BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of)
)
HARBISON-WALKER REFRACTORIES COMPANY)

Appearances:

For Appellant: Burl D. Lack and
Albert F. Skelly
Attorneys at Law

For Respondent
and Petitioner: Jack E. Gordon
Counsel

OPINION ON REHEARING

The petition giving rise to a rehearing in the above entitled matter was filed by the Franchise Tax Board pursuant to section 26077 of the Revenue and Taxation Code, in response to a decision rendered by this board on May 4, 1970, sustaining the Franchise Tax Board's action in denying the claims of Harbison-Walker Refractories Company for refund of franchise tax in the amounts of $398.30, $694.92, $694.64 and $976.83 for the taxable years 1954, 1955, 1956 and 1957, respectively, and reversing the Franchise Tax Board's action in denying the claims of Harbison-Walker Refractories Company for refund of franchise tax in the amounts of $3,125.13, $1,469.73, $8,758.26, $6 944.53, $6,296.73, $3,876.90 and $3,158.38 for the t&able years 1958, 1959, 1960, 1961, 1962, 1963 and 1964, respectively.

Generally speaking, the issue presented by those appeals was whether the appellant, Harbison-Walker Refractories Company, was engaged in a unitary business operation with any of its subsidiary corporations. Appellant filed franchise tax returns for each of the years in question based upon the theory that it alone was engaged in a unitary business

operating within and without of California.. The Franchise Tax Board initially determined that two of appellant's subsidiaries, Canadian Refractories Limited and Northwest Magnesite Company, should have-been included in the unitary enterprise during the taxable years 1958 through 1964. After negotiations the parties subsequently agreed that Northwest Magnesite Company was not part of the unitary operations. Evidently the assessments for taxable years 1954 through 1957 were appealed by Harbison-Walker Refractories Company because it believed that the Franchise Tax Board's unitary business determination applied to those years as well as to 1958 and subsequent years. In its initial brief the Franchise Tax Board stated that the assessments for 1954 through 1957 were unrelated to the unitary business question, and those years therefore will not be further treated here.

The elimination of Northwest Magnesite Company from appellant's unitary business, operations results in certain adjustments in its franchise tax liability for the years on appeal. That elimination increases or reduces appellant's tax as follows:

Taxable Year	Tax Increase (Decrease)
1958	$ (374.76)
1959	(86.21)
1960	(977.55)
1961	1,131.41
1962	241.47
1963/1964	[illegible]

Although all of the above adjustments are proper, the statute of limitations prevents the assessment of the additional tax indicated for the years 1961,1962 or 1963.

The sole issue remaining for decision at the appellate level was whether Canadian Refractories Limited, a wholly owned subsidiary of appellant until 1963 (when 30 percent. of the stock of Canadian Refractories Limited was sold publicly), was a part of the parent's unitary business operation during the years in question. Initially the appeals were submitted for decision on the basis of the memoranda contained in the file, without oral hearing. After examination of the evidence contained in the record, this board concluded that appellant and its Canadian subsidiary, Canadian Refractories Limited, were not engaged in a unitary business operation during the years in question. (Appeals of Harbison-Walker Refractories Co., Cal.St.Bd. of Equal., May 4, 1970.)

Thereafter on May 29, 1970, the Franchise Tax Board (petitioner) filed its timely petition for rehearing. That petition raised certain doubts as to whether the facts had been fully developed by the parties in their earlier appellate briefs. In addition, almost simultaneously with our board opinion in the Harbison-Walker appeals, the California Court of Appeal rendered its decision in Chase Brass and Copper Co. v. Franchise Tax Board, 10 Cal. App. 3d 496 [86 Cal. Rptr. 350, 87 Cal. Rptr. 239], appeal dismissed and cert. denied, 400 U.S. 961 [27 L. Ed. 2d 381]. That case also presented a unitary business question, and the court there enunciated some guidelines which we believed might be relevant to this board's determination of unitary business questions. For the above reasons, on December 7, 1970, we granted the Franchise Tax Board's petition for rehearing in the matter of the Appeals of Harbison-Walker Refractories Co., supra.

