



**BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA**

In the Matter of the Appeals of)
 CAMPBELL CHAIN COMPANY OF)
 CALIFORNIA AND CAMPBELL REALTY)
 OF CALIFORNIA, INC.)

Appearances:

For Appellants': John F. Banker, Attorney at Law'
 For Respondent: Peter S. Pierson, Associate Tax Counsel

O P I N I O N

These appeals are made pursuant to section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of Campbell Chain Company of California and Campbell Realty of California, Inc., against proposed assessments of additional franchise taxes as follows:

	<u>Taxable year</u> <u>ended</u>	<u>Amount</u>
Campbell Chain Company of California	April 30, 1961	\$10,223.16
"	April 30, 1962	11,020.68
"	April 30, 1962	809.28
Campbell Realty of California, Inc,	April 30, 1960	984.38
"	April 30, 1961	982.73
"	April 30, 1962	422.53
"	April 30, 1962	2,236.32

Campbell Chain Company of California (hereafter referred to as California Chain) and Campbell Realty of California, Inc., are wholly owned subsidiaries of Campbell Chain Company, a Pennsylvania corporation, The parent company also owns subsidiaries outside of California, one of which manufactures chain

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In Iowa and three of which lease property to the parent and to the Iowa manufacturing subsidiary,

Prior to 1959 the products manufactured outside of this state were sold on the West Coast through the use of warehouses in California, Oregon and Washington. The finished product was shipped to these warehouses and distributed on orders solicited by salaried salesmen and independent representatives,

On May 1, 1959, California Chain commenced operations here and the parent corporation formally withdrew from the state. The parent transferred to California Chain the inventories in the West Coast warehouses and machinery was shipped to California to start the plant. Salesmen employed by the parent were transferred to California Chain and experienced shop supervisors came to California to train new personnel.

California Chain achieved its first production in the week of June 13, 1959. In that week it produced 54,000 pounds of chain. Production increased thereafter to the point that in the week of May 2, 1960, it produced 151,000 pounds. Additional finished inventory was acquired from its parent at cost. This inventory constituted 76.8 percent of California Chain's sales in the first year (income year ended April 30, 1960, taxable year ended April 30, 1961) and 14.94 percent of its sales in the second year. On a separate accounting basis, California Chain operated at net losses of \$9,636.54 and \$89,486.20 for the respective years,

All advertising for the manufacturing corporations in the Campbell group was handled by one advertising agency as one account through the parent corporation. The parent billed California Chain for this service according to the amount of the advertising placed in western publications plus a share of the advertising placed in national publications, based upon western circulation. The parent company also billed and collected, all of California Chain's accounts with its customers, and the salaries of eleven salesmen were paid by the parent and then charged to California Chain. The corporations had a number of common officers and directors. The principal managing officer of California Chain was a California resident who was not an officer of the other corporations. The parent company's top officials visited California Chain two or three times a year and their advice and counsel was always available,

Campbell Realty of California, Inc., owned the plant operated by California Chain and leased it to California Chain on a net rental basis. This was the only function of Campbell Realty.

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Respondent determined that California Chain and Campbell Realty were engaged in a unitary business with the other corporations in the Campbell group. It combined the entire income of the group and assigned a portion of **it** to this state through application of the usual formula composed of the **factors** of property,, payroll and sales,

The issues involved **in** this case **are**, first,, whether California Chain and Campbell Realty of California, **Inc.**, were engaged in a unitary business with the other corporations in the Campbell group, and second, whether *respondent* applied an appropriate allocation formula,

A business is unitary when the operation of the portion of the business done within the state is dependent upon or contributes to the operation of the business without the state. (Edison California Stores Inc. v. McColgan, 30 Cal. 2d 472 [183 P.2d 16]) A further test for determining the existence of a unitary business was first set forth in Butler Bros. v. McColgan, 17 Cal. 2d 664 [111 P.2d 3343, aff'd, 315 U.S. 501 [86 L. Ed. 991]]. If there is **unity** of ownership, unity of operation evidenced by central purchasing, advertising, accounting and management, and unity of use in the centralized executive force and general system of operation, then the unitary nature of the business is established. These tests were recently confirmed in Superior Oil Co. v. Franchise Tax Board, 60 Cal. 2d 406 (34 Cal. Rptr. 545, 386 P.2d 33) and Honolulu Oil Corp. v. Franchise Tax Board, 60 Cal. 2d 417 [34 Cal. Rptr. 552, 386 P.2d 40].

Appellants contend that the California operations did not contribute to the out-of-state income and that the unitary features were present to such a minimal degree that they did not satisfy the test set forth in the Butler Bros. case. Appellants cite a decision of this board, Appeal of Carl M. Halvorson, Inc., decided March 20, 1963. In that case centralized overhead expenses of approximately \$16,000 were contrasted with direct costs of over \$1,000,000 to demonstrate that centralization of functions was at a minimum. We stated in the Halvorson opinion that from all that appeared in the record "the earnings and losses of appellant's various projects would have been substantially the same whether or not they had been under common ownership,"

Be cause of the mutual dependency and contribution that existed in the case now before us, the Halvorson appeal has no application, California Chain depended upon inventories and equipment received from its parent, In addition, the parent supplied California Chain with experienced salesmen and shop supervisors plus the counsel and advice of the parent corporation's top officials. On the other hand, California Chain contributed to the success of the overall venture by supplying

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a market for chain produced in other states, thus permitting a lower per unit cost of production, (See Altman & Keesling, Allocation of Income in State Taxation (2d ed, 1950), p. 94.) The operation of manufacturing in one state and selling in another is a classic example of a unitary business. (Bass, Ratcliff & Gretton v. State Tax Commission, 266 U.S. 271 [69 L. Ed. 282], Altman & Keesling, Allocation of Income in State Taxation, (2d ed. 1950), pp; 90, 101.)

