BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
SWIFT & COMPANY)

Appearances:

For Appellant: James L. Morrison
Attorney at Law

For Respondent: Jack E. Gordon
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 protests of Swift & Company,,, against proposed assessments of additional franchise tax in the amounts of $15,688.83, $10,952.31 and $14,944.24 for the income years 1960, 1961 and 1962, respectively.

The sole question for decision is whether appellant was engaged in a unitary business with its division, A. C. Lawrence Leather Company, and with its wholly owned subsidiary, Derby Foods, Inc., during the years 1960, 1961 and 1962.

Appellant, an Illinois corporation with its principal place of business in Chicago, is primarily engaged in the meat packing business. On a smaller scale it manufactures and sells other products, including such diverse items as agricultural chemicals, livestock and poultry feeds, pet foods, ice cream and, during the years in question, peanut butter. Appellant also sells animal hides to tanning companies located both in the United States and in foreign countries.

Appeal of Swift & Company

In December 1952, the A. C. Lawrence Leather Company (hereafter referred to as Lawrence) became an operating division of appellant. Prior to its merger with appellant and during the years in question, Lawrence was primarily engaged in the business of tanning animal hides and selling the leather to shoe and garment manufacturers and to other producers of leather goods. Its principal place of business was in Peabody, Massachusetts, and it also operated several tanneries in other states in the East. All plants and equipment utilized by Lawrence were owned by appellant, and no rent was paid for that use.

The president of Lawrence, a Mr. Johnson, was also a vice president of appellant. He was the only officer common to appellant and to Lawrence. Johnson had been with Lawrence for some years prior to the merger, and during the appeal years he traveled to Chicago about once a month to attend meetings of appellant's officers. Johnson and the other officers of Lawrence were in charge of its day-to-day operation as a division of appellant. In this regard Lawrence maintained its own purchasing, market research, personnel and advertising departments, and it had independent research and development facilities. It also maintained its own sales department and had its own salesmen who operated primarily in the eastern part of the United States. Lawrence's leather sales in California were effected through independent agents, and no stock of goods was maintained here. Lawrence employees were covered under, appellant's pension plan.

During the years in question Lawrence purchased about 18 percent of its animal hides from appellant, at competitive prices. Those purchases represented approximately 18 percent of appellant's total sales of hides in the United States, Lawrence being appellant's largest single hide outlet. Appellant's hide sales to Lawrence amounted to $4,782,550 in 1960, $5,197,705 in 1961, and $4,354,198 in 1962. In addition, Lawrence occasionally purchased other items from appellant, such as cleaning soaps, pastes, and other supplies. All of the sales and purchases between Lawrence and Swift were handled by means of debits and credits to an intercompany account, rather than being cash transactions.

Prior to 1952 Lawrence had not been a very profitable business, and in some years it had even operated at a loss. Following its merger into appellant Lawrence's financial state improved considerably, as is evidenced by its profits during the years on appeal:

$3,681,456 in 1960, $2,600,167 in 1961, and $4,145,524 in 1962.

Derby Foods, Inc., (hereafter referred to as Derby) is a wholly owned subsidiary of appellant. It was incorporated under Illinois law and has its main office in Chicago. Derby is primarily engaged in the manufacture and sale of peanut butter; in addition, it produces a sideline of specialty meat products. During the years in question appellant was also manufacturing peanut butter and some specialty meat products, and to that extent Derby was in competition with its parent, although distinct trademarks were used by each company.

In the years on appeal, Derby's day-to-day operations were handled by its own executive staff. However, *two* of Derby's three directors were also on appellant's board of directors, and five of its ten officers functioned in similar positions for appellant. In addition appellant paid the salaries of Derby's officers, charging only the salary of Derby's president back to the subsidiary. The plant and equipment used by Derby in Chicago, though located apart from appellant's facilities, were owned by appellant and leased to Derby.