An oral hearing was held on this petition for rehearing on June 2, 1971. The facts developed there, and in the briefs filed on rehearing, are set forth below. Harbison-Walker Refractories Company (hereafter referred to as appellant), a Pennsylvania corporation, is a leading manufacturer of refractories. These products are generally made of fireclay, silica, magnesite, or chrome, and are used to line various types of high temperature commercial furnaces. In 1945 appellant acquired all of the stock of Canadian Refractories Limited, a Canadian corporation which was engaged in the same general business as appellant. During the years in question appellant had manufacturing plants and sales offices located in various states, including California. Its Canadian subsidiary operated two plants and a mine in Quebec, Canada, and had sales offices and warehouses throughout Canada.

Canadian Refractories Limited was managed by its own executive staff located in Canada. Of its ten directors, eight were Canadian citizens and two were United States citizens who were officers of appellant. One of the latter was appellant's president. The president of the Canadian company was also a member of appellant's board of directors.

For the most part appellant and its Canadian subsidiary independently mined or purchased the raw materials necessary to fabricate refractories. However, Canadian Refractories Limited did acquire approximately 75 percent of its chrome requirements from the Philippine Islands under a contract negotiated by appellant. During the years in question those chrome purchases ranged from

a low of $283,674 in one year to a high of $948,120 in another. They represented approximately 13 percent of the Canadian company's total purchases of raw materials. (Prior to this rehearing we were unaware of the high percentage of the Canadian company's chrome needs which were supplied under the contract executed by its parent.)

Appellant and Canadian Refractories Limited maintained separate sales forces and primarily sold their own products to their own customers. However, in the years in question there were substantial intercompany sales, allegedly at the same price discounts available to non-affiliated purchasers. During the period from 1957 through 1963 an annual average of approximately 2.5 percent of appellant's total sales were sales to its Canadian subsidiary. These sales ranged from approximately $900,000 in 1958 to almost $2½ million in 1963. Appellant's sales to Canadian Refractories Limited consisted primarily of fireclay and high alumina 'brick, products which were not produced by the Canadian company. Those purchases from the parent company represented an annual average of approximately 16 percent of the Canadian company's total costs.

During the same 'period, an average of 11.7 percent of Canadian Refractories Limited's sales (from .7 percent in 1957 to 22 percent in 1963) were to appellant. The amounts of those sales rose from $81,186 in 1957 to over $3½ million in 1963. The Canadian products were sold to customers in the United States by appellant's sales force. and were then either shipped directly from Canada or from appellant's warehouses in the United States where they had been in storage. The Canadian company had no salesmen residing in the United States though several of its Canadian employees did spend a small amount of time in the United States acting as technical sales representatives and advising appellant's salesmen with respect to sales of the Canadian products.

Appellant annually charged its Canadian affiliate a general services. fee, ranging from $40,000 in 1957 to $60,000 in 1963, or about 3.7 percent of the subsidiary's total annual selling and administrative expense. This fee was for unspecified purposes but presumably covered the cost of general management-services.

Canadian Refractories Limited maintained its'own purchasing department and did not engage in any centralized purchasing activities conducted by its parent other than the Philippine chrome purchases mentioned earlier. The Canadian subsidiary also had its own accounting, advertising,

and legal departments. It purchased its own insurance protection, created employee benefit programs which were independent of those of the parent company, and negotiated its own union contracts. The Canadian corporation also maintained separate research and engineering departments, although it is conceded that there were exchanges of technical information between the two companies. There was no centralization of personnel functions, although appellant did offer training assistance to its Canadian subsidiary when necessary.. Each company had separate trademarks for its products, though a few were registered in both the United States and Canada, and some of the brand names of the two companies were strikingly similar.

