BEFORE THE
CALIFORNIA UNEMPLOYMENT INSURANCE APPEALS BOARD

In the Matter of:

CAPITOL INDUSTRIES, INC.
(Petitioner)

DEPARTMENT OF HUMAN RESOURCES DEVELOPMENT

PRECEDENT
TAX DECISION
No. P-T-158
Case No. T-72-18

The petitioner, Capitol Industries, Inc., has appealed from Referee's Decision No. BK-T-4436, which denied its petition for review.

STATEMENT OF FACTS

During the entire calendar year of 1969 and the first two calendar quarters of 1970, there were three separate corporations in existence which were registered with the Department as three different employing units. Each corporation was assigned its own contribution rate for the calendar year 1969, and then later for the calendar year 1970, based on its own separate employment experience. Each corporation separately reported contributions and wages under its own account number.

The first of these corporations was Capitol Records, Inc., which had been registered as an employer and reporting contributions under its account number, 003-7783, ever since the second quarter of 1942. The second corporation was Capitol Records Distributing Corporation which had been registered as an employer and reporting contributions under its account number, 039-9473, ever since September 1, 1948. The third corporation was Capitol Industries, Inc., which had just registered as an employer and begun reporting contributions under its account number, 198-9967, as of the beginning of the calendar year 1969.

On January 1, 1969, the first and second corporations became wholly owned subsidiaries of the third one which we will hereafter refer to as the parent corporation. Either on that date or on some subsequent one not later than June 25, 1970, this corporate family was formed into a unitary type of economic organization that is considered to be but a single employing unit

under the provisions of Unemployment Insurance Code section 135. The exact date when this unity of enterprise was established in the operation of the business cannot be pinpointed with certainty from the evidence in the record, but the Department, after investigation, concluded. that this also occurred as of January 1, 1969.

On June 25, 1970, the parent corporation made two written requests of the Department:

1. It requested permission to report all contributions and wages paid by the first corporation under its own (the parent's) account number, 198-9967.

2. It requested that the reserve account of the first corporation be consolidated with its own account.

In support of its requests, the parent corporation pointed out to the Department that:

> ". . . Capitol Records, Inc. is a wholly owned subsidiary of Capitol Industries, Inc. Both corporations are engaged in related fields of entertainment.
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> "Capitol Industries, Inc. directs and controls the activity of Capitol Records, Inc. in the operation of the businesses in California. Centralized management and control are exercised over the personnel of the corporations. Personnel are transferred between the corporations and service longevity and accrued benefits are retained with no distinction made as to where or for whom the work was performed.
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> "The two organizations are financially integrated and funds flow in both directions between the parent corporation and its subsidiary. Capitol Records, Inc. is, however, under the financial control of Capitol Industries, Inc. Because of this unity of ownership, management decision making and labor relations, the two corporations should be considered a single employing unit for Unemployment Insurance purposes."

At this time, June 25, 1970, no mention was made of the second subsidiary corporation, Capitol Records Distributing Corporation, either in connection with the reporting of contributions and wages, or in regard to consolidation of accounts. However, at the hearing before the referee, the parties agreed that the second corporation should have been included in the requests; that whatever was said about the first corporation was also true of the second one; that it, too, had a unity of ownership, management and operations with the parent and first corporations; and that its omission in the requests was purely an error.

A little more than a month later, specifically on July 31, 1970, the two subsidiary corporations were merged. In the merger the separate legal existence of the first corporation ended. The surviving second corporation has continued to be a wholly owned subsidiary of the parent corporation operated in the same way.

On August 5, 1970, less than a week after the merger, the parent corporation asked to amend its requests of June 25, 1970. It pointed out that the first corporation had been merged into the second, and that the unity currently existing was only between the parent and the second corporation.

On August 13, 1970, the Department completed its investigation into the relationships between the three corporations. It found that the first and second corporations had become wholly owned subsidiaries of the parent corporation on January 1, 1969. It concluded that effective as of that date they had become a single employing unit for the purposes of the code because of unity of enterprise.

On September 2, 1970, the Department issued a written ruling to the parent corporation to this effect. It notified the parent corporation that it had consolidated reports filed for prior years by the three corporations. It enclosed with the ruling an Amended Contribution Rate Notice establishing a 2.2 percent employer tax rate for the calendar year 1970 for the single employing unit.

