



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
MOLE-RICHARDSON COMPANY)

For Appellant: John S. Warren
Attorney at Law

For Respondent: John R. Akin
Counsel

O P I N I O N

This appeal is made pursuant to section 25666 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Mole-Richardson Company against proposed assessments of additional franchise tax in the amounts of \$11,071, \$16,475, \$23,640, and \$33,416 for the income years 1972, 1973, 1974, and 1975, respectively.

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The question presented by this appeal is whether appellant's operations constituted a single unitary business during the income years 1972, 1973, 1974, and 1975.

Appellant is a California corporation, all the stock of which was owned during the appeal years by trusts of the Parker family. Warren Parker was the president and chief executive officer of appellant and the affiliated corporations involved in this appeal. Warren's four sons and his son-in-law were active in the operation of appellant and its affiliates.

Appellant was originally engaged solely in the design, manufacture, rental, and sale of specialized lighting equipment for motion picture and television studios and photographers. The renting of this equipment was handled by Mole-Richardson Rental Corporation (Rental), appellant's wholly owned subsidiary. Appellant's and Rental's operations were headquartered in Hollywood, California.

Shortly before the appeal years, appellant expanded its activities to include farm and ranch operations, an insurance agency, and real property rentals. All of these business activities were managed from appellant's Hollywood headquarters.

Appellant's farm and ranch activities consisted of the ownership and operation of farm and ranch properties in Colorado; the breeding, raising, and sale of cattle, hogs, and horses; and the training and racing of horses; Appellant attempted to promote the use of its Colorado properties as shooting locations for motion pictures and television, but this was not accomplished.

The insurance agency, in Colorado, is a general agent for casualty, property, life, and health insurers. The agency sold "animal mortality insurance," some of which was on animals sold by the farm and ranch operation.

Mole-Parker Enterprises (Enterprises) is appellant's sister corporation, owned by trusts and individuals of the Parker family. Appellant and Enterprises owned real property in California and Colorado which was rented to others.

Management activities for appellant and its affiliates, such as accounting, purchasing, advertising, personnel records and decisions, payroll and expense payments, and financing, were conducted at appellant's

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headquarters in Hollywood, California. These activities were handled by members of the Parker family who were officers of appellant and its affiliates. Construction, land development, purchasing, and general policy decisions for all the operations were made by these same individuals. Employee group insurance and pension programs were combined for all the operations and administered in Hollywood. All liability insurance was obtained from one carrier. Appellant's general counsel, David A. Parker, handled the general legal matters for all the operations. All advertising was developed and produced in-house through appellant's Hollywood office.

For its 1972, 1973, 1974, and 1975 income years, appellant filed its California franchise tax returns on the basis of a combined report which included the income from all of appellant's and its affiliates' operations, i.e., the light manufacturing, farm, and insurance agency divisions, Rentals, and Enterprises. Respondent determined that appellant was engaged in two unitary businesses: the "light group," which included the light manufacturing division and Rentals, and the "farm group," which included the farm and insurance agency divisions and Enterprises. Therefore, it recomputed appellant's franchise tax liability, applying separate apportionment formulas to the income of each group.

A taxpayer deriving income from sources both within and without this state is required to measure its California franchise tax liability 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] (1947).) If the taxpayer is engaged in two or more unitary businesses, the income of each unitary business is separately determined and then apportioned by a formula based on the factors related solely to that unitary business. (Cal. Admin. Code, tit. 18, reg. 25120, subd. (b) (art. 2.5).)

The existence of a unitary business is established if either of two tests is met. The California Supreme Court has held that a unitary business is definitely established by the presence of unity of ownership, unity of operation as evidenced by central accounting, purchasing, advertising, and management divisions, and

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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.) Respondent's determination is presumptively correct, and appellant bears the burden of showing that it is incorrect.

Unity of ownership is not disputed here. However, respondent contends that the light-group and farm group are dissimilar types of businesses which are insufficiently integrated to be considered a single unitary business under either the three unities test or the contribution or dependency test.