'Further evidencing the integration between the companies is the centralized advertising that existed, the sharing of officers and directors, the parent's practice of billing and collecting all of California Chain's accounts and the payment by the parent of the salaries of California Chain's salesmen. Because the operations of these corporations were not distinct in nature, but rather consisted of manufacturing and selling the same product,, the entire group was well adapted to derive benefits from integrating various functions, It is worthy of note that, due to the identification of the product by joint advertising, the efficiency achieved by each corporation in meeting quality standards and servicing customers reflected upon all of the corporations in the group,

That there was mutual contribution and 'dependency between Campbell Chain Company of California and Campbell Realty of California, Inc., seems beyond argument, The realty corporation supplied the manufacturing corporation with operating properties and, in turn, depended entirely upon the manufacturing corporation for its income, The same relationship prevailed with respect to the out-of-state manufacturing and realty corporations.' The link between the manufacturing corporations, which has already been demonstrated, brings all of the realty corporations into connection as parts of the unitary system,

Inasmuch as the entire business was unitary in nature,' the income attributable to California must be determined by the formula method, and not by separate accounting, (Edison California Stores, Inc. v. McColgan, 30 Cal, 2d 472 [183 P.2d 16].) The allocation formula of property, payroll and sales, here applied by the Franchise Tax Board, has frequently been upheld and its fairness has been declared settled, (John Deere Plow Co. v. Franchise Tax Board, 38 Cal, 2d 214 [233 P.2d 569], appeal dismissed, 343 U.S. 939 [96 L. Ed. 1345].) Appellants, however, contend that because the California operations were new and many of the employees were 'untrained, the payroll and property were not productive of income and it was improper to include them in the formula,

A reference by appellants to the Appeal of Woodward, Baldwin & Co., Inc Cal. St. Bd. of Equal., May 28, 1963, in

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support of **their** position is misdirected, That case, wherein we sustained the Franchise Tax Board's practice of omitting the property factor with respect to personal service businesses, bears no resemblance to this case, **Our rationale** there, that "property is not a material income producing factor in this type of business" has no application to a business of manufacturing and selling,

However it may be phrased, appellants' argument is essentially the same as that presented by the taxpayer in the John Deere Plow case, supra, 38 Cal, 2d 214 (238 P.2d 569) **appeal dismissed**, 343 U.S. 939 [96 L. Ed, 1345]. There the taxpayer showed variations from the national average in the ratios of wages to sales, property to sales, and selling and general expense to sales and yet the court approved the use of the customary **property**, payroll and sales formula. The **following** language of the court (at page 224) applies to these appellants:

The fact that the taxpayer may show that according to a separate accounting system the activities in the taxing state were less profitable than those without the state, or even resulted in a loss, does not preclude use of a formula as a **method of apportionment of the unitary income** ... 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 accordance with its usual procedure, respondent included the property in the property factor at its book value. Appellants suggest that market value should be used on the ground that the older, more productive property out of the state had a much lower ratio of book to market value than the new property in California, We have, however, on several occasions sustained the Franchise Tax Board's use of book values for purposes of the **property factor**, (Appeal of Sudden and Christenson, Inc., Cal, St. Bd. of Equal., Jan, 5, 1961; Appeal of Aberdeen Plywood Corp., Cal. St. Bd. of Equal., May 2, 1961; Appeal of The Sweets Co. of America, Inc., Cal, St, Bd. of Equal., June 23, 1964.) The approach **consistently** followed with respect to all other taxpayers **must prevail** here, As we stated in the Appeal of Sudden and Christenson, Inc., supra:

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It would be impossible to annually ascertain the fair market value of all property used by enterprises doing business in California; the 'use of book value-is a good practical substitute for fair market values in the formula, (See Altman & Keesling, Allocation of Income in State Taxation, Second Edition, 1950, pp. 114, 115.)

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 the following appellants, against proposed assessments of additional franchise tax in the amounts and for the years specified, be and the same is hereby sustained.

	<u>Taxable year ended</u>	<u>Amount</u>
Campbell Chain Company of California	April 30, 1961	\$10, 223.16
"	April 30, 1962	11, 020.68
"	April 30, 1962	809.28
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"	April 30, 1962	422.53
"	April 30, 1962	2, 236.32

Done at Sacramento, California, this 27th day of October, 1964, by the State Board of Equalization.

Paul R. Leake, Chairman
John W. Lynch, Member
Richard C. ..., Member
_____, Member
_____, Member

Attest: [Signature], Secretary