



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of
PERK FOODS CO. OF CALIFORNIA



Appearances:

For Appellant: Daniel W. Gage
Attorney at Law

For Respondent: Peter S. Pierson
Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Perk Foods Co. of California against proposed assessments of additional franchise tax in the amounts of \$868.28, \$1,321.72 and \$1,464.37 for the income years ended September 30, 1957, 1958 and 1959, respectively.

Two questions are raised by this appeal: (1) whether appellant and its parent, Perk Foods Company, are engaged in a single unitary business; and (2) if so whether respondent, in applying an income allocation formula, properly considered only 25 percent of appellant's out of state deliveries from its California plant to be sales outside of California.

Appellant, incorporated under California law, is wholly owned by Perk Foods Company, an Illinois corporation. The principal business activity of both parent and subsidiary is the manufacture and sale of dog and cat food.

The parent company owns and operates factories in Illinois, where its head office is located, in Kansas and in Pennsylvania. It manufactures its products under the brand names of "Perk," "Vets" and "Peak." Appellant owns and

Appeal of Perk Foods Co. of California

operates a plant in Los Angeles, California. In July 1958, appellant commenced operating a second plant in Hillsboro, Oregon. Appellant also manufactures and sells pet foods under the "Vets'" label. It has been obliged to vary the formula and ingredients from those of its parent's product in order to conform to the requirements of California law.

Appellant and its parent corporation have common officers and interlocking boards of directors, who determine major corporate policies for both companies and maintain overall supervision. Appellant is charged with a portion of the salaries of those officers of the parent who spend time working with appellant's management.

Both corporations obtain labels from the same supplier at a volume discount under a master contract negotiated by the parent company. Since 1948 the parent company has participated in a "Pilot Guide Dog Fund," organized to provide guide dogs for the blind. Every can of dog food manufactured by the parent corporation bears a label notifying the purchaser that if the label is mailed to the Pilot Guide Dog Foundation in Chicago, Perk Foods Company will donate to the Fund its profit on the sale of that can. Appellant's labels bear a similar inscription,

When financing is necessary, appellant borrows from its parent at the same rate of interest which the parent pays to its lender. This interest rate is lower than appellant would have to pay to a local, independent lender.

Appellant's accounting office is located in Chicago. The same Chicago accounting firm prepares the tax returns, annual reports, and profit and loss statements of both appellant and its parent.

Appellant has exclusive sales territories in the western part of the United States. It purchases its own raw materials from independent sources and manufactures its products in its own plants. It conducts local advertising campaigns and does its own billing and collecting of accounts.

The great majority of out of state sales of products manufactured by appellant in California are sold through independent brokers. Appellant, however, employs two salesmen who reside outside of California and another salesman who spends 40 percent of his time outside the state. Appellant's own salesmen work with the brokers' salesmen and all orders which they obtain are channeled through the brokers. In addition, appellant's sales manager spends 50 percent of his time in other states, supervising appellant's salesmen, training salesmen employed by brokers, visiting retail and chain outlets with brokers and their salesmen, and helping with local advertising and promotion.

Appeal of Perk Foods Co. of California

Respondent determined that appellant and its parent were engaged in a unitary business and combined their income, allocating it within and without California pursuant to section 25101 of the Revenue and Taxation Code by applying the usual allocation formula composed of property, payroll and sales factors. Income allocated to California was included in the measure of appellant's franchise tax. In computing the sales factor of the allocation formula respondent treated as out of state sales 25 percent of the out of state deliveries of products manufactured in California.

Appellant urges that its operations and those of Perk Foods Company are not sufficiently integrated to constitute a unitary business. Appellant also argues that in any event 70 percent of its out of state deliveries should be treated as out of state sales for purposes of the sales factor of the allocation formula.

If a unitary business is conducted within and without the state by two or more corporations, then their income must be combined and allocated within and without the state by an appropriate formula. (Edison California Stores, Inc. v. McColgan, 30 Cal. 2d 472 [183 P.2d 16].)

In Butler Bros. v. McColgan, 17 Cal. 2d 664 [111 P.2d 334], aff'd, 315 U.S. 501 [86 L. Ed. 991], it was held that the unitary nature of a business was established by the existence of (1) unity of ownership, (2) unity of operation evidenced by central purchasing, advertising, accounting and management, and (3) unity of use in the centralized executive force and general system of operation. Subsequently, in Edison California Stores, Inc. v. McColgan, 30 Cal. 2d 472 [183 P.2d 16], the California Supreme Court declared that a unitary enterprise exists 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. These tests were recently reaffirmed and given a broad interpretation 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]. A careful review of these existing decisions reveals a progressive broadening of the meaning and application of the unitary concept.

Though appellant contends its business is conducted separately and apart from that of Perk Foods Company, there are certain areas of integration. There is unity of ownership, joint executive management, and utilization for some purposes of the same accounting firm in Chicago. The centralized purchasing of labels for both appellant and its parent provides them with a volume discount in price which would not be

Appeal of Perk Foods Co. of California

available if each purchased its supply individually. By borrowing money from its parent, appellant is concededly able to obtain cheaper financing than would be available to it in dealings with independent local lenders. Notwithstanding appellant's contentions that its product differs from the "Vets'" pet food manufactured by its parent and that it conducts its own independent advertising campaigns, mutual benefit and dependence seem almost certain to accrue from the advertising and sale of a product bearing the same trade-mark, produced by corporations with substantially the same names. In addition, mutual benefits were no doubt received through joint participation in the "Pilot Guide Dog Fund."

Bearing in mind that we are considering operations identical in nature, conducted by closely related corporations under almost the same names and utilizing the same trade-mark, we conclude that the business was unitary under the broadening judicial concept of that term. The income of appellant and its parent, therefore, must be combined and allocated by an appropriate formula.

We must next consider the propriety of respondent's action in treating only 25 percent of appellant's out of state deliveries from its California plant as out of state sales for purposes of the sales factor of the allocation formula.

Respondent's regulations provide that "The sales or gross receipts factor generally shall be apportioned in accordance with employee sales activity of the taxpayer within and without the State Promotional activities of an employee are given some weight in the sales factor." (Cal. Admin. Code, tit. 18, reg. 25101, subd. (a).)

The evidence is insufficient to establish the exact or even approximate number of sales attributable to the activities of appellant's employees outside of California. It is apparent, however, that many of the out of state sales are attributable to activities by independent brokers and their salesmen. Appellant has only a small number of employees operating over a wide territory outside of this state. It is entirely possible that their activities accounted for less than 25 percent of the out of state sales.

Respondent has discretion, within reasonable limits, to determine what is a proper apportionment of income within and without the state. (El Dorado Oil Works v. McCollgan, 34 Cal. 2d 731 [215 P.2d 4], appeal dismissed, 340 U.S. 801 [95 L. Ed. 589]; Pacific Fruit Express Co. v. McCollgan, 67 Cal. App. 2d 93 [153 P.2d 607].) Upon the record before us, we cannot say that respondent has abused its discretion.

Appeal of Perk Foods Co. of California

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 protest of Perk Foods Co. of California against proposed assessments of additional franchise tax in the amounts of \$868.28, \$1,321.72, and \$1,464.37 for the income years ended September 30, 1957, 1958, and 1959, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 23rd day of November, 1966, by the State Board of Equalization.

Geo. A. Spilly, Chairman
John W. Hynes, Member
Van R. Leake, Member
_____, Member
_____, Member

ATTEST: J. H. Hearn, Secretary
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