

Appeal of Data General Corporation

The issue for resolution is whether **appellant** has established error in respondent's determination that appellant and its subsidiaries were engaged in a single unitary business.

Data General Corporation (DG) was incorporated in Delaware in 1968. DG and its wholly owned subsidiaries (the DG group) are engaged in the design, manufacture and sale of small and medium size, general purpose **digital computers**, peripheral equipment, software and **related products**. The DG group also provides software services, **maintenance**, and training to its customers.

The DG group's executive headquarters and primary manufacturing facilities are located in **Massachusetts**. Additional manufacturing facilities are located in California, **Canada**, **Hong Kong** and Thailand. Components manufactured or assembled at these additional facilities are shipped to the Massachusetts facility for **final assembly**. Since 1972, DG has operated a semiconductor research and testing facility in California. DG sales offices and service depots are located in several California cities and in other states and **foreign countries**. DG personnel service DG equipment at company service depots and at customer facilities.

DG has four domestic subsidiaries which are described below. **Data General Commercial Systems, Inc.** is a Delaware corporation which produces software and peripheral equipment used in the manufacture of **DG's minicomputers**. The software packages are either sold with computers or sold to **DG's customers** as needed. **Data General International Sales Corporation**, a Delaware corporation, is a domestic international sales **corporation (DISC)** which sells DG computer equipment to foreign customers. **Data General Investment Corporation**, a Delaware corporation, was organized to invest accumulated **excess funds** of the DG group for future expansion, for the purchase of equipment, and for other capital **improvements**. The investments of this subsidiary are managed by **DG's officers**. **Data General Europe, Inc.**, a Delaware corporation, was formed to oversee the DG group's **foreign operations** and to provide administrative services to **DG's foreign subsidiaries**.

In addition to the domestic subsidiaries described briefly above, the active foreign subsidiaries which respondent combined with DG and the jurisdiction in which each is organized are as follows:

Appeal of Data General Corporation

Data General, Ltd.	United Kingdom
Data General of Canada, Ltd.	Canada
Data General GmbH	Germany
Data General Australia Pty., Ltd.	Australia
Data General France SARL	France
Data General Computers Gesellschaft M.B.H.	Austria
Data General S.A.	Belgium
Data General S.P.A.	Italy
Data General Holland N.V.	Netherlands
Data General Corporation (Sweden) AB	Sweden
Data General Hong Kong, Ltd.	Hong Kong
Data General Thailand	Thailand

These foreign subsidiaries distribute DG computer equipment. In addition, the Canadian subsidiary manufactures and **assembles** DG computers, and the Hong Kong and Thailand subsidiaries assemble certain DG components which are used in computers assembled at United States facilities.

After an audit, respondent determined that the DG group was engaged in a single unitary business and that appellant's net income, derived from a California source, should be determined by formula apportionment of the combined income of appellant and its domestic and foreign subsidiaries. Appellant protested, and the denial of its protest led to this appeal.

When a taxpayer derives income from sources both within and without California, it is required to measure its California franchise tax liability by its net income derived from or attributable to sources within this state. (Rev. & Tax. Code, § 25101.) If the taxpayer is engaged in a unitary business with affiliated corporations, the amount of income attributable to California sources must be determined by applying an apportionment formula to the total income derived from the combined unitary operations of the affiliated companies. (See **Edison California Stores, Inc. v. McColgan**, 30 Cal.2d 472 [183 P.2d 16] (1947); **John Deere Plow Co. v. Franchise Tax Board**, 38 Cal.2d 214 [238 P.2d 569] (1951), app. **dism.**, 343 U.S. 939 [96 L.Ed. 13451 (1952)].

The California Supreme Court has determined that a unitary business is definitely established by the existence of: (1) unity of ownership; (2) unity of operation as evidence by central purchasing, advertising, accounting and management divisions; and (3) unity of use

Appeal of Data General Corporation

in a centralized executive force and general system of operation. (Butler Bros. v. McColligan, 17 Cal.2d 664, 678 [111 P.2d 334] (1941), affd., 315 U.S. 501 [86 L.Ed. 991] (1942).) The court has also held that a business is unitary when the operation of the business within California contributes to or is dependent upon the operation of the business outside the state. (Edison California Stores, Inc. v. McColligan, supra, 30 Cal.2d at 481.) These principles have been reaffirmed in more recent cases. (Superior Oil Co. v. Franchise Tax Board, 60 Cal.2d 406 [34 Cal.Rptr. 545, 386 P.2d 33] (1963); Honolulu Oil Corp. v. Franchise Tax Board, 60 Cal.2d 417 [34 Cal.Rptr. 552, 386 P.2d 40] (1963)) The existence of a unitary business may be established if either the three unities or the contribution or dependency test is satisfied.

Respondent's determination that appellant is engaged in a **unitary** business with its domestic and foreign subsidiaries is presumptively correct. (Appeal of John Deere Plow Co. of Moline, Cal. St. Bd. of Equal., Dec. 13, 1961.) The burden to produce sufficient credible evidence to negate the existence or significance of the unitary connections relied upon by respondent and thereby overcome the presumptive correctness of respondent's determination is upon appellant. (See Appeal of Saga Corporation, Cal. St. Bd. of Equal., June 29, 1982.)