At the rehearing stage of this matter another source of information about appellant's operations was brought to our attention for the first time. The 4th edition of Modern Refractory Practice was published by appellant in 1961, and it presents an extensive compilation of data on refractories and their applications, with special reference to products made by appellant and its affiliated companies. The book was intended to be of special service to users of refractories, and is utilized by purchasing agents, by research and design engineers, by plant operators, and also as a textbook in engineering schools. In its foreword the development of appellant's business is described as follows:

> Steady growth has marked the history of Harbison-Walker. From a single small plant built in Pittsburgh in 1865 for the manufacture of fireclay brick, the company has developed into a multi-plant organization making hundreds of products, representing virtually every type of refractory. The plants, including those of subsidiaries and affiliates, are located in fourteen states across the nation, in Canada, and in several other countries. (p. 10.)

* * *

> A major factor in Harbison-Walker's success and growth is a continuous research program, conducted always with the goal of improving the performance of the company's products, and of developing new products to meet specific needs. (p. 10.)

* * *

> Harbison Walker's complete line of products permits unbiased choice to secure balanced furnace life and lowest refractories costs. Sales offices are located in all the large industrial centers of the United States, in Canada, Mexico, and other countries. The manufacturing plants and complementary warehouses are so widely distributed geographically that they can make deliveries to any destination over a wide area with most favorable delivery time and transportation costs. (p.11.)

In a section entitled "Refractories Made in Canada", appellant's publication states:

> Joining with Canadian Refractories Limited, Harbison-Walker Refractories Company demonstrated its faith in the future of Canadian industries and its appreciation of the quality of CRL products. The way was thus cleared for exchange of technical' information to the advantage of consumers of the refractories manufactured by both companies. The progressive policies of Canadian Refractories Limited were continued and the program of expansion accelerated. (p. 182.)
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> Canadian Refractories Limited maintains a complete engineering service to assist the user in the selection and application of refractory materials. In addition to the products manufactured in Canada the company supplies all Harbison-Walker'products. (p. 183.)

Upon reconsideration of the facts of this case; both those known to us prior to our earlier decision and those developed in connection with this rehearing, we believe that the unitary business tests which have been espoused by the courts have now been satisfied. (See 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 v. McColgan, 30 Cal. 2d 472 [183 P.2d 16].) In spite of the substantial autonomy of the day-to-day operations of Canadian Refractories Limited, we conclude that sufficient contribution and operational interdependence have been established between appellant and

its Canadian subsidiary to justify a finding that the Canadian company was a part of appellant's unitary business. Set out below are a few considerations causing us to revise our earlier opinion.

Chrome ore is a basic refractory material, containing unique chemical characteristics which cause it to play an important role in the industry. (Modern Refractory Practice, p. 101.) During the years in question Canadian Refractories Limited obtained approximately 75 percent of its total chrome requirements under a contract negotiated by its parent. Appellant stated this was done because "it was felt that one arrangement would avoid a duplication of purchase administration." This type of operational interdependence and economic benefit is unitary in nature. (See Appeal of Anchor Hocking Glass-Corp., Cal. St. Bd. of Equal., Aug. 7, 1967.)

Although it has been contended that there is no centralization of advertising functions as between appellant and its Canadian subsidiary, the publication of Modern Refractory Practice makes this contention somewhat untenable. From the few excerpts from that book which are set out above, one gets the definite impression that Canadian Refractories Limited is considered by appellant to be an integrated part of the unitary operation. The complete line of Canadian products is listed and described. In this way, appellant does advertise the products of its Canadian subsidiary. Furthermore, it is conceded by appellant that representatives of Canadian Refractories Limited occasionally give free technical assistance to appellant's salesmen, presumably with respect to the Canadian products being sold in the United States. These facts also indicate a mutuality of contribution and interdependence.