Application of the 2.2 percent rate to the contribution returns filed by the three corporations for the first and second calendar quarters on 1970 developed a credit of $9,086.27 in favor of the consolidated employing unit. The parent corporation, however, was of the opinion that the correct computation of the 1970 rate for the unit should be 1.4 percent. On September 11, 1970, the parent corporation requested reconsideration of the

ruling of September 2, 1970 indicating that it wanted to protest the amended rate notice if reconsideration was denied.

The basis for protest was the inclusion of the employment experience of the first corporation in the computation of the amended 1970 rate, which the parent corporation considers to be erroneous for two reasons:

1. Because that corporation ceased to exist after July 31, 1970, and the Department had been advised of that fact prior to the issuance of its ruling on September 2, 1970, and

2. Because such inclusion forces the successor employer to accept the experience of a predecessor employer in violation of its right under the code to accept or refuse such experience.

Four days later, on September 15, 1970, the parent corporation formally protested the amended contribution rate. On November 10, 1970, the Department denied the protest. On November 12, 1970, the parent corporation filed the petition for review that is before us in this proceeding.

REASONS FOR DECISION

Under the provisions of sections 977 and 978 of the Unemployment Insurance Code, the employer tax rate for a particular year is established upon the basis of the "net balance of reserve" (as defined in code section 904) properly in the employer's reserve account as of the applicable "computation date" (as defined in code section 902). In the matter at hand, the applicable "computation date" for establishing the petitioner's 1970 employer tax rate was June 30, 1969. The amount of the "net balance of reserve" properly in the petitioner's account as of that date will not be affected by the fact that the legal existence of the first corporation ceased some thirteen months afterward on July 31, 1970.

Under such circumstances, this subsequent cessation of the first corporation's existence is of no legal significance in making a correct computation of the petitioner's employer tax rate for the calendar year 1970. This being so, it follows that the further fact that the Department was also aware that the first corporation had ceased to exist before it issued its ruling

on September 2, 1970 is equally of no legal significance for this purpose. Accordingly, we must hold that the first position advanced by the petitioner in support of its protest is without merit.

The real question is raised by the petitioner's second position. In computing the petitioner's amended 1970 employer tax rate, the Department included in the petitioner's "net balance of reserve," experience that had previously been accumulated in the separate reserve account of the first corporation. Is the petitioner being forced by this inclusion to accept into its reserve account the experience of a predecessor employer in violation of a right upon its part under the code to accept or reject such experience?

In order to resolve this question, the experience of the first corporation which the Department used in the computation of the petitioner's amended 1970 employer tax rate, must be divided into two component parts:

The first component will consist of that portion of this experience which was accumulated in the first corporation's reserve account while it was truly a separate employing unit (and employer). This was prior to the time that the unity of enterprise between the corporations came into existence. That component of the experience was <u>properly</u> accumulated in the first corporation's reserve account, and cannot be placed in the petitioner's account except by compliance with the <u>transfer</u> of reserve account provisions of the code.

The second component will consist of that portion of the experience which was accumulated in the first corporation's reserve account after it became a part of the single employing unit that represented the whole organization. This component was <u>erroneously</u> accumulated in the first corporation's reserve account. It properly belongs in the account of the single employing unit that represents the whole enterprise.

The Department merely corrected an error that it had made in its accumulation of experience when it included this second component in the petitioner's "net balance of reserve" for the computation of its amended 1970 employer tax rate. Such a correction of error is not a transfer of reserve account within the meaning of the concepts of the Unemployment Insurance Code. A transfer of reserve account involves the movement of employment experience <u>properly</u> accumulated in one account to another account for the special reasons and in accordance with the special procedures set forth in code sections 1051 through 1060.

The Department's authority to correct an error in an account stems from its duty under code section 1026 to maintain the account. Impliedly, this includes a duty to maintain it correctly. Only to the extent that the law itself restricts the Department's authority to correct an error that it finds, should it refrain from doing so.

The provisions of code section 1036 do restrict the Department's authority to correct an error that it finds in a statement of account that it has previously furnished to an employer. In order to correct such an error, the Department must give notice of the correction to the employer prior to the expiration of the rating period (i.e. calendar year) to which the particular statement relates. Because of this restriction the Department is not able to correct a tax rate which it has assigned to an employer for any year that is prior in time to the one in which the notice of correction is given.

