



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA.

In the Matter of the Appeal of)
THE SENG COMPANY OF CALIFORNIA)

Appearances:

For Appellant: Peter C. Bradford
Attorney at Law

For Respondent: Lawrence C. Counts
Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to section 25077 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claims of The Seng Company of California for refunds of franchise taxes in the amounts of \$719.89, \$5,535.90, \$5,578.26, and \$5,596.14 for the income years ended June 30, 1959, June 30, 1960, June 30, 1961, and June 30, 1962, respectively,

Seng of Illinois (hereinafter referred to as "Seng") is an Illinois corporation engaged in the manufacture and sale of furniture components with headquarters in Chicago, Appellant. a wholly owned subsidiary of Seng, is a California corporation with offices in Los Angeles, California. Seng also owns Western Washer and Stamping Company (hereinafter referred to as "Western") a second California corporation which operates a manufacturing plant and maintains offices in Los Angeles, California.

Appellant, Seng, and Western each utilized separate accounting to determine net income. Appellant and Western declared the income computed by this method as the measure of their franchise tax. No portion of the separately computed Seng income was attributed to California sources.

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Respondent determined that appellant, Seng, and Western were engaged in a unitary business and by formula apportionment attributed a portion of the combined income of the three companies to California,

Appellant is Seng's West Coast sales outlet, The operations conducted by appellant and Seng are admittedly unitary and to this extent, appellant concedes the propriety of the action taken by respondent on the refund claims. However, it contends that Western should have been excluded from the unitary group because (1) Western was engaged in a separate and distinct type of business, and (2) Western's contribution to the unitary business was insignificant,

For the years under review, approximately 61 percent of Western's income was derived from the sale of high quality, precision metal washers which it manufactured. An additional 17 percent of its income was derived from varied job-shop work orders, and the balance of 22 percent of its income was derived from the sale of casters. An average of 10 percent of Western's caster production was sold to Seng for use in its furniture products. These sales were the source of approximately 2 percent of Western's income, but constituted less than 1 percent of Seng's annual purchases.

Since the year 1955, Seng and Western have had interlocking directors and officers. A succession of local managers have been assigned responsibility for Western's operations. The local manager occasionally consulted with the Chicago-based personnel of Seng by telephone on pricing and sales policies. Executives and officers from Chicago visited Western on an average of twice yearly,

After Seng acquired control of Western, but before the years here in question, an attempt was made to establish Western as a West Coast manufacturing plant for Seng's products. This attempt was unsuccessful, and production was discontinued after a few months. No joint sales promotion or marketing of the products of the two companies was undertaken.

Seng provided Western substantial financial support in the form of loans and expense payments. It required that Western's operating receipts be placed in a special account and that withdrawals be made only with the consent of Seng's treasurer.

Seng purchased some insurance on behalf of Western, provided summary accounting services from its Chicago office, and performed other services for which it charged Western a management fee which varied in amount from \$100 to \$500 per month.

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Western leased to appellant business space at a common business location in California, and the two companies shared the cost of building maintenance. Western's personnel performed a small amount of routine assembly work plus warehousing and inventory handling of appellant's products, Western also furnished appellant accounting, clerical, and other supporting services for a monthly fee which varied in amount from \$100 to \$850. Additionally, Western regularly paid for supplies, stationery, local taxes, utilities, and other expenses incurred by appellant and received reimbursement for these items directly from Seng.

Where commonly owned multistate business operations are carried on, separate accounting may be used to determine income attributable to California sources only if the business carried on within this state is truly separate and distinct so that the segregation of income may be made clearly and accurately (Butler Bros v. McColgan, 17 Cal, 2d 664 [111 P.2d 334], aff'd, 315 U.S. 501 [86 L. Ed. 991].) If the business operation within this state is dependent upon or contributes to that carried on without the state, then there exists but a single unitary business and allocation of the entire business income to sources within and without the state by means of formula apportionment is required, (Edison California Stores, Inc. v. McColgan, 33 Cal. 2d 472 [183 P.2d 16]; Honolulu Oil Corp. v. Franchise Tax Board, 60 Cal, 2d 417 [34 Cal. Rptr. 552, 386 P.2d 40].)

