



BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )  
MARYLAND CUP CORPORATION )  
i

Appearances:

For Appellant: Cary D. Cooper  
Attorney at Law  
  
For Respondent: Joseph W. Ke gler  
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 Maryland Cup Corporation against proposed assessments of additional corporation income tax in the amounts of \$15,086.48, \$11,591.16, \$5,833.86 and \$5,552.01 for the taxable years ended September 30, 1960, 1961, 1962 and 1963, respectively.

Appellant is a Maryland corporation which was formed in 1926 by the Shapiro family. During the years in question, members of this family held 76 percent of the company's stock, and appellant owned, either directly or through its ownership of a subsidiary, all the stock of 31 companies which operated in various states. six of these corporations and appellant were engaged in the manufacture and sale of paper or plastic cups and containers. Another four subsidiaries produced and sold paper products, including book matches, drinking straws, and cups. The production and sale of ice cream cones involved 15 corporations. Three companies were concerned with research and engineering; one of these specialized in the ice cream cone field. Two corporations rented real property to other subsidiaries, and one company served the corporate group in the field of

Appeal of Maryland Cup Corporation

advertising. Respondent states that members of the Shapiro family occupied most of the positions in a system of interlocking directorates which existed among the parent and its subsidiaries. Also, evidently the president and sometimes other key officers of each subsidiary were officers or directors of the parent. However appellant maintains that the managers of each corporation had almost absolute discretion in terms of both operating and long-range policy decisions.

Four subsidiaries were incorporated and headquartered in California, and information submitted by the parties indicates that at least 11 other corporations either did business in this state or had intercompany contacts with the California subsidiaries. During the years in question, intercompany sales, leases, or services were executed or provided by almost all of the members of the corporate group. The following data has been submitted concerning intercompany sales of paper and plastic products and ice cream cones:

<u>Fiscal Year</u>	<u>Total Sales</u>	<u>Intercompany Sales</u>	<u>Approximate Percentage</u>
1960	\$53,691,204	\$ 7,735,047	17
1962	64,140,634	14,178,056	22
1963	78,194,144	18,577,852	23

Appellant states that these sales were made at a price equal to, or higher than, the price charged to unrelated purchasers.

The brand names of "Sweetheart", relating to paper and plastic products, and "Party Pak", relating to drinking straws and ice cream cones, were used throughout the corporate group and were nationally advertised. Other brand names were localized in either the eastern or western markets. The western subsidiaries and appellant participated in quantity purchases of advertising materials. Appellant states that such centralized advertising purchases were smaller than the total separate purchases of this type made by the companies. The corporations conducted independent sales activities, however some combined efforts also occurred, and in 1962 a new division was formed to market the group's home package products. Certain storage facilities were shared by some of the companies.

Two of the corporations engaged in research and engineering also manufactured machines both for other members of the affiliated group and for lease to ice cream

## Appeal of Maryland Cup Corporation

manufacturers. The latter machines produced ice cream novelties and used containers manufactured by various subsidiaries. Appellant and 18 of the companies each owned equal interests in Maryland-Cado, Inc., the corporation engaged in research pertaining to ice cream cone manufacture. Nearly all paper and plastic products were centrally designed by the parent's art department. Appellant states that each operating company also had an independent research program.

Certain types of insurance coverage -- public and general liability, comprehensive, and fire -- were purchased on a group basis. Many of the midwestern and eastern corporations used the same accounting firm, and a Baltimore law firm was general counsel for all of the companies. Certain employee benefit plans were shared by the corporate group: a stock option plan available to officers and key personnel, and a profit-sharing plan available to salaried or commissioned employees.

For each of the years in question, appellant filed a California corporation income tax return and seven subsidiaries filed franchise tax returns. Appellant and four of these companies each applied its own allocation formula to compute its tax liability. The three other subsidiaries characterized their activities, plus those of another subsidiary, as one unitary enterprise. The Franchise Tax Board determined that the entire group of affiliated corporations was engaged in a single unitary business. Whether this determination was correct is the primary issue of the instant appeal.