In addition to common ownership, respondent based its unitary determination on the fact that the DG group was engaged in a single line of business, coupled with the existence of strong centralized **management**, shared know-how, intercompany product flow, central coordination of service functions and the use of a common name;

Appellant's annual reports and its reports to the Securities and Exchange Commission **describe** the DG group as being engaged in a single line of business; the design, manufacture, sale and service of electronic computers and associated accessory equipment. A vertically integrated business enterprise has consistently been regarded as a classical example of a unitary business. (See, e.g., John Deere Plow Co. v. Franchise Tax Board, supra; Chase Brass & Copper Co. v. Franchise Tax Board, 10 Cal.App.3d 496 [87 Cal.Rptr. 239], app. disp. and cert. den., 400 U.S. 961 [27 L.Ed.2d 381] (1970); Cal. Admin. Code, tit. 18, reg. 25120, subd. (b) (arts. 2 and 2.5).)

Public documents prepared by appellant are replete with examples which indicate that the DG group's worldwide business was operated by a strong centralized

Appeal of Data General Corporation

management team. For example, in 1972, a national sales manager, responsible to the vice president-of-marketing, was appointed to direct national sales operations. In the same year, a general manager of European operations was appointed to coordinate foreign sales, promotion, and service support. In 1973, three new vice **presidents** were appointed to oversee accounting, **sales**, and European operations. The position of vice president and controller was also established in 1973 to oversee expanding accounting operations and to supervise the financial reporting **of the** entire DG group. In 1974, two more vice presidents were elected; one was responsible for engineering while the other supervised domestic and international personnel activities. These appointments broadened the group's senior officers to seven experienced executives responsible for all major corporate functions. It is evident that the strong centralized management which was viewed as a significant indicator of unity by the court in Chase Brass & Copper Co. v. Franchise Tax Board, *supra*, is present here.

The DG group is engaged in a single line of business involving sophisticated, rapidly changing technology which consists of the design, manufacture, sale and service of electronic computers and associated equipment. Under these circumstances, it is apparent that substantial intercorporate exchange of know-how, a significant unitary characteristic, was present. (See, e.g., Appeal of Beecham, Inc., Cal. St. Bd. of Equal., March 2, 1977; Appeal of Grolier Society, Inc., Cal. St. Bd. of Equal., Aug. 19, 1975; Appeal of F. W. Woolworth Co., Cal. St. Bd. of Equal., July 31, 1972.)

Intercompany product flow is a major unitary characteristic. (See, e.g., Chase Brass & Copper Co. v. Franchise Tax Board, *supra*; Appeals of the Anaconda Company, Cal. St. Bd. of Equal., May 11, 1972.) During the **appeal** years, the bulk of the final assembly **of the** DG group's finished products took place in the Massachusetts plant. However, many of the subassemblies were manufactured in California, Canada, Hong Kong and Thailand and shipped to the United States location for final assembly and testing prior to marketing. Thus, it is readily apparent that there was a substantial intercompany product flow.

As indicated by its annual reports, a hallmark of the DG group is the central coordination of its staff functions such as: finance, accounting, research and development. Personnel **development** and training programs,

Appeal of Data General Corporation

advertising, and customer training were also developed and coordinated on a group-wide basis. Furthermore, the sole purpose of Data General Europe was to oversee and provide the **necessary** assistance to the group's European subsidiaries. These factors are a further indication of unity. (See, e.g., Superior Oil Co. v. Franchise Tax Board, supra; Honolulu-Oil Corp. v. Franchise Tax Board, supra.)

Finally, the name "Data General" was used by all the corporations in the DG group., While not of overwhelming significance, the use of a common name is yet another unitary factor. (See, e.g., Appeal of Perk Foods Co. of California, Cal. St. Bd. of Equal., Nov. 23, 1966.)

In opposition to respondent's unitary determination, appellant has simply asserted that DG is a diversified multinational enterprise, and that the foreign operations are separate and distinct functional organizations which operate autonomously as evidenced by a decentralized management. Appellant's sole support for this assertion is an organizational chart which indicates that all aspects of European operations are centralized under the vice president for European operations. Rather than supporting appellant's assertion, the organizational chart, by emphasizing the centralization of all European operations, lends additional credence to respondent's unitary determination. Appellant has submitted no other evidence or argument.

In summary, ' we are convinced that appellant has failed to satisfy its burden of proving that respondent's unitary determination was erroneous; Therefore, tie conclude that, when viewed in the aggregate, the unitary characteristics relied upon by respondent are sufficient to **establish the existence of a single integrated economic enterprise under either the contribution or dependency test or the three unities test.** Accordingly, respondent's determination that DG and its domestic and foreign subsidiaries **were engaged** in a single unitary business must be sustained.

Appeal of Data General Corporation

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 26077 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claims of Data General Corporation for refund of additional franchise tax in the amounts of **\$14,184.70, \$36,177.88, and \$56,834.77** for the income years ended September 30, 1972, 1973, and 1974, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this **26th** day of July, **1982**, by the State Board of Equalization, with Board **Members** Mr. Bennett, Mr. Dronenburg and Mr. Nevins present.

William M. Bennett, Chairman

Ernest J. Dronenburg, Member

-Richard Nevins, Member

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