BEFORE THE
CALIFORNIA UNEMPLOYMENT INSURANCE APPEALS BOARD

In the Matter of:

NATION FLIGHT SERVICE, INC.,
and Others
(Petitioners)
(See Appendix)
[Appendix removed in accordance
with California Code of Regulations,
title 22, section 5109(e)]

PRECEDENT
TAX DECISION
No. P-T-358
Case No. T-76-6
and Others

DEPARTMENT OF BENEFIT PAYMENTS

Office of Appeals Nos. SF-T-6648
and Others
(See Appendix)
[Appendix removed in accordance
with California Code of Regulations,
title 22, section 5109(e)]

The Department of Benefit Payments (hereinafter "Department") has appealed from a consolidated decision of an Administrative Law Judge which granted the petitions for reassessment of the following corporations (hereinafter "petitioners"):

1. Nation Flight Service, Inc.
2. Torvick Sales Co., Inc.
3. Torvick Investment Co., Inc.
4. Torvick, Inc.
5. Hone Manufacturing Co.

STATEMENT OF FACTS

Robert C. Torvick is currently, or was during the period to which the assessment relates, a shareholder, director, and corporate officer of the petitioners and of Torvick Management Consultants (hereinafter "TMC"). With respect to the period in question, Torvick was carried on the payroll of TMC.

The Department, alleging that services were rendered by Torvick to each of the petitioners, has allocated the sums paid Torvick to each of the petitioners, and assessed them on their supposed share of Torvick's salary. In order to determine the validity of the assessment, we must briefly review the activities of each petitioner, TMC, and Torvick.

Nation Flight Service, Inc. is in the business of buying, selling, and leasing Cessna aircraft; providing flight instruction; operating a shop; and selling aircraft fuel. In either 1970 or 1971, Torvick purchased one-half of the outstanding stock of National Flight Service, Inc. After holding the stock for three months, Torvick sold his interest to TMC for what he paid. In 1973 TMC sold its shares for approximately a $6,000 profit. During the time that Torvick or TMC had an interest in this corporation, Torvick served as vice-president of the corporation and was a member of the Board of Directors. The president of Nation Flight Service, Inc. testified that Torvick was not familiar with the business of the company and thus was not involved in the day-to-day management of the firm.

Torvick Sales Co., Inc. (hereinafter “Sales Co.”) is the Volvo and Fiat agency in Santa Rosa. Torvick owns 60 percent of the stock, is chairman of the Board of Directors, and serves as president of the corporation. The general manager of Sales Co. operates the day-to-day affairs of the business; he hires the personnel, sets the prices of automobiles, approves trade-ins, signs conditional sales contracts, and order automobiles from the distributors. Torvick visits the company once or twice a month.

Torvick Investment Co., Inc. (hereinafter “TIC”) is the Datsun agency in Santa Rosa. Torvick owns 60 percent of the stock, is chairman of the Board of Directors, and serves as president of the corporation. The vice-president and new car sales manager of TIC testified that Torvick does not maintain an office on the premises and has short visits to the business once a week or once a month. The day-to-day operation is conducted by the vice-president who engages employees, sets automobile prices, makes credit decisions, and orders cars.

Torvick, Inc. is the Mercedes-Benz agency in Santa Rosa. Torvick owns all the stock, is chairman of the Board of Directors, and serves as president of the corporation. Again Torvick does not maintain an office on the premises and visits the business for short periods - perhaps three times a week for about 15 minutes each visit. Also, once again, there is a general manager with full authority to conduct the usual business affairs.

This company is the successor of Joe Torvick, Inc., which the Department initially assessed but later dismissed.

Hone Manufacturing Co. is located in the Los Angeles area and manufactures overdrive transmission units. Torvick purchased the stock of Hone in July 1972 and became chairman of the Board and president of the corporation. Since the firm is not based in the Santa Rosa area and since Torvick does not have a background in engineering or manufacturing, there is a manager who hires personnel, sets prices, and generally runs the business. Torvick visits the premises on an irregular basis.

