BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of	)	
	)	NO. 83A-317-MW
BREDERO CALIFORNIA, INC.,	)	
BREDERO CONSULTING, INC., AND	)	
BEST BLOCKS, IN',.	)	

For Appellant: James P. Daze
Treasurer

For Respondent: Karl F. Munz
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 Bredero California, Inc., Bredero Consulting, Inc., and Best Blocks, Inc., against proposed assessments of additional franchise tax in the amounts and for the years as follows: Bredero California, Inc. --$2,468 for income year 1980; Bredero Consulting, Inc. --$50,968 for income year 1980; and Best Blocks, Inc. --$8,628 for income year 1979.

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 this appeal: (1) whether respondent properly determined that appellants were not entitled to file a combined report for income year 1979: and (2) whether respondent properly determined that Bredero California, Inc. (BCI), and Bredero Consulting, Inc. (Consulting), should not be included in a combined report with EBB Holding Company, Inc. (HBB), Best Blocks, Inc. (BB), and Hokanson Building Block Co., Inc. (Aokanson), for income year 1980.

BCI owned 100 percent of Consulting and HBB. HBB, in turn, owned 100 percent of BB and Hokanson, both of which were apparently acquired by HBB during 1979. BCI is described as "a holding company and financial intermediary for its subsidiaries." (App. Br. at 2.) It provided it subsidiaries with advice and approval concerning expansion and assisted them in obtaining financing. It provided loans and capital to HBB for the acquisition and operation of Hokanson and BB. Consulting provided real estate consulting services, both for its affiliates and unrelated real estate companies. It coordinated the accounting and tax planning for its two subsidiaries.

HBB is a holding company and financial intermediary for BB and Hokanson. It received funds from BCI and loaned them to BB and Hokanson on more favorable terms. BB and Hokanson both manufacture and distribute concrete blocks and other building materials.

Two individuals, Mr. Hoek and Mr. Roodenburg, served as officers and/or directors of each of the companies, except for Consulting, where Mr. Hoek was president and Mr. Roodenburg was neither an officer nor a director. The total number and identities of the other officers and directors is not revealed in the record.

During 1979, appellants allege that BCI "conducted consulting business' (App. Br. at 9) in New York and, late in the year, formed a subsidiary to carry out these activities. Appellants state that this subsidiary filed a franchise tax return in New York in 1979 and paid the minimum franchise tax. Although BCI or its new subsidiary accrued income in that year, appellants state that no taxable income was reported to New York because both corporations were on the cash method of accounting.

For 1979 and 1980, BCI filed combined reports which included its subsidiaries. Respondent determined that appellants were not entitled to file a combined

report in 1979 because none of the companies had income from sources outside California. Respondent also determined that neither BCI nor Consulting were unitary with any of the other corporations during 1980, and, therefore, could not be included in a combined report.

When a taxpayer derives income from sources both within and without California, it 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 unitary business with an affiliated corporation or corporations, the amount of business 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 569] (1951), app. dism., 343 U.S. 939 [96 L.Ed. 1345] (1952).) Corporations engaged solely in intrastate business activities have no right, at least for income for income years beginning prior to 1980, [2/] to file a combined report and be treated as a unitary business, even though they would have been considered as such had the business activities been interstate. (Appeal of The Grupe Company, et al., Cal. St. Bd. of Equal, Jan. 8, 1985; Appeal of E. Hirschberg Freeze Drying, Inc., Cal. St. Bd. of Equal., Oct. 28, 1980.)

