



BEFORE THE STATE BOARD OF EQUALIZATION
'OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
THE **STANWICK** CORPORATION)

Appearances:

For Appellant: Robert A. **DeWitt**
Attorney at Law

For Respondent: Gary M. Jerrit
Counsel

O P I N I O N

This appeal is made pursuant to section 25666 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of The **Stanwick** Corporation against proposed assessments of additional franchise tax in the amounts of \$174.16, **\$7,232.88**, and **\$16,633.24** for the income years ended April 30, 1974, April 30, 1975, and April 30, 1976, respectively.

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The issue presented for decision is whether **The Stanwick Corporation** and its subsidiary, **Stanwick International, Inc.**, were engaged in a unitary business.

The **Stanwick Corporation** (hereafter "Stanwick") is a Delaware corporation headquartered in Arlington, Virginia. It, was incorporated in 1962 to provide a variety of professional, technical and managerial services to the United States Navy. The scope of its customers has since broadened to include industrial, institutional and commercial clients. The company is involved primarily in developing operation, maintenance, and management systems and producing technical manuals. During the appeal years, **Stanwick** operated an office in California which conducted engineering studies, performed systems design, and prepared technical publications. The parties agree that the California division is part of the unitary business of Stanwick. The question at issue is whether a foreign subsidiary of Stanwick, **Stanwick International, Inc.**, is also part of the unitary business.

Stanwick International, Inc. (hereafter "Stanwick International") was formed by **Stanwick** in 1969 to engage in business ventures in overseas markets. In 1972, officers of **Stanwick** and **Stanwick International** negotiated a contract with the Imperial Iranian Navy for **Stanwick International** to provide facilities management' for the repair, engineering, and supply departments of an Iranian naval repair ship based at Bandar Abbas, Iran. The primary activities of **Stanwick International** consisted of staffing the repair department of the repair ship, operating the repair ship's power plant, training Iranian naval personnel and civilian employees, and managing the operations of a naval shipyard in Bandar Abbas. The Iranian Navy also requested that **Stanwick International** take charge of certain assignments other than repair services. These assignments consisted of developing a training center study, overhauling communications and ordnance equipment, and performing two systems design contracts. Because **Stanwick International** did not have the expertise necessary to perform these assignments, it negotiated the contracts with the understanding that the work would be subcontracted out. The two systems design contract& were awarded to Stanwick. The equipment over-haul and the training center contracts were subcontracted to other parties.

Both **Stanwick** and **Stanwick International** are headquartered in the same building in Arlington, Virginia. Four of the six directors of **Stanwick International** were

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also directors of Stanwick, and four of its six officers were also officers of Stanwick. The meetings of the board of directors for both companies took place in Arlington, Virginia. The president of **Stanwick International** was Mr. Ralph Shifley, who was also the executive vice president and treasurer of Stanwick. The executive vice president of **Stanwick International** was Mr. John Kalina, who was also a vice president of Stanwick. Both Mr. Shifley and Mr. Kalina worked at the corporate headquarters in Arlington. The day-to-day operations of **Stanwick International** were managed by a vice president, Mr. Andrew Bodnaruk. Mr. Bodnaruk was neither an officer nor a director of Stanwick.

The domestic recruitment of employees to work in Iran was done at the corporate headquarters in Arlington. In 1975, the recruiting function was taken over by Metier International, Inc. (hereafter "Metier"), a newly formed subsidiary of Stanwick. John Kalina (executive vice president of **Stanwick International** and vice president of Stanwick) became the president of Metier. Metier recruited almost exclusively for **Stanwick International**. Many of the domestically hired employees were former United States naval officers. Because of the difficult living conditions in Iran, it was unusual for an American employee to work there more than a few years; therefore, American employees were hired on the basis of a **one-** or two-year contract. All foreign employees were recruited by Mr. Bodnaruk.

Stanwick International maintained separate accounts, prepared its own financial statements, budgets and payroll for all Iranian employees. Employees who worked at the corporate headquarters in Arlington were placed on Stanwick's payroll, and **Stanwick International** reimbursed **Stanwick** for all amounts paid these individuals. **Stanwick International** was included in Stanwick's consolidated income tax return which was prepared in Arlington.

Stanwick International obtained and administered all insurance for foreign employees as required by Iranian law. **Stanwick** administered all corporate liability insurance required by American law.

Stanwick International was responsible for marketing its services to the Iranian government. **Stanwick** assisted by periodically preparing marketing pamphlets which **Stanwick International** could not conveniently produce in Tehran.

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Stanwick International administered its own Iranian bank accounts and furnished its own letters of credit, performance guarantees, and advance working capital guarantees. There was no intercompany financing between **Stanwick** International and Stanwick..

The companies had no common employee benefit plans, no standardized procedures, and no exchange of personnel. **Stanwick** International purchased all of its own supplies except certain paper and forms which **Stanwick** obtained because they were unavailable in Iran. **Stanwick** International wrote its own Iranian contracts and retained an Iranian law firm.

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, 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. (See Edison California Stores, Inc. v. McColgan, 30 Cal.2d 472 [183 P.2d 16] (1947).) If, however, the business within this state is truly separate and distinct from the business without the state so that the segregation of income may be made clearly and accurately, the separate accounting method may properly be used. (Butler Brothers v. McColgan, 17 Cal.2d 664, 667 [111 P.2d 334] (1941), affd., 315 U.S. 501 [86 L.Ed. 9911 (1942)].)