TMC is wholly owned by Torvick who is chairman of the Board and president of the corporation. In addition to Torvick, TMC has seven employees - a controller, business manager, secretary, systems manager, computer operator, and key punch operator. It provides management services for both the petitioners and others. In 1971 it entered into separate contracts with each petitioner whereby TMC in return for a monthly fee agreed to provide the following services:

1. Bookkeeping, including the preparation of financial statements;

2. The selection of a CPA to conduct periodic audits and provide tax advice and attorneys to provide routine legal advice;

3. The installation and supervision of business office procedures and controls;

4. Sales and service promotion and control programs;

5. The conception and design of advertising programs;

6. Planning and development of future business growth;

7. Representation in contract negotiations and disputes;

8. Selection of insurance agents and personnel to oversee the company's insurance needs.

The agreement states that the personnel used by TMC in the performance of its duties under the contract shall be either employees of TMC or independent contractors. The terms of the agreements are one year with the provision that the term shall be automatically extended one year unless ten days before the expiration of the year either party in writing revokes the contract. Except for Nation Flight Service, Inc., the petitioners' contracts with TMC remained in effect on the hearing date.

Management from both the petitioners and TMC testified that during the term of the agreements there was practically daily contact between TMC and the operating corporations, since TMC relies upon management of the petitioners to supply the information necessary to perform the above-listed services. In addition to the services in the agreement, TMC maintains and collects the petitioners' accounts receivable, so TMC personnel must keep in close contact with management of the petitioners. While TMC provides advice regarding such matters as budgeting, advertising, and insurance coverage, each operating company itself makes the final decision on such matters. There was, however, no testimony that any of the petitioners had ever disregarded the advice of TMC. Moreover, we note that a bill from TMC to "Inter-Mtrs Inc." for June 1973 showed on the masthead of the statement the insignias of Datsun, Mercedes-Benz, Volvo, Fiat, Nation Flight Service, and Hone Manufacturing Co.

After TMC's services were secured, the petitioners no longer paid Torvick a salary or included him in their pension plans. Thereafter, Torvick was paid directly by TMC and became a member of its pension plan. The total amount paid Torvick after he was removed from the petitioners' payrolls and placed on TMC's remained about the same.

Torvick testified that in 1970 he found that as his business affairs were expanding rapidly it was no longer possible to personally manage the business. Therefore he formed the management company and turned over the day-to-day management to subordinates who could give operations the close attention required. As a shareholder of and officer in the petitioners, he understandably continued to be concerned with the successes of the ventures, so remained as an authorized person on the petitioners' bank accounts; continued to sign routine reports, such as tax returns, prepared by the petitioners; and occasionally attended dealers' meetings. Some loans to the petitioners were guaranteed by Torvick and other shareholders personally, as required by the lenders.

REASONS FOR DECISION

The Unemployment Insurance Code requires employer contributions with respect to wages paid for employment up to the maximum amount established by law (sections 930 and 976). To be liable for contributions with respect to an individual it must be shown that the individual was in employment with and received wages from an employer. Thus, we will examine in order (1) whether Torvick was in the employ of the petitioners, and (2) whether he received wages from them.

"Employment" is defined as services rendered by an employee (section 607). The term "employee" includes a corporate officer (section 621(a)). Torvick, as a corporate officer, was then in employment with each of the petitioners. Hence, we answer the first question in the affirmative.

For the balance of this decision, we will consider whether Torvick received wages from the petitioners. “Wages" is defined as remuneration for personal services (section 926). The Department contends that services had been rendered for the petitioners despite the existence of TMC. The petitioners contend that all of Torvick's services were rendered for TMC.

In considering this question we shall examine the following issues:

(1) Is the unity of enterprise theory applicable;

(2) May the separate corporate existence of TMC be disregarded;

(3) Did Torvick perform services for the petitioners.

(1) IS THE UNITY OF ENTERPRISE THEORY APPLICABLE

We will first examine the applicability of the unity of enterprise theory. If the petitioners and TMC are regarded as one unified business enterprise, additional contributions will not be due with respect to the amount paid Torvick since TMC has reported Torvick as its employee and paid contributions up to the maximum wage limitation (Appeals Board Decision No. P-T-19).