Derby had its own research, advertising, and purchasing departments and its own sales and distribution system. Derby's products were sold throughout the United States by independent brokers, and the marketing agreements made with these brokers were handled entirely by Derby's marketing personnel, without direction from appellant. There was no common warehousing of Derby's and appellant's products. Occasionally appellant did legal work or credit investigations for Derby, but appellant was reimbursed for such services. Appellant's tax department prepared Derby's tax returns.

During the years in question Derby purchased some of its raw materials from appellant. The bulk of *these* purchases were of peanut oil, an essential ingredient in the production of peanut butter. In 1960 and 1961 Derby acquired all of its peanut oil from appellant. With respect to its specialty meat products line, Derby purchased 5 percent of its meat from appellant, the remaining 95 percent from independent brokers. Derby's purchases from appellant during the appeal years amounted to $583,058 in 1960, $648,757 in 1961, and $179,675 in 1962, representing an average of about 4½ percent. of Derby's total purchases of raw materials during the three-year period. Derby's sales to appellant, in turn, *were* $1,627, $12,330, and $14,281 in 1960, 1961, and 1962, respectively, which was less than

one percent of Derby's total sales. Derby's balance sheets reveal additional transfers of funds between parent and subsidiary as follows:

Income Year	Due to Parent	Due from Parent
1960	$ 91,468	
1961	253,956	-
1962		$20,394

In its California franchise tax returns appellant has never included the net income of either Lawrence or Derby in its unitary income. With respect to Lawrence, separate accounting is used and no California return is filed. Derby files its own California franchise tax returns as a unitary business separate and apart from appellant. Respondent's determination that appellant, Lawrence, and Derby were all engaged in a single unitary business, and that the net incomes of Lawrence and Derby should therefore be included in appellant's combined unitary income, gave rise to this appeal.

If a corporation, or a group of corporations, is engaged in a unitary business operation, the combined income must be allocated within and without the state by an appropriate formula. (Rev. & Tax. Code, § 25101; Edison California Stores, Inc. v. McColgan, 30 Cal. 2d 472 [183P.2d 16].) In its decisions 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], the California Supreme Court reaffirmed the two tests it has promulgated for use in determining the existence of a unitary business. A unitary business exists when there is unity of ownership, unity of operation as evidenced by central purchasing, advertising, accounting, and management, and unity of use in the centralized executive force and general system of operation (Butler Bros. v. McColgan, 17 Cal. 2d 664 [111 P.2d 3343, aff'd, 315 U.S. 501 [86 L. Ed. 991]), or 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, supra.)

With respect to both Lawrence and Derby, appellant concedes unity of ownership. It also agrees that there is a degree of unity of use, as evidenced by certain central executive forces and the general system of operations in such a corporate family. Appellant urges,

however, that the requisite operational unity is lacking, since both the Lawrence division and Derby had their own independent purchasing, advertising, accounting and sales departments which functioned autonomously and free of control by appellant. It is further contended by appellant that the transfers of raw materials and other goods between appellant and both Lawrence and Derby were insignificant in amount.

This board has previously held that central performance of service or overhead functions is not essential to a finding that a unitary business exists, if the operations of the entire organization are otherwise unified to the extent that they are mutually dependent and contribute to each other. (Appeal of Combustion Engineering, Inc., Cal. St. Bd. of Equal., July 7, 1967; Appeal of Cutter Laboratories, Cal. St. Bd. of Equal., Nov. 17, 1964.) We have also considered the dependency and contribution test met if, by reason of the common ownership and the method of operation employed, the profits of the business are materially greater (or its losses less) than they would have been if the various parts of the business had been operated without benefit of the connection. (Appeal of Sudden & Christenson, Inc., Cal. St. Bd. of Equal., Jan. 5, 1961.)