For 1979, the question is whether appellants have demonstrated that there was sufficient out-of-state activity to permit the filing of a combined report. Appellants assert that at least one member of the affiliated

2/ Section 25101.15, enacted by chapter 390 of the 1980 statutes, permits intrastate "unitary" businesses to file combined reports for income years beginning on or after January 1, 1980. Section 25101.15 provides:

> If the income of two or more taxpayers is derived solely from sources within this state and their business activities are such that if conducted within and without this state a combined report would be required to determine their business income derived from sources within this state, then such taxpayers shall be allowed to determine their business income in accordance with Section 25101.

group engaged in business activity in New York during 1979. However, no facts are presented which support this assertion. Appellants state that their out-of-state activities "included analysis of potential New York real estate activities" (App. Br. at 9-10), but we are not told what that involved or what other activities were also engaged in. We also have no idea where these services were performed or by whom. Appellants' own report of their activities in that year as shown on schedule R (Resp. Ex. C), does not support their assertion of out-of-state activities, since it reveals that they had no property, employees, or sales anywhere except in California. Appellants also state that they were subject to New York state franchise tax and filed a return for 1979 with that state, paying the statutory minimum tax. Voluntary filing and payment of the minimum tax, however, does not show entitlement to file a combined report unless it is accompanied by actual enyagament in business activity, at least sufficient for nexus, in that state. (Cal. Admin. Code, tit. 18, reg. 25122, subd. (b)(1) (art. 2.5).) Appellants have failed to prove that any of the affiliated corporations engaged in such business activity in New York in 1979. We must conclude, therefore, that respondent was correct in disallowing a combined report for 1979.

For 1980, appellants apparently filed their combined report as an "intrastate unitary business" pursuant to section 25101.15.[3/] The question for that year is whether BCI and/or Consulting were unitary with any of the other affiliated corporations.

The California Supreme Court has determined that a unitary business is definitely established by the existence 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 [111 P.2d 334] (1941); affd., 315 U.S. 501 [86 L.Ed. 991] (1942).) The California supreme Court has also held that a business is unitary when the operation of the business within California contributes to, or is dependent upon, the operation of the business outside the state. (Edison California Stores, Inc. v. McColgan, supra, 30 Cal.2d at p. 481.) To demonstrate the existence of a single unitary business, it is necessary to do

3/ See footnote 2, supra.

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 involved. (Appeals of Santa Anita Consolidated, Inc., et al., Cal. St. Bd. of Equal., Apr. 5, 1984.)

Appellants point to the interlocking officers and directors, intercompany financing, and the provision of services to the other affiliates by BCI and Consulting as support for their'contention of unity existed among these corporations. Upon examination of these factors, we must conclude that appellants have not shown that they resulted in sufficient functional integration for a finding of unity.

The factors relied upon by appellants will often exist in any group of affiliated corporations, regardless of how functionally unrelated they may be. Appellants' burden then, is to show how these factors distinguish their group of corporations as a functionally integrated enterprise, rather than a mere group of commonly owned corporations. Appellants have failed to do this. Their situation is, in many respects, similar to that of the appellants in the Appeals of Santa Anita Consolidated, Inc., et al., supra. Our discussions in that opinion regarding the lack of significance we attached to the common management, intercompany financing, and centralized services relied upon by the appellants in that appeal are equally applicable here and we incorporate them by reference.

We are impressed by the fact that there were many opportunities for functional integration among the members of this affiliated group. If the opportunities were availed of and sufficient integration achieved, it has not been demonstrated in the record before us. Although there was certainly extensive financial direction and control exercised in this group of corporations, the failure to demonstrate that there was significant functional or operational integration compels us to conclude that these corporations were not engaged in a unitary business during 1980. 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 protests of Bredero California, Inc., Bredero Consulting, Inc., and Best Blocks, Inc., against proposed assessments of additional franchise tax in the amounts and for the income years as follows: Bredero California, Inc.-- $2,468 for income year 1980; Bredero Consulting, Inc.-- $50,968 for the income year 1980; and Best Blocks, Inc.-- $8,628 for the income year 1979, be and the same is hereby sustained.

Done at Sacramento, California, this 6th day of May, 1986, by the State Board of Equalization, with Board Members Mr. Nevins, Mr. Collis, Mr. Bennett, Mr. Dronenburg and Mr. Harvey present.

Richard Nevins, Chairman

Conway H. Collis, Member

William M. Bennett, Member

Ernest J. Dronenburg, Jr., Member

Walter Harvey*, Member

*For Kenneth Cory, per Government Code section 7.9