Under the unity of enterprise doctrine the employing unit upon which basis contributions are collected is considered to include the entire business enterprise of the unit, irrespective of the form under which the unit is organized. The doctrine was originally developed by the California appellate courts in cases where one employing unit was alleged to have succeeded another when there had been a mere change in legal form but no change in operation. In Crook v. Department of Employment (1947), 78 Cal. App. 2d 208, the court held that a new entity was not created when a decree of distribution of a decedent's estate was made where there had been no change in the business itself or in the relationship of the employees of the business to the employer. In McHenry, Inc. v. CESC (1952), 112 Cal. App. 2d 245, the court found there was no change in the employing unit when former partners incorporated their business where there was no change in the type of business or the location of the business after incorporation. Similarly, in McIntosh v. Director of Employment (1956), 145 Cal. App. 2d 628, the court failed to find a creation of a new employing unit when, after the death of one of the partners, the partnership business was continued without change by the surviving partner and the widow of the deceased partner.

The courts in each of these cases stated that the change of organizational form did not lead to the creation of a new enterprise. This is known as the vertical concept of unity of enterprise.

Since 1963, the Board has in a series of cases extended the doctrine to affect organizations on a horizontal basis, as well. Thus, in Tax Decisions Nos. 2354 and 2370, and Appeals Board Decisions Nos. P-T-19 and P-T-33, existing business organizations were considered a single employing unity.

In Walra, Inc. (Tax Decision No. 2354) a partnership and a separately incorporated store were deemed to be one employing unit. The entire operation had the same trade name, ownership, management, purchasing, and pricing. Personnel were transferred from unit to unit in accordance with overall policy, and new units were opened and old ones closed on the basis of overall operation. In Seaboard Finance Company (Appeals Board Decision No. P-T-19) and Bethlehem Steel Corporation (Appeals Board Decision No. P-T-33) a parent company and its wholly owned subsidiary companies were considered one employing unit. Seaboard Finance Company and its subsidiaries had the same board of directors and corporate officers; operated under a common name in the same type of business; used the same operating manual; followed the same business policies; maintained central payroll records; followed common vacation policies; provided common retirement policies; and freely transferred personnel within the organization.

In Warrington Lumber Company (Tax Decision No. 2370) there was a single employing unit of Ward and Harrington Lumber Company, Warrington Lumber Company, and Public Mill and Lumber Company. These companies functioned in a highly integrated manner from the same headquarters. Trussco, Inc., however, which manufactured roof trusses rather than supplying the building needs of developers, and thus operated a business distinct from the other corporations, was not included in the same employing unit despite the fact it was owned by the same interests as those so included. Also, Trussco was located in a different area, paid its employees from its separate payroll account, and followed different management policies.

The past decisions of this Board have pointed out the foundations of the doctrine and found instances in which it is applicable. However, partly because of the paucity of the experience with the horizontal concept of the doctrine and the nature of the cases which had come before us, the Board did not explicate the necessary elements of the doctrine. Since the doctrine was applied, the following nonprecedent decisions have been issued:

Verner Farms, et al (T-65-33 et al)
Sand Door & Plywood Co. of Fresno, et al
(T-67-16 et al)
Neill Engineers, Inc., et al (T-67-41 et al)
McAnally Egg Enterprises, et al (T-67-47 et al)
Armored Transport, Inc., San Diego Division, et al
(T-68-30 et al)
Servisoft of Orange Coast (T-68-36)
Gabriel Container Co., et al (T-70-59 et al)
Compatibility Services, Inc., et al (T-70-75 et al)
General Can Company (T-72-71)
Professional Nurses Bureau, Inc. (T-72-85)
Envirofood Personnel Services, Inc., et al
(T-73-45 et al)
Purity Oil Sales, Inc. (T-75-5)

Armed with this experience, we are ready to assess what evidence is necessary to establish that a functioning organization is a single enterprise.

In doing so, we are mindful of the analogous doctrine utilized in determining the taxable income of a California Corporation. When a corporation engages in multi-state business, including business in California, and the business is unitary, there must be an allocation of the firm's total income to determine that portion which is derived from and attributable to the California corporation (Revenue and Taxation Code, section 25101 and Article 2 [commencing with section 25120], Chapter 17, Part 11, Division 2).

In the leading case of Butler Brothers v. McColgan (1941), 17 Cal. 2d 664, the California Supreme Court found a unitary business where there was common ownership; central purchasing, advertising, accounting, and management; and a unity of operation. On page 678 the court stated as follows:

> ". . . it is our opinion that the unitary nature of appellant's business is definitely established by the presence of the following circumstances: (1) Unity of ownership; (2) Unity of operation as evidenced by central purchasing, advertising, accounting and management divisions; and (3) unity of use in its centralized executive force and general system of operation. . . ."

