in the Appeal of Saga Corporation, decided by this board on June 29, 1982, we must distinguish

> between those cases 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.

In a case of clear vertical or horizontal integration, the benefits to the group from certain basic connections are usually obvious. Where the various affiliated entities engage in distinct lines of business, however, without apparent vertical or horizontal integration, any alleged "unitary factors" must be supported by sufficient evidence to show that they resulted in a functionally integrated enterprise, rather than mere diversification of the corporate portfolio by investment in affiliates whose operations are unrelated to the rest of the business. (See Container Corp. v. Franchise Tax Board, supra, 463 U.S. at 178; Appeal of Twentieth Century-Fox Film Corporation, 89-SBE-007, Mar. 2, 1989); 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 appellants contend that they were unitary with San Joaquin because 1) the ownership requirement was met; 2) they had interlocking officers and directors; 3) only Fait and one other were authorized to sign checks for the subsidiaries; 4) San Joaquin provided financing for the subsidiaries; 5) they had a common CPA firm; 6) beginning in 1976, all but San Joaquin had common liability insurance; 7) beginning in 1976, they had a common insurance agent; 8) they had a common in-house legal department (Fait's son); 9) they shared common headquarters; 10) some employees performed functions for both San Joaquin and the subsidiaries; and 11) they all submitted monthly reports to Fait and were subject to budget and financial controls. Appellants argue

that these factors demonstrate unity between themselves and San Joaquin under both the three unities test and the contribution or dependency test.

The FTB concedes that the ownership requirement is met but argues that the "unitary factors" listed by appellant are not sufficient to support a finding of a unitary business, absent some showing that they result in functional integration of the oil-refining activities with the activities of the subsidiaries. The FTB points out that the factors relied on by appellant are either unsupported by evidence, lacking explanation as to integrating effect, or simply the actions of a prudent investor.

Although appellants have presented a considerable list of "unitary factors," we find that there has been no showing at all of how these factors caused San Joaquin's oil-refining activities to be integrated with the mobile home park and condominium development activities of the subsidiaries. While San Joaquin, through Fait and his management team, did provide overall management and some staff services for the subsidiaries, there is no evidence that any of this contributed to the functional integration of San Joaquin's operations with those of the subsidiaries. Other potentially integrating factors cited by appellants have not been shown to be substantial in either quantity or quality and, therefore, do not indicate the existence of a unitary business. In short, the attributes relied upon by appellants demonstrate nothing more than a parent corporation's oversight of its unrelated investments. (See, e.g., Appeals of Hollywood Film Enterprises, Inc., Cal. St. Bd. of Equal., Mar. 31, 1982; Appeals of Santa Anita Consolidated, Inc. et al., supra; Appeal of J. B. Torrance, Inc., supra; Appeals of Andreini & Company and Ash Slough Vineyards, Inc., Cal. St. Bd. of Equal., Mar. 4, 1986.)

Appellants also argue that the facts in the Appeal of Wynn Oil Company, decided by this board on February 6, 1980, "dictated a unitary finding and closely parallel the facts present in this appeal . . . ." (App. Memo. of Pts. and Auth. at 9.) They conclude that a finding of unity is, therefore, dictated in this appeal. However, each case must be decided on its own factual record and we have found that this record does not support a finding of unity. In any case, Wynn Oil was decided before the line of United States Supreme Court cases, starting with Mobil Oil Corporation v. Commissioner of Taxes, 445 U.S. 425 [63 L.Ed.2d 510] (1980), and culminating in

Container Corp. v. Franchise Tax Board, supra, in 1983, which has impelled the present focus on evidence of a functionally integrated enterprise. The facts in Wynn Oil would almost certainly be found insufficient to support a finding of unity were that case to be subjected to the analysis that has generally been used in more recent cases. We conclude that Wynn Oil has no continuing validity as precedent, and cases which have relied on it must also be considered questionable. Therefore, we do not agree with appellants' contention that Wynn Oil "dictates" a finding of unity in the present appeal, no matter how parallel the facts in the two cases might be.

For the reasons discussed above, the action of the Franchise Tax Board in this matter must be sustained.

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 Meadows Realty Company, et al., against proposed assessments of additional franchise tax in the amounts and for the income years cited above, be and the same is hereby sustained.

Done at Sacramento, California, this 24th day of January, 1990, by the State Board of Equalization, with Board Members Mr. Collis, Mr. Carpenter, and Mr. Davies present.

Conway H. Collis*, Chairman

Paul Carpenter, Member

John Davies**, Member

_____, Member

_____, Member

*Abstained

**For Gray Davis, per Government Code section 7.9