



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal)
)
of)
HALLIBURTON OIL WELL CEMENTING)
COMPANY)

Appearances:

For Appellant: Mackay; McGregor, Reynolds & Bennion
Attorneys at Law

For Respondent: Burl D. Lack, Chief Counsel;
Crawford H. Thomas, Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to Section 25 of the Bank and Corporation Franchise Tax Act (now Section 25667 of the Revenue and Taxation Code) from the action of the Franchise Tax Board on the protests of Halliburton Oil Well Cementing Company to proposed assessments of additional tax in the amounts of \$4,511.50, \$5,980.78 and \$6,450.13 for the income years 1943, 1944 and 1945, respectively.

Appellant, a Delaware corporation with its principal office at Duncan, Oklahoma, does business at approximately 150 locations in various states. It qualified to do business in California and commenced doing business within this State in January, 1934. It is primarily engaged in the servicing of oil wells, and two of these services, the cementing of oil wells and the testing of oil wells, produce the major part of its revenue. In addition to these activities Appellant manufactures, purchases and sells a variety of oil well supplies and equipment. The manufacturing is done in Oklahoma and Texas, and the sales are made by the various branches.

Appellant maintains general offices, manufacturing plants, and laboratories at Duncan, Oklahoma. The officers of the corporation, its controller, chief engineer, sales manager, purchasing agent, traffic manager, production manager, and other executives have their headquarters there. Each branch has its own local management, but local management and prices are subject to the

control of the central office. Each branch maintains some accounting records, but the major portion of customer billing is done by the Duncan office and monthly profit and loss statements are prepared at that office for each of the branches.

National advertising through trade journals is placed through the Duncan office and Appellant's catalog is published there. Research and development laboratories are maintained at Duncan where experimental and laboratory work is carried on in connection with the processes which Appellant uses in all localities. General engineering problems are discussed between local engineers and the general engineering department, and engineering schooling is provided at Duncan.

Bulk cement used in cementing oil wells is purchased locally by each branch, as are some of the other supplies and equipment purchased for resale. All of the operating equipment, together with some supplies and equipment for resale, is purchased through the Duncan office or manufactured by Appellant. Appellant operates under uniform trade names in all areas and similar equipment and operating methods are employed at all branches.

For the income years in question Appellant filed its franchise tax returns on a separate accounting basis as respects its service activities and the sale of goods other than those manufactured by it. A portion of Appellant's total "apportionable" overhead and general operating expense, however, was allocated to California in the ratio that direct operating expense within California bore to total direct operating expense. Income from the sale of goods manufactured by Appellant was allocated to California by the use of a formula composed of (1) the value of property employed in its manufacturing division, (2) the cost of manufacture and (3) sales of manufactured articles.

The returns showed a loss in California of \$14,731.31, a gain of \$2,301.42 and a loss of \$37,290.93 for the three successive years and taxes of \$21.25, \$78.25 and \$21.25, respectively, were paid. Adjusting its returns to reflect subsequent federal adjustments to net income Appellant now computes losses of \$17,732.90, \$12,058.02 and \$21,165.53 for the respective years. For the same years the corporation's net income or profit from its operations as a whole was \$2,292,627.56, \$2,830,477.34 and \$2,863,898.67, respectively,

The Franchise Tax Commissioner (now succeeded by the Franchise Tax Board) determined that all of Appellant's activities constituted a unitary business and allocated the income therefrom to sources within and without California by the use of the three factor formula consisting of property, payroll, and sales (gross revenues). The application of this formula resulted in attributing income to California in the amounts of \$133,316.29, \$178,206.85 and \$190,334.71 for the respective years, representing approximately six percent of total net income for each of those years.

Section 10 of the Bank and Corporation Franchise Tax Act (now Section 24301 of the Revenue and Taxation Code), in effect during the period here involved, provided that "when the income of the bank or corporation is derived from or attributable to sources both within and without the State, the tax shall be measured by the net income derived from or attributable to sources within this State ... determined by an allocation upon the basis of sales, purchases, expenses of manufacture, pay roll, value and situs of tangible property or by reference to any of these or other factors or by such other method of allocation as is fairly calculated to determine the net income derived from or attributable to sources within this State."

Appellant states that its activities constitute three separate lines of business:

"(a) Renting equipment, under written contracts, and furnishing skilled operators of such equipment to be employed by the oil operator or producer in the servicing of oil and gas wells ...

"(b) The purchase and sale of tangible personal property, consisting primarily of bulk cement.

"(c) The manufacture and sale of certain oil well supplies?

It contends that only the third category constitutes a unitary business subject to apportionment by formula,

As respects the first two categories of its business, Appellant argues that each branch constitutes a separate and distinct business, locally managed, incurring its own distinct costs and producing its own revenue. Computed on the basis of separate accounting, and as an average for the three years in question, the net profit from categories (a) and (b), before deducting "apportionable" central overhead and operating expenses, was approximately 13 percent of gross revenue within California, as compared to 27 percent without California,

Only if Appellant's business within this State is truly separate and distinct from its business without the State, so that the segregation of income may be made clearly and accurately, may it properly use the separate accounting method. Stated conversely, if there is any evidence to sustain a finding that the operations of Appellant within California depended upon or contributed to its entire operations, the entire business of Appellant is unitary and requires apportionment by the formula method to prevent overtaxation to the corporation or undertaxation by the State. Butler Erothers v. McColgan, 17 Cal. 2d 664, pp. 667-668.