In Butler Brothers, separate divisions of an Illinois Corporation were found to be a unitary business enterprise. The doctrine was extended in Edison California Stores v. McColgan (1947), 30 Cal. 2d 472, to operations of a parent and subsidiary corporations. The court on page 481 of the opinion answered the criticism that it was guilty of ignoring the separate corporate identity of the taxpayer:

> "The ascertainment of income by the apportionment method is not necessarily a disregard of the corporate entity nor an extension of the provisions of the statute by implication. . . ."

In summary, if there is a unity of ownership, operation, and use, the business is a unitary business operation, irrespective of the organization of the business into separate corporations.

In Chase Brass and Copper Company v. Franchise Tax Board (1970), 10 Cal.App.3d 496, the court examined the meaning of the terms "unity of operation" and "unity of use." At issue was whether a wholly owned subsidiary of Kennecott Copper Company was unitary with the parent corporation and other Kennecott subsidiaries involved in the exploration for copper, its mining, fabrication, manufacturing, and the sales of copper goods.

With respect to the unity of operation, the court stated on page 502:

> "Although there is not a clear demarcation between what is 'operation' and what is 'use,' in general it may be said that the acts falling within the category of 'operation' are the staff functions, and those within 'use' are the line functions."

The court explained "Unity of Use" as follows on page 504:

> "Unity of use relates to executive forces and operational systems. . . ."

In deciding whether the staff functions of the companies were unitary, the court considered such matters as the purchase of items other than copper (especially insurance protection), advertising, accounting methods, legal advice, financing of repairs and the retirement plan for salaried employees. Of major importance in determining if the line functions of the companies were unitary was the integration of executive forces.

In our nonprecedent decisions we have likewise found that there was a unified business enterprise when the same individual or group owned or controlled the various organizations; there was centralized management; and the operation of the businesses was coordinated. For instance in both Verner Farms and McAnally Farms the separate farms were operated as one integrated unit. On the other hand, although Gabriel Construction Company and its subsidiaries were jointly owned and in complementary operations, the lack of single management precluded a finding that there was a single employing unit.

In summary, to establish a unity of enterprise, the following unities must be established:

(a) Ownership. It is not necessary that the same individual own exactly the same percentage of each organization. However, a majority interest in each organization must be in the hands of one individual or group of closely associated individuals.

Here we would consider that this unity was present since Torvick owned or had a majority interest in all the corporations.

(b) Operation. There must be central control over each of the firms. Evidence of this factor would be common management, personnel policies, operation manuals, pricing, collections, and financing.

In the present instance, while there was some inter-corporate coordination, each company had its separate management, corporate personnel were not transferred, and the corporations had distinctive management policies. Thus, we do not believe there was the requisite unity of operation.

(c) Use. The organization must be used for a common purpose. Each entity should be coordinated with the entire operation. Evidence of this unity is common advertising and name and organization-wide planning as was found in Walra, Inc. and Seaboard Finance Company. A good example of the type of coordination required is in Warrington Lumber Company where the three corporations which were one enterprise had complementary operations: Ward and Harrington Lumber Company catered to the building material needs of small tracts, commercial buildings, individual homes, and the drop-in trade; Warrington Lumber Company supplied the needs of large tract developments; and Public Mill and Lumber, Inc. supplied trucks, forklifts, cranes, hoists, and other items of equipment used by the other companies.

> Here, at least three of the organizations were in competition with each other. Moreover, three firms are automobile agencies, one firm manufactures overdrive transmissions, and one firm is in the airplane business. There is no apparent coordination between them, as there was between the entities in the Chase Brass and Copper Company case. Hence, this unity is also lacking.

We are thus constrained to conclude in the instant case that the petitioners and TMC cannot be considered a single employing unit.

(2) MAY THE CORPORATE EXISTENCE OF TMC BE DISREGARDED

Like the unitary nature of business doctrine, the unity of enterprise doctrine recognizes the separate existence of the legal entities which comprise the enterprise. As we stated on page 18 of Seaboard Finance (P-T-19 supra):

> "It is the functioning organization, then, that becomes the 'employing unit' under the provisions of code section 135. Such an organization may be an aggregative unit like an association or joint venture, and in the same way it may be an aggregation of corporate entities instead of individuals, in which event these entities are the legal persons who are to be recognized as the responsible elements of the unit. To regard corporations as such elements is not to disregard their separate legal entity but merely to acknowledge the business use that is being made of it."