Appellant has stated that a number of services were centralized for all the operations and that several members of the Parker family provided the overall management for all of the operations from appellant's headquarters in Hollywood. However, the recitation of a number of centralized functions is insufficient to establish unity under either of the two tests developed by the California Supreme Court. (Appeal of Allied Properties, Inc., Cal. St. Bd. of Equal., March 17, 1964.) The factors present must be examined to distinguish

between those cases in which unitary labels are applied to 'transactions and circumstances which . . . 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., June 29, 1982.)

Appellant has not shown that the factors upon which it relies were of such significance that the two groups must be considered as a single unitary business. Factors relating to unity of operation, such as centralized accounting and advertising, were present in some degree, but there is no evidence that they resulted in any substantial mutual advantage or operational integration. While the executives of appellant did provide financial and policy guidance for all the operations,

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this does not appear to have contributed to any significant integration between the two groups. The type of executive assistance provided is that which is ordinarily found in any case where a closely held corporation operates a number of enterprises. (Appeal of Jaresa Farms, Inc., Cal. St. Bd. of Equal., Dec. 15, 1966.) It reveals **nothing** more than any owner's interest in overseeing its assets. (See Appeal of Hollywood Film Enterprises, Inc., Cal. St. Bd. of Equal., March 31, 1982.)

Appellant contends that subdivision (b) of respondent's regulation 25120 (Cal. Admin. Code, tit. 18, reg. 25120, subd. (b) (art. 2.5)) supercedes our analyses in cases such as Appeal of Allied Properties, Inc., supra, and Appeal of Jaresa Farms, Inc., supra. It argues that, pursuant to that regulation, the two groups must be found to be engaged in a **single** unitary business. Regulation 25120, subdivision (b), provides, in relevant part:

The determination of whether the activities of the taxpayer constitute a single trade or business or more than one trade or business will turn on the facts in each case. In general, the activities of the taxpayer will be considered a single business if there is evidence to indicate that the segments under consideration are integrated with, dependent upon or contribute to each other and the operations of the taxpayer as a whole. The following factors are considered to be good indicia of a single trade or business, and the presence of any of these factors creates a strong presumption that the activities of the taxpayer constitute a single trade or business:

* * *

(3) Strong centralized management: A taxpayer which might otherwise be considered as engaged in more than one trade or business is properly considered as engaged in one trade or business when there is strong central management, coupled with the existence of centralized departments for such functions as financing, advertising, research, or purchasing. Thus, some conglomerates may properly be considered as engaged in only one trade or business when the central executive officers are normally involved in the operations of the various divisions and there are centralized offices

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which perform for the divisions the normal matters which a truly independent business would perform for itself, such as accounting, personnel, insurance, legal, purchasing, advertising, or financing.

Although Allied Properties, supra, and Jaresa Farms, supra, were **decided** before the enactment of regulation 25120, we do not find them to be superceded by anything in that regulation. Both those appeals and the regulation emphasize that the particular facts of each case govern its decision and that there must be evidence to indicate integration or dependency or contribution in order to find a single unitary business. Example (3) of regulation 25120, subdivision (b), when read in context, should not, and, **we** believe, does not, contradict this emphasis. Therefore, the mere **presence** of certain centralized management and service functions is not sufficient to support a finding of unity where those functions are not significant enough, in a particular case, to indicate integration or contribution or dependency. As mentioned earlier, the factors relied upon by appellant do not show any significant integration of the two groups, but merely show the ordinary oversight which would be expected **in** any closely held group of diverse enterprises. We conclude that appellant has failed to show that the farm operations group and the lighting group were engaged in a single unitary business.. Respondent's action, therefore, **must 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 Mole-Richardson Company against proposed assessments of additional franchise tax in the amounts of \$11,071, \$16,475, \$23,640, and \$33,416 for the years 1972, 1973, 1974, and 1975, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 26th day of October , 1983, by the State Board of Equalization, with Board Members Mr. Bennett, Mr. Collis, Mr. Dronenburg, Mr. Nevins and Mr. Harvey present.

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| <u>William M. Bennett</u> | , Chairman |
| <u>Conway H. Collis</u> | , Member |
| <u>Ernest J. Dronenburg, Jr.</u> | , Member |
| <u>Richard Nevins</u> | , Member |
| <u>Walter Harvey*</u> | , Member |

*For Kenneth Cory, per Government Code section 7.9