There is nothing in this, however, that imports that the Department may not correct an error which it finds that it has made in the maintenance of the account itself. Such a correction is necessary in order that the error will not continue to be perpetrated onward indefinitely into the future statements that will subsequently be furnished to the employer. Without such a correction the employer's future tax rates would no longer really be computed in accordance with the true merit rating principles that the code prescribes.

What the petitioner refers to as its right under the code to accept or refuse the experience of a predecessor employer, really refers to the affirmative step of making an application which is generally required of a successor employer before the Department can make a transfer of reserve account. However, we have already pointed out why there is no transfer of reserve account involved in the action which the Department took in including in the petitioner's "net balance of reserve," this second component of the first corporation's experience which really belonged to the petitioner. Accordingly, there was no action by the petitioner under the transfer of reserve account provisions of the code that was a necessary prerequisite before the Department could take the action that it did in regard to this component of the experience.

Thus, the second component of the first corporation's experience was properly included in the computation of the petitioner's amended 1970 employer tax rate, but how about the first component of that corporation's experience - the part that was properly accumulated in the first corporation's reserve account while it was still truly a separate employing unit? We have already pointed out that no error was involved in this accumulation. The only

way that this component could have become a part of the petitioner's reserve account, was by some action properly taken under the transfer of reserve account provisions of the code.

Considering the matter in the light of those provisions, we note that the same event which brought about the creation of a unity of enterprise, also had the effect of constituting an "acquisition" by a successor employer of the business of a predecessor employer within the meaning of code section 1051. Following that event, there was also the necessary continuation of the business by the successor which code section 1051 requires. Also following that event, the petitioner continued through error or inadvertence to file contribution reports and pay contributions for the account and at the rate determined by the Department to apply to the first corporation.

Under the mandatory provisions of code section 1054, such reporting and payment are deemed to be in lieu of an application for transfer of reserve account. They are given the same effect as though a specific application for transfer had been filed during the 90-day period beginning with the date of acquisition. The Department is then required under code section 1052 to transfer the employment experience of the predecessor to the successor as of the date of the acquisition for the purpose of determining the contribution rate of the latter after such acquisition as if the operations of the predecessor had at all times been carried on by the successor.

Accordingly, there was a proper transfer of reserve account which brought the first component of the first corporation's experience into the petitioner's reserve account effective as of the date that the first corporation became a part of the petitioner's unitary organization, and with the effect as if it had always been a part of the petitioner's own operations. Unfortunately, however, the record before us does not clearly establish that this event occurred during the year 1969. If it did, then the petitioner's amended 1970 employer tax rate has been properly computed.

This is because, under code section 1052, the petitioner's rate must be determined after the acquisition with the same effect as if the operations of the predecessor had at all times been carried on by the successor. However, if the acquisition took place during the year 1970, then code section 1060 prevents any change in the rate for that year resulting from the transfer, from becoming effective before the beginning of the calendar quarter next succeeding the effective date of the transfer, i.e., the date of the acquisition.

Accordingly, if the "acquisition" actually took place during the first quarter of 1970, the Department's computation of the petitioner's amended 1970 employer tax rate would be in error for the first quarter (only) of that year. Likewise, if the "acquisition" took place during the second quarter of 1970, the Department's computation of this rate would be in error for the first two quarters of that year. Subject to these contingencies, the petitioner's amended 1970 employer tax rate has been correctly computed in accordance with the provisions of the code.

Upon the basis of the information which the petitioner presented, the Department, after investigation, concluded that the single employing unit came into existence because of a unity of enterprise on January 1, 1969. The petitioner presented no evidence to the contrary at the referee's hearing, although the opportunity was available for it to do so. Upon the principle that in this type of proceeding, the burden of proof is on the petitioner, we hold that the petitioner has failed to show any error in the computation of its amended 1970 employer tax rate. Accordingly, its protest must be denied in its entirety.

DECISION

The decision of the referee is affirmed.

Sacramento, California, December 6, 1973.

CALIFORNIA UNEMPLOYMENT INSURANCE APPEALS BOARD

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