In the case of the relationship between Lawrence and appellant, the following unitary factors were present: (1) Lawrence operated as a division of appellant; (2) an officer of appellant served as president of Lawrence, thereby maintaining a close tie with appellant's management; (3) the plants and equipment used by Lawrence in its various tanneries were owned by appellant, and Lawrence paid no rent for its use of those facilities; (4) employees of Lawrence were covered under appellant's pension plan; and (5) Lawrence was appellant's largest single market outlet for its animal hides, a natural by-product of appellant's meat packing business and, conversely, appellant provided Lawrence with a convenient and continuous source of hides. In spite of the contention that Lawrence's purchases of hides from appellant were not significant in amount, we are not persuaded that 18 percent of a tanner's total purchases of hides is insignificant, particularly when those purchases amounted to four or five million dollars per year.

In our opinion the above facts clearly establish that during the years 1960-1962 appellant and its Lawrence division were operating as components of a unitary business. A review of Lawrence's earnings

record prior to its merger with appellant leaves little doubt that the association was financially beneficial to both Lawrence and appellant.

With respect to Derby and appellant, the following integrating links existed during the appeal years: (1) Derby was a wholly owned subsidiary of appellant; (2) it manufactured certain food products which were substantially the same as products manufactured by appellant; (3) Derby and appellant shared a number of the same directors and officers whereby Derby obtained the benefit of appellant's executive guidance and managerial expertise; (4) appellant paid the salaries of all Derby's officers except its president; (5) the plant and equipment used and leased by Derby were owned by appellant; (6) although Derby's purchases of raw materials from its parent represented only about 4½ percent of Derby's total purchases of raw materials, they did amount to substantial amounts of money, and during 1960 and 1961 Derby acquired its entire supply of one essential ingredient of Its main product from appellant; and (7) Derby's balance sheets indicate that during the years there was an additional flow of cash, commodities, or services between it and appellant, tending to further disprove Derby's allegation of its complete operational independence.

Viewed in the aggregate we believe that the above facts show that, as between appellant and Derby, there was substantial mutual dependency and contribution during the years in question. In our opinion it cannot be said that Derby was operating a separate business in those years. We must therefore agree with respondent's determination that appellant and Derby were engaged in a unitary business operation, and that Derby's net income should have been included in appellant's unitary income for allocation purposes.

Appellant raises one additional point which should be discussed. Appellant states that after field audits of appellant's records for certain years prior to 1958, respondent has on two previous occasions made initial determinations that appellant, Lawrence, and Derby were engaged in a single unitary business operation. On both occasions appellant protested, and respondent ultimately withdrew the additional assessments it had proposed. Appellant argues that since the business operations of Lawrence, Derby, and appellant did not change between those earlier audited years and the years now on appeal, the same result should be reached here.

As respondent correctly points out, section 26424 of the Revenue and Taxation Code provides:

> In the determination of any issue of law or fact under this part, neither the Franchise Tax Board, nor any officer or agency having any administration duties under this part nor any court shall be bound by the determination of any other officer or administrative agency of the State. In the determination of any case arising under this part, the rule of res judicata is applicable only if the liability involved is for the same year as was involved in another case previously determined under this part.

When faced with this identical question on another occasion (Appeal of Allied Properties, Inc., Cal. St. Bd. of Equal., Mar. 17, 1964) we interpreted section 26424 as follows:

> This section demonstrates a legislative intent that we should decide cases such as the one before us wholly on their own merits, without regard to the determination by the Franchise Tax Board, express or implied, with respect to years other than those before us in the particular case.

Accordingly, we conclude that respondent's determination that appellant, Lawrence, and Derby were all engaged in a single unitary business during the years 1960, 1961 and 1962, must be sustained.

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 Swift & Company against proposed assessments of additional franchise tax in the amounts of $15,688.83, $10,952.31 and $14,944.24 for the income years 1960, 1961 and 1962, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 7th day of April, 1970, by the State Board of Equalization.

_____, Chairman

_____, Member

_____, Member

_____, Member

_____, Member

ATTEST: _____, Secretary