BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of)
) No. 83A-389-MW
ANDREINI & COMPANY AND)
ASH SLOUGH VINEYARDS, INC.)

Appearances:

For Appellants: John B. Lowry
Attorney at Law

For Respondent: Eric J. Coffill
Counsel

O P I N I O N

These appeals are made pursuant to section 25666[1/] of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Andreini & Company against proposed assessments of additional franchise tax in the amounts of $52,070 and $24,581 for the income years ended December 31, 1979, and December 31, 1980, respectively, and on the protest of Ash Slough Vineyards, Inc., against proposed assessments of additional franchise tax in the amounts of $200, $200, and $200 for the income years ended December 31, 1978, December 31, 1979, and December 31, 1980, 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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Two questions are presented by these appeals: (1) whether Andreini & Company ("Andreini") and Ash Slough Vineyards, Inc. ("Ash Slough"), were engaged in a single unitary business during the 1978, 1979, and 1980 income years: and (2) whether certain items of appellants' income were properly reclassified by respondent as nonbusiness income.

Andreini, a closely held California corporation, is a major insurance broker, primarily for agricultural clients, in California and other western states. The shareholders, officers, directors, and principal. managers of Andreini were John and George Andreini and Michael Colzani.

In the late 1970's, appellant became interested in diversifying and investing surplus capital in an agricultural enterprise. In early 1978, Andreini purchased land for development into a commercial vineyard. The vineyard operation was incorporated in 1978 as Ash Slough, a wholly owned subsidiary of Andreini. Ash Slough had the same officers and directors as Andreini. McCarthy Farming Company ("McCarthy") was hired to develop and operate the vineyard. Ash Slough first began selling grapes during the 1980 income year.

The three principals of Andreini and Ash Slough, John and George Andreini and Michael Colzani, made all major policy decisions as to business ventures to be undertaken by Ash Slough and planned and secured financing for those ventures. Andreini made annual cost projections for Ash Slough and received monthly reports on expenditures from McCarthy. Large loans were made to Ash Slough by Andreini in 1978 and 1979 and all debts incurred by Ash Slough were guaranteed by Andreini. Accounting services for Ash Slough were performed by Andreini's accounting department free of charge. Andreini arranged Ash Slough's liability insurance and the three principals negotiated the management contract with McCarthy.

For the years at issue, Andreini filed its franchise tax returns on the basis of combined reports which included Ash Slough. Respondent determined that Ash Slough was not part of Andreini's unitary business during the 1978, 1979, and 1980 income years and issued proposed assessments based on a recomputation of franchise tax liability using separate accounting.

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).)

There are two alternative tests used to determine whether a business is unitary. The California Supreme Court has held that the existence of 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 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 regarding the existence of a unitary business is presumptively correct, and appellants bear the burden of showing that it is incorrect.

To demonstrate the existence of a single unitary business, it is necessary to do more than simply list circumstances which are labeled "unitary factors." Such "factors" are distinguishing features of a unitary business only when they show that there was functional integration between the corporations or divisions involved. 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. (Appeal of Saga Corporation, Cal. St. Bd. of Equal., June 29, 1982.)

Appellants contend that they were unitary because there was unity of ownership, the two companies were financially integrated, had common administrative services, common management, and common professional services. They also argue that Andreini acquired new insurance clients through Ash Slough. Respondent agrees

that unity of ownership existed, but contends that the other factors relied upon by appellant do not demonstrate a functionally integrated enterprise under either the three unities test or the contribution or dependency test. We must agree with respondent.

In many respects, we find appellants' situation to be markedly similar to that of the appellants in the Appeal of Santa Anita Consolidated, Inc., et al., decided by this board April 5, 1984. Despite appellants' protestations to the contrary, our discussions in that opinion regarding the lack of significance attributed to common management, intercompany financing, and centralized services are equally applicable here and, we incorporate them by reference. The use in common of an accounting firm and lawyer, while often listed as a unitary indicator, has not been shown in this case to have resulted in any material advantage and, therefore, is not particularly significant.