Even if a complete centralization of business functions does not exist, a business is unitary if the integration is such that it results in earnings to the group materially greater than they would have been if each segment were operated without the connection with the other parts. (Appeal of McCall Corp., Cal, St, Bd, of Equal., June 18, 1963; Appeals of Beatrice Food Co. and Meadow Gold Dairies of California, Inc., Cal. St. Bd. of Equal., Nov. 19, 1958.)

Applying the foregoing tests, we conclude that Western was not a truly separate business and that its inclusion in the unitary group was proper.

Appellant's sales were the ultimate source of income from the goods manufactured by Seng. In order to carry out its function appellant, a sales company with few employees, required business facilities and supporting services. Western supplied these business facilities and services and in so doing functioned virtually as a department of appellant. This made duplication of facilities and services in California unnecessary and effected a cost saving. In this manner, Western contributed to the production of unitary income.

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While the significance of some of the items contributed by Western could be regarded as minimal when considered individually, we cannot agree that they were collectively insignificant. The functions performed by Western for appellant were required for the production of unitary income and Western's sales of casters to Seng were additional contributions. On the evidence before us the intercompany charges between these commonly owned corporations do not provide a reliable measure of actual value,

Western's operations were, in turn, dependent upon Seng. To the extent it was feasible, Western's business functions were grouped with those of Seng so as to realize the economic benefits which accrue to the operation of a larger business unit. This is indicated by intercompany sales and purchases of merchandise wherever possible, joint purchases of insurance, and the accounting services, financial support, consultation and other miscellaneous services provided by Seng. This interchange of goods and support contributed to the solvency of Western, assisted in Western's continuing support of appellant and resulted in additional cost savings to the group,

It is also fairly inferable that Western benefited from overall managerial supervision and control maintained by Seng through the interlocking directors and officers. This control is apparent from the frequent changes initiated in Western's local management, the consultation provided on pricing and sales policies and the direct control exercised by Seng over Western's receipts and disbursements,

We have thus found that there was mutual dependency and contribution between the operations of Western and Seng and appellant. In our opinion the total savings which resulted from this relationship were substantial. The interdependence existed within the framework of a general system of operations which called for Seng to manufacture goods and provide financing and management for the group; for appellant to make sales; and for Western to provide necessary supporting services. In this fashion the three commonly owned corporations functioned as a unit. Since Western's activity was an integral part of this income producing unit, the value of its contribution may not be measured by a separate accounting charge. (Edison California Smores, Inc. v. Colgan, supra, 30 Cal, 2d 472 [183 P.2d 16]; John Deere Flow Co. v. Franchise Tax Board, 38 Cal, 2d 214 [238 P.2d 509], appeal dismissed, 343 U.S. 939 [96 L. Ed. 1345]).

The Appeal of Allied Properties, Cal. St. Bd. of Equal. May 17, 1964, and Appeal of Simeo, Inc., Cal. St. Bd. of Equal., Oct. 27, 1964, relied on by appellant, are distinguishable from this appeal. In those appeals we found that the centralization

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of certain limited functions of varied and distinct types of business, such as a hotel, and a ranch, resulted in little cost savings and did not detract from the accuracy of separate accounting. Here, all of the corporations were integrally linked together in performing various aspects of manufacturing and selling. Their combined operations produced savings and income which cannot be reflected adequately by separate accounting.

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 26077 of the Revenue and Taxation Code that the action of the Franchise Tax Board in denying the claim of The Seng Company of California for refunds of franchise taxes in the amounts of \$719.89, \$5,535.90, \$5,578.26, and \$5,596.14 for the income years ended June 30, 1959, June 30, 1960, June 30, 1961, and June 30, 1962, respectively, be and same is hereby sustained,

Done at Sacramento, California, this 7th day of March, 1967, by the State Board of Equalization,

Paul K. Leaker Chairman
John W. Lynch Member
Robert [unclear] Member
Robert [unclear] Member
[unclear] Member

ATTEST: [Signature], Secretary