Another clearly unitary factor present here is the substantial two-way flow of products between appellant and Canadian Refractories Limited, accomplished by intercompany sales. In 1963 as much as 22 percent of Canadian Refractories Limited's total production was sold to its parent. During the years 1957-1963 those sales totalled $11,333,320. Sales from appellant to the Canadian company during that same period totalled $13,104,595. Even if those intercompany sales were made at normal market prices, as appellant contends, there is still a beneficial aspect. In a recent unitary business decision by the California courts, Chase Brass and Copper Co. v. Franchise Tax Board, supra, 10 Cal. App. 3d 496 [86 Cal. Rptr. 350, 87 Cal. Rptr. 2393, appeal dismissed and cert. denied, 400 U.S. 961 [27 L. Ed. 2d 381], the court of appeal recognized that benefit when it stated, with respect to a one-way

flow of goods from parent to subsidiary, "To have a buyer of a substantial portion of the parent's production throughout the years must be assumed to be an advantage." (10 Cal. App. 3d 496, 505.) This statement would seem doubly true where there is a two-way flow of products.

In Chase Brass and Copper Co. v. Franchise Tax Board, supra, 10 Cal. App., 3d 496 [86 Cal. Rptr. 350, 87 Cal. Rptr. 239], appeal dismissed and cert. denied, 400 U.S. 961 [27 L. Ed. 2d 381], the court concluded that Kennecott Copper Corporation and its wholly owned subsidiary, Chase Brass and Copper Company, were engaged in a unitary business operation. In reaching that conclusion the court placed special emphasis on the significance of integrated executive forces. It stated:

> The integration of executive forces is an element of exceeding importance. It is top level management which is credited...with the effects of corporate enterprises. Chief executives of large organizations are regarded as highly prized acquisitions.... For a subsidiary corporation to have the assistance and direction of high executive authority of such a corporation as Kennecott is an invaluable resource....

The court then went on to say, after observing that the day-to-day' operations of Kennecott's subsidiaries were handled by executives of those subsidiaries:

> The "major policy matters'! are what count in our estimation of integration. Day to day operations are made at various levels by many executives in any organization. They are made, no doubt, by a multitude of officials of Kennecott and its subsidiaries. Major policy is another thing. This was the concern of Kennecott)
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> It is true that the president of Chase had a complete staff and line organization under his direction, but executive control at the highest level was in Kennecott.

We believe that similar emphasis should be given in the instant case. Appellant is the largest manufacturer of refractories in the world; Canadian Refractories Limited also had already established a fine reputation in the industry in Canada prior to its acquisition by appellant in 1945. The benefit to each corporation of having the president of the other serve on its board of directors seems apparent. The opportunity for 2 pooling of technic21 knowledge, research developments, and expertise, while expanding the markets of both corporations, would seem to be of immeasurable mutual value.

We therefore conclude that Canadian Refractories Limited was properly treated by petitioner as being part of appellant's unitary business operation during the years in question.

ORDER ON REHEARING

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 our order of May 4, 1970, in the matter of the Appeals of Harbison-Walker Refractories Company be modified in part, reversed in part, and reaffirmed in part as follows, in accordance with this opinion on rehearing:

(1) To reflect the agreement of the parties that Northwest Magnesite Company was not a part of the unitary business of its parent during the years 1958 through 1964, it is ordered that the claims for refund of franchise tax of Harbison-Walker Refractories Company be allowed to the extent of $374.76, $86.21, $977.55 and $84.89 for the taxable years 1958, 1959, 1960 and 1964, respectively;

(2) In accordance with our determination upon rehearing that Canadian Refractories Limited was a part of its parent's unitary business operation during the taxable years 1958 through 1964, it is ordered that the claims for refund of franchise tax of Harbison-Walker Refractories Company in the amounts

of $3,125.12, $1,469.73, $8,758.26, $6,944.53, $6,296.73, $3,876.90 and $3,158.38 for the taxable years 1958, 1959, 1960, 1961, 1962, 1963 and 1964, respectively, be and the same are hereby denied,; except for the above adjustments resulting from the elimination of Northwest Magnesite Company from appellant's unitary business operation; and,

(3) In all other respects, our prior order of May 4, 1970, in the matter of the Appeals of Harbison-Walker Refractories Company is affirmed upon rehearing.

Done at Sacramento, California, this 15th day of February, 1972, by the State Board of Equalization.

John W. Lynch, Chairman

_______________, Member

Geo. R. Reilly, Member

William G. Bennett, Member

_______________, Member

ATTEST: W. W. Dunlop, Secretary