Although we have not been furnished with detailed information concerning the nature of the centralized services furnished to its branches by Appellant, it is apparent from the magnitude of its centralized operations, and from statements contained in its catalog, that the servicing of oil wells is a highly integrated

and technical business, To a considerable extent, Appellant's success nationally is dependent upon its ability to furnish uniform scientific and technical services at oil fields throughout the country. To make these services available nationally on a competitive basis, Appellant provides, for the benefit of its branches everywhere, centralized management, centralized financing, centralized shop and manufacturing facilities, centralized research, engineering and training facilities, centralized advertising and some centralized purchasing. We think that provision of these diversified and extensive services and facilities in the manner described constitutes ample evidence that each branch operation is dependent upon and contributes to the entire operation.

As **pointed out** by the Franchise Tax Board, the Appellant itself seems to recognize the unitary nature of its oil well servicing business. Among excerpts furnished to us from Appellant's 194.2 catalog are the following:

Approximately 350,000 cementing jobs have been successfully done by the Halliburton organization. With its widely located equipment and experienced men in the field and its research and development facilities in the shops and laboratories, it has met and solved many types of cementing problems,

Halliburton cementing equipment is exclusive and is designed to perform under the most **severe** oil field conditions, To come up to Halliburton standards, the **strongest** commercial trucks are manufactured to our **specifications**. Special high pressure **pumps** and other special equipment mounted on the trucks are made in Halliburton shops,

Halliburton cementing crews specialize in oil well cementing, It is their "**trade**." Each man receives thorough training, Back of **him** are supervision and management by men long skilled in the business, The organization also includes engineers, **geologists and** chemists, trained in the fundamentals of science, who assist in overcoming special problems.

Halliburton is a large and long-established company, sincerely interested in the industry it serves. It believes in providing uniform quality of service to all operators, regardless of location of their wells. Halliburton does not, therefore, confine its activities to the boom fields where a large volume of business is to be gotten, but maintains equipment in ALL fields in order that the operator, when drilling in a remote section, may be just as sure of the same efficient service as in boom territory.

Because the importance of good cementing cannot be over-emphasized-- and because inferior cementing jeopardizes the entire investment in a well--the Halliburton organization realizes that in order to maintain leadership, it must put considerable of its earnings back into development of the science.

Chemistry, physics and mechanics are so closely interwoven in the servicing of wells that no service is complete without chemical and physical research.

The **HOWCO** laboratories stand behind the big red trucks at your wells, with an energetic and ever growing program of research.

In its efforts to establish the non-unitary nature of portions of its business, Appellant has characterized its local purchases and sales of cement as a separate business, The Franchise Tax Board, however, has stated, and it has not been denied by Appellant, that sales of bulk cement are made only in conjunction with the service of cementing oil wells by Appellant. Similarly, a separate charge designated as rental is made for equipment furnished by Appellant and used by its crews in servicing wells. While Appellant is not **precluded from itemizing** its charges in any manner mutually **agreeable** to itself and its customers, the mere separation of such **charges** does not constitute each step in the process of servicing an oil well a separate line of business,, To the contrary, it appears clear that the sale of cement and the rental of equipment are related to and a part of the single unitary business of servicing oil wells,

In support of its attack upon the formula method of apportionment of its income, Appellant **has submitted** thorough and comprehensive tables of figures which, by the use of separate accounting, demonstrate that net income from California business for the years in question was not comparable to profits earned elsewhere, The figures are used to establish that (1) sales (**gross revenues**) in California do not produce their proportionate **share** of net income (2) payrolls in California do not produce their proportionate'share of net income. and (3) the use of property in the line of business giving rise to the greatest part of the entire net income is a relatively minor and incidental factor, Thus the formula is said to produce an erroneous and arbitrary result,

This argument overlooks the fact that the use of a formula does not presuppose that the factors employed are productive of net income in the taxing State in the same proportion as they are for the business as a whole. In John Deere Plow Co. v. Franchise Tax Board, 38 Cal, 2d 214, pp. 224-225, the Court

stated that "Varying conditions in the different states wherein the integrated parts of the whole business function must be expected to cause individual deviation from the national average of the factors in the formula equation, and yet the mutual dependency of the interrelated activities in furtherance of the entire business sustains the apportionment process." In that case the variations were even greater than appear here and the formula method used by the Franchise Tax Board was sustained. Furthermore, we cannot accept the proposition that property was a minor factor in producing income where a large part of the income is derived from the furnishing of trucks and special equipment with operators in connection with the cementing and testing of oil wells.

Lastly, Appellant contends that certain income from intangible assets amounting to \$106,495.84 received by it during the years 1943 through 1945 was improperly included in allocable income by the Franchise Tax Board. The determining factor is whether the intangibles were an integral part of the unitary business. See the opinions of this Board in Appeal of Marcus-Leso-line, Inc., decided July 7, 1942, and Appeal of Houghton Mifflin Company, decided March 28, 1946. A presumption of correctness attaches to the determination of the Franchise Tax Board, and Appellant has the burden of proving it incorrect. Welch v. Helvering, 290 U.S. 111, 115; Lucas v. Kansas City Structural Steel Co 281 U.S. 264, 271. Appellant stated only that the income consisted of interest on notes, rents and royalties. It did not attempt to show that the intangibles were not a part of the unitary business, and, therefore, the Franchise Tax Board's determination in this respect must be upheld.

ORDER

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 Kalliburton Oil Well Cementing Company to proposed assessments of additional franchise tax in the amounts of \$4,511.50, \$5,980.78 and \$6,450.13 for the income years 1943, 1944 and 1945, respectively,

be and the same is hereby sustained.

Done at Sacramento, California, this 20th day of April, 1955,
by the State Board of Equalization.

J. H. O u i n n , Chairman

Paul R. Leake , Member

Robert E. McDavid , Member

Geo. R. Reilly , Member

Robert C. Kirkwood Member

ATTEST: Dixwell L. Pierce , Secretary