There are times when the separate corporate existence is disregarded. If the separate existence of TMC were to be disregarded, the petitioners would be regarded as having employed Torvick himself when they entered into the management agreement. In which case, Torvick would have rendered services to them directly, and the amounts he was paid would have been wages received from the petitioners.

The separate existence of a corporation will be disregarded if it is established that the corporation is dominated or controlled by an individual and that the failure to disregard the entity would sanction a fraud or promote injustice (Lyons v. Stevenson (1977), ___ Cal. App. 3d ___, 135 Cal. Rptr 457). In Associated Venders, Inc. v. Oakland Meat Company (1962), 210 CA 825, 26 Cal. Rptr 806, 816 ff., there is an exhaustive survey of factors which have led courts to pierce the corporate veil. Included are such matters as the failure to segregate funds of the separate entities, the holding out by an individual that he is personally liable for the debts of the corporation, inadequate capitalization, and the diversion of corporate assets to an individual. There is no evidence of such factors in this case.

TMC operated in a manner distinct from the other corporations. Its dealings with the petitioners were at arm's length. Furthermore, there is not the slightest hint that any fraud or injustice would arise if the corporation's separate existence were recognized. For the reasons stated above, we find that TMC is not the alter ego of Torvick.

(3) DID TORVICK PERFORM SERVICES FOR THE PETITIONER

The final issue to be addressed is whether irrespective of the doctrines of unity of enterprise and alter ego Torvick rendered services for the petitioners. The Department argues that in resolving this question we must realistically consider the nature of services that a corporate officer performs. On pages 2 and 3 of its brief, the Department states:

> ". . . In his capacity as an officer of a corporation, an individual must use his efforts to keep the corporation going and perform functions that are necessary to the business life of the corporation. With regard to an automobile dealership, a corporate officer certainly need not carry a wrench, change tires, wash windows, personally sell automobiles, personally purchase automobiles, hire and fire salesmen or clerical staff; it is an officer's function to see that these things are done by the best management means for the wellbeing of the corporation. The simple hiring of a person to see that these functions are carried out is a very important service to a corporation."

The Department does not cite any court case or Board decision that would substantiate its contention that merely because the shareholder/officer appoints general managers, follows his investment, signs routine business reports, and arranges financing, that he is thereby rendering service as an officer.

The Department's "Answer to the Petitions for Reassessment" refers to our decisions in Connecticut Fire Insurance, et al (Tax Decision No. 1455) and in Tanner Motor Tours, Ltd., et al (Tax Decision No. T-66-77 et al). The decision in Connecticut Fire Insurance Company was specifically disapproved in Seaboard Finance Company (see page 15 of the decision and Appendix B). Also, the holding in Tanner Motor Tours is suspect since that decision was issued prior to Seaboard and is premised on the belief that the unity of enterprise doctrine applies only in a successor-predecessor relationship.

More to the point is the well reasoned Revenue Ruling 74-390, 1974-32 Internal Revenue Bulletin 14. The Internal Revenue Service ruled that for the purposes of, inter alia, the Federal Unemployment Tax Act, operating corporations are not liable for contributions with respect to officers who perform only minor ministerial functions for them and are paid by a management corporation for services performed for it. In the Ruling the Service states:

> "In determining whether services actually performed by a corporate officer in that capacity may be considered to be of a minor or nominal nature the character of the services, the frequency and duration of their performance, and the actual or potential importance or necessity of the services in relation to the conduct of the corporation's business, are the primary elements to be considered. Thus, occasional, routine signing of documents, presiding over or attendance at infrequent meetings, and similar isolated or noncontinuous acts having no significant bearing or effect on the day-to-day functioning of the corporation in the conduct of its business, will be considered, as a general rule, to be services of a minor or nominal nature."

We agree with the petitioners that Torvick's services were rendered for TMC for which he was paid and on which service contributions have been collected. We do not regard the occasional duties performed directly for the petitioners to subject the payments to him to further taxation.

DECISION

The decision of the Administrative Law Judge is affirmed. The petitions for reassessment are granted.

Sacramento, California, May 31, 1977.

CALIFORNIA UNEMPLOYMENT INSURANCE APPEALS BOARD

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