Appellants' argument that Ash Slough provided Andreini with new insurance clients, while superficially appealing, does not stand up under closer scrutiny. They argue that use of McCarthy as manager of Ash Slough strengthened Andreini's longstanding ties with that company and the strengthened relationship with McCarthy helped attract new insurance clients for Andreini. They also contend that they obtained as new clients wine grape growers, wineries, fertilizer suppliers, and an agricultural trucking firm. While McCarthy may have been more inclined to refer clients to Andreini after becoming the manager, there is no proof that referrals from McCarthy would not have occurred in any case, given the longstanding prior relationship between Andreini and McCarthy. In addition, even if new clients were obtained after Ash Slough was established, this does not show that the operations of Andreini and Ash Slough were integrated. Mere ownership of an agricultural enterprise would have increased Andreini's exposure to purchasers and suppliers in the agricultural community. We must conclude that any new business which may have been generated by Andreini's relationship with Ash Slough does not lead to the conclusion that the two companies were functionally integrated.

We find that the factors relied upon by appellants do not show any significant integration of the two companies, but merely show the ordinary oversight which would be expected in any closely held-group of diverse enterprises. The financial direction and control which Andreini exercised over Ash Slough, although pervasive,

when unaccompanied by any significant operational integration, is simply insufficient to support a finding that the two were engaged in a unitary business.

The second issue to be considered is whether respondent properly classified certain items of appellants' income in 1980 as nonbusiness income, allocable in full to California. These. items were: (1) dividends received from investments in common stock of unaffiliated companies; (2) capital gains from the sale of common stock of those unaffiliated companies-; (3) income from Andreini's partnership interest in "651 Brannan Street," a partnership which apparently owns an office building in San Francisco; (4) interest from U.S. Treasury obligations: and (5) a partnership loss from "Dixon Appaloosa," a partnership apparently formed to breed and show a stallion named "Apache Double."

"Business income" and "nonbusiness income" are defined in section 25120 as follows:

> (a) "Business income" means income arising from'transactions and activity-in the regular course of the taxpayer's trade or business and includes income from tangible and. intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.
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> (d) "Nonbusiness income" means all income other than business income.

Appellants contend that the items must be considered to be business income because respondent has not overcome the presumption of Regulation 25120 that "the income of the taxpayer is business income unless clearly classifiable as nonbusiness income." (Cal. Admin. Code, tit. 18, reg. 25120, subd. (a), (art. 2.5).) It argues that respondent has merely relied on such labels as "dividends" and "capital gains" in its classification of these items, disregarding the directive of Regulation 25120, subdivision (a), that such labels are not determinative.

Appellants have correctly stated the language of the regulations, but we must disagree with their position on this issue. Respondent has not merely relied

on labels to classify these items, but has based its determination on the only information it had regarding the transactions from which the income arose.

While there is a presumption in the regulation in favor of business income, we do not believe that this can override the language of the statute, which requires that we examine the transactions and activity which give rise to the income to determine its character. Regulation 25120, subdivision (a), cited by appellants, also requires this examination. The little information which we have regarding these transactions casts great doubt-in our minds that any of this income could have arisen from "transactions and activity in the regular course of [Andreini's] trade or business" as an insurance broker, as asserted by appellants.

Appellants have not revealed the nature of the items or the transactions which produced this income. They have merely stated that the investments were made from working capital, extra cash, and cash held in special accounts maintained in connection with appellants' business. The source of the money for investment, however, is not necessarily determinative of the character of the income from investments. Appellants refer to several examples in the regulations as controlling, but fail to tell us how these examples relate to the specific investments which they made. Respondent's determination, which appears justified on the few facts before us

> cannot be successfully rebutted when the taxpayer fails to present relevant evidence as to the issue in dispute. [Citations.] When, as in this appeal, the taxpayer has the needed information or has access to the necessary evidence but does not produce it, [it] is not in a position to complain of adverse consequences.

(Appeal of Credit Bureau Central, Inc., Cal. St. Bd. of Equal., Feb. 2, 1981; see also Appeal of Johns-Manville Sales Corporation, Cal. St. Bd. of Equal., Aug. 17, 1983.)

On the basis of the foregoing, we must sustain respondent's action.

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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 Andreini & Company against proposed assessments of additional franchise tax in the amounts of $52,070 and $24,581 for the income years ended December 31, 1979, and December 31, 1980, respectively, and on the protest of Ash Slough Vineyards, Inc., against proposed assessments of additional franchise tax in the amounts of $200, $200, and $200 for the income years ended December 31, 1978, December 31, 1979, and December 31, 1980, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 4th day of March, 1986, by the State Board of Equalization, with Board Members Mr. Nevins, Mr. Collis, Mr. Dronenburg and Mr. Harvey present.

Richard Nevins, Chairman

Conway H. Collis, Member

Ernest J. Dronenburg, Jr., Member

Walter Harvey*, Member

_____, Member

*For Kenneth Cory, per Government Code section 7.9