The existence of a unitary business is established if either of two tests is met. (Appeal of F. W. Woolworth Co., Cal. St. Bd. of Equal., July 31, 1972.) The California Supreme Court has determined that the existence of a unitary business is established by 'the presence of: (1) unity of ownership; (2) unity of operation as evidenced by central purchasing, advertising, accounting, and management divisions; and (3) unity of use in its centralized executive force and general system of operation. (Butler Brothers v. McColgan, supra, 17 Cal.2d at 678.) The court has also stated that a business is unitary when the operation of the portion of the business done within California is dependent upon or contributes to the operation of the business outside California. (Edison California Stores, Inc. v. McColgan, supra, 30 Cal.2d at 481.)

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Respondent argues that the facts in this appeal show that the operations of **Stanwick** International were unitary with those of **Stanwick** under both of these two tests. In support of its argument that the relationship between the two companies satisfies the contribution and dependency test, respondent points to a centralized management, the recruitment done for **Stanwick** International by Metier, and the subcontracting work done by Stanwick.

With respect to centralized management, appellant contends that Mr. Bodnaruk operated **Stanwick** International autonomously, and the function of the other directors was limited to ratifying his decisions. Appellant's position is not substantiated by the record. While the record shows that Mr. Bodnaruk managed the day-to-day affairs of **Stanwick** International in Iran, there is evidence which shows that major business decisions were made under the direction of Mr. Shifley and Mr. Kalina. On a submission to respondent, appellant describes the negotiation of the Iranian contracts as being done by Mr. Bodnaruk under the guidance of the president and executive vice president of **Stanwick** International. Further evidence of an integrated executive force is seen in the amount of its general and administrative expenses which **Stanwick** allocated to **Stanwick** International: \$108,000 for the income year ended April 30, 1974; \$371,000 for the income year ended April 30, 1975; and \$568,000 for the income year ended April 30, 1976. These amounts constituted 23 percent, 56 percent, and 72 percent of the entire amount of general and administrative expenses incurred by **Stanwick** in the respective years. In the message of the chairman of the board in the annual report of the income year ended April 30, 1976, Mr. **Stanwick** made the following statement concerning the extent of Stanwick's management resources directed toward **Stanwick** International:

As in the previous year, the majority of revenues and profits were generated by **Stanwick** International, Inc., our wholly-owned subsidiary operating primarily in the Middle East. Our financial and management resources were taxed to the limit to support this sizable increase in business. As a consequence, a minimum of resources were available to strengthen and expand our domestic operations. In spite of this handicap, the parent corporation turned in in a modest profit for the year.

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Management expects the growth in our international **business** to continue but probably at a less rapid rate than in the immediate past. As our financial strength increases it is expected that we will soon be able to devote a larger share of our **available** resources to the strengthening of **management** and to the development of **our domestic** business. This should not only further improve our profitability but broaden our base and provide further stability to our company.

We find the foregoing factors evidence of an integrated management rather than the type of oversight which a parent company gives to an investment in a subsidiary.

A second area of contribution and dependency can be seen in the recruitment of personnel for **Stanwick International** by Metier, **Stanwick's** other wholly owned subsidiary. Appellant points out that Mr. **Bodnaruk** devoted 10 percent of his time to personnel matters, and that Metier recruited **140** of approximately 400 persons **Stanwick International** employed in Iran during the fiscal year ended April 30, 1976. However, appellant also states that the employees recruited by Metier were the higher level, technical personnel, while employees hired in Tehran by **Stanwick International** were the nontechnical personnel. Thus **Stanwick International** was dependent upon Metier to recruit its key employees, a significant contribution.

A third area of contribution and dependency is the work subcontracted to **Stanwick** by Stanwick' International. Two of the four additional contracts entered into by **Stanwick International** were subcontracted to Stanwick. The income from these systems **design** contracts comprised 13.9 percent of Stanwick's gross revenues for the income year ended April 30, 1975, and 27 percent of Stanwick's gross revenues for the income year ended April 30, 1976. The revenues **Stanwick International** earned from systems design and engineering constituted 22 percent and 30 percent of its gross income for the income years ended April 30, 1975, and April 30, 1976, respectively.

The interdependence resulting from centralized management, **recruiting** of key personnel, and subcontracting work which brought substantial revenue to both corporations is significant. Although some elements, such

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as a substantial flow of goods, are absent, we believe that the combination of all the ties between the parent and the subsidiary show contribution and dependency which results in a mutual interdependence between the two companies.

The three unities test for a unitary business is also met in this case. **Stanwick** International is the wholly owned subsidiary of **Stanwick** so there is unity of ownership. With respect to unity of operation, we have already discussed the intercompany recruitment of personnel. Even though other operating functions were performed by **Stanwick** International, the record shows that they were not handled entirely independently. For example, insurance for foreign employees was obtained by **Stanwick** International; insurance required by American law was obtained by **Stanwick**. **Stanwick** International marketed its own services, but **Stanwick** assisted by preparing marketing pamphlets. **Stanwick** International did its own purchasing, but **Stanwick** obtained certain supplies which were unavailable in Iran. **Stanwick International** did its own accounting, but employees who worked at the corporate headquarters were on **Stanwick's** payroll. We find enough operational interaction between the two companies to satisfy the unity of operation prerequisite. The unity of use prerequisite is satisfied by a centralized executive force as we discussed under the contribution and dependency test. Therefore, respondent's determination that **Stanwick** and **Stanwick** International were engaged in a unitary business will be sustained.