When taxpayers derive income from sources both within and without California, their tax liabilities shall be measured by the net income derived from or attributable to sources within this state. (Rev. & Tax. Code, § 25101.) If a business is unitary, the income attributable to California must be computed by formula allocation rather than by the separate accounting method. (Butler Bros. v. McColgan, 17 Cal. 2d 664 [111 P.2d 334], aff'd, 315 U.S. 501 [86 L. Ed. 991]; Edison California Stores, Inc. v. McColgan, 30 Cal. 2d 472 [183 P.2d 16].) The above cited cases developed two tests for determining whether a business is unitary. Under one test such status is found if the unities of ownership, operation, and use exist. (Butler Bros. v. McColgan supra.) Under the other test, a business is unitary when operation 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, supra.) Recent

Appeal of Maryland Cur, Corporation

decisions of the California Supreme Court have reaffirmed these tests. (Superior Oil Co. v. Franchise Tax Board, 60 Cal. 2d 406 [34 Cal. Rptr. 545, 386 P.2d 33]; Honolulu Oil Corp. v. Franchise Tax Board, 60 Cal. 2d 147 [34 Cal. Rptr. 552, 386 P.2d 40].)

In the instant situation we think that the above tests have been satisfied. In view of the Shapiro family's ownership and control of the affiliated corporations, it may be reasonably inferred from the facts that there was an intercorporate exchange of significant information relevant to the two basic industries in which the group was involved, and that decisions affecting more than one company were centralized. (Appeal of Anchor Hocking Glass Corp., Cal. St. Bd. of Equal., Aug. 7, 1957.) A very substantial amount of intercompany sales and leases occurred. Although preferential pricing was absent, such sales and leases still provided the transacting parties with the availability of, and markets for, the products or realty involved. (Appeal of AMP Inc., Cal. St. Bd. of Equal., Jan. 6, 1969.) Certain corporations provided the affiliated group with significant research, engineering, and design services. (See Appeal of American Can Co., Cal. St. Bd. of Equal., Nov. 19, 1958.) Although the companies also conducted independent research, the common ownership and control of the corporations and the similarity of their products indicate that the data which resulted from such research was shared. (Appeal of AMP Inc., supra.) One subsidiary specialized in advertising for the corporate group, and the various companies used common brand names which were advertised on a national basis. (See Appeal of Perk Foods Co. of Calif., Cal. St. Bd. of Equal., Nov. 23, 1966.) Significant benefits also accrued from centralized sales and warehousing activities, accounting and legal services, and insurance and employee benefit plans. We must conclude that appellant and its 31 subsidiaries were engaged in a single unitary business during the years in question.

Appellant contends that the application of the three-factor allocation formula in the instant situation results in the apportionment of an unreasonable amount of income to California, and consequently violates the due process and equal protection clauses of the Fourteenth Amendment to the United States Constitution. This board has a well established policy of abstention from deciding constitutional questions in an appeal involving proposed assessments of additional tax. (Appeal of Humphreys Finance Co., Inc., Cal. St. Bd. of Equal., June 20, 1960.) This policy is based upon the absence of any specific statutory authority which would allow the Franchise Tax Board to obtain judicial review of a decision in a case

Appeal of Maryland Cup Corporation

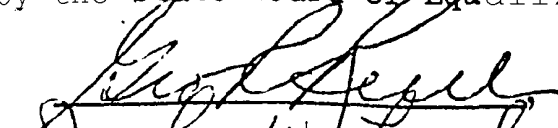
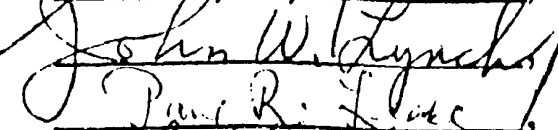
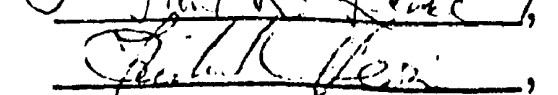
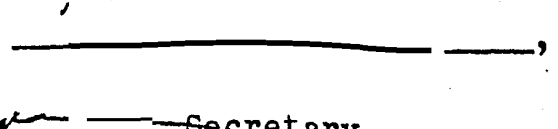
of this type, and our belief that such review should be available for questions of constitutional importance. This abstention policy properly applies to the instant case.

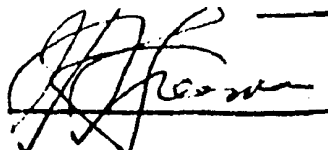
O R D E R

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 Maryland Cup Corporation, against proposed assessments of additional corporation income tax in the amounts of \$15,086.48, \$11,591.16, \$5,833.86 and \$5,552.01 for the taxable years ended September 30, 1960, 1961, 1962 and 1963, respectively, be and the same is hereby, sustained.

Done at Sacramento, California, this 23rd day of March, 1970, by the State Board of Equalization.

  
\_\_\_\_\_, Chairman  
  
\_\_\_\_\_, Member  
  
\_\_\_\_\_, Member  
  
\_\_\_\_\_, Member

\_\_\_\_\_, Member  
ATTEST:  \_\_\_\_\_, Secretary