BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
I-T-E CIRCUIT BREAKER COMPANY)

Appearances:

For Appellant: Cyrus A. Johnson
Attorney at Law

For Respondent: Jack E. Cordon
Supervising Counsel

OPINION

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 I-T-E Circuit Breaker Company against proposed assessments of additional franchise tax in the amounts of $2,458.60 and $1,585.65 for the income years 1961 and 1962, respectively.

Subsequent to the filing of this appeal, appellant conceded the correctness of the proposed assessments except for the adjustments arising from respondent's treatment of appellant

and its wholly -owned subsidiary, The Chase -Shawmut Company, as a single unitary business. Consequently, the only issue remaining for decision is whether appellant and Chase-Shawmut were engaged in a single unitary business during the years in question.

Appellant is a Pennsylvania corporation engaged in the business of developing, manufacturing, and selling control equipment for the transmission and distribution of electricity. Curing the years on appeal, it had several manufacturing and sales divisions with plants and offices located throughout the United States, including California. In those same years it also owned a number of foreign and domestic subsidiaries which manufactured various types of electrical equipment. One such subsidiary was Chase -Shawmut, a manufacturer of fuses.

Appellant acquired control of Chase-Shawmut in 1953 and became its sole shareholder in 1957. Following the close of World War II, Chase-Shawmut's financial structure had become progressively weaker, reaching the point of severe losses in the years just prior to and just after appellant's acquisition of the company, Since part of Chase-Shawmut's financial difficulties at the time appellant acquired control was a serious shortage of working capital, appellant provided short -term-loan assistance during 1954 and 1955. Then, in 1958 and 1959, appellant made further loans to Chase -Shawmut totaling $710,000 to finance plant modernization and expansion. These later loans were advanced by appellant because Chase-Shawmut's financial condition was still too weak to secure a loan in the commercial market, except on the most restrictive and costly basis. The record does not reveal the terms of these loans, except that repayment was based on Chase-Shawmut's ability to pay. As of the beginning of the income years 1961 and 1962, Chase-Shawmut was indebted to appellant in the respective amounts of $700,000 and $590,000. By early 1965 the loans had been completely repaid, and by the end of 1968 Chase-Shawmut was able to declare a dividend of $700,000, its first dividend since World War II.

During each of the years on appeal, two of appellant's officers were members of Chase-Shawmut's five-man board of directors. At least one of the two, A. G. Bosanko, appellant's vice president for indoor distribution, was also a director of

appellant. In his capacity as a director of Chase-Shawmut , Mr. Bosanko concerned himself with overall managerial problems, including coordination with other parts of appellant's enterprise to avoid positions contradictory to the aims of both Chase-Shawmut and appellant. Robert D. Scott, appellant's vice President- for plant and equipment, was the other I-T-E officer .on Chase-Shawmut's board in 1961 and 1962. According to the testimony of P. Cordon Johnston, Chase-Shawmut's president, Mr. Scott was an extremely capable construction, machinery, and plant expert, and he was on Chase-Shawmut's board because Mr. Johnston needed an assistant in those areas.

In addition to the assistance provided by Mr. Bosanko and Mr. Scott, appellant rendered a number of other services to Chase-Shawmut during 1961 and 1962. Mr. Karl K . Kahler, appellant's vice president of employee relations, provided professional assistance and guidance to Chase-Shawmut's president when the latter negotiated contracts with Chase -Shawmut's local labor union. In the area of insurance matters, Chase-Shawmut's principal protective coverage - fire; theft, and product liability - was included as a subordinate element under appellant's insurance policies in the interests of uniform service and economy. Appellant also provided some accounting and engineering services , including the conduct of Chase-Shawmut's annual audit and dealings with the policing and restrictive bodies such as Underwriters Laboratories. To cover the above services, appellant charged Chase-Shawmut fees of $65,550 in 1961, and $69,900 in 1962. The amounts of these fees were determined by appellant without consultation with Chase -Shawmut's officers.

During both years in question, Chase-Shawmut sold substantial amounts of fuse products to appellant and its other subsidiaries. The record permits only approximations, but it appears that these sales constituted about 10 - 15% of Chase-Shawmut's total sales in each year and about 80% of appellant's fuse purchases in each year. In dollar amounts, Chase-Shawmut's sales to its affiliates approximated $400,000 in 1961 and $450,000 in 1962. The selling prices were computed under Chase-Shawmut's established pricing policies but were discounted by 15% to all affiliated companies. Unrelated purchasers of Chase-Shawmut products received volume discounts, but only up to a maximum of 10%.

When a corporate taxpayer derives income from sources both within and without California, its franchise tax liability must be measured by the net income derived from sources within this state. (Rev. & Tax. Code, 8 25101.) If the taxpayer is engaged in a unitary business with affiliated corporations, the 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] and John Deere Plow Co. v. Franchise Tax Board, 38 Cal. 2d 214 [238 P. 2d 569], appeal dismissed, 343 U.S. 939 [96 L. Ed. 1345].) The California Supreme Court has set forth two general tests for determining whether a business is unitary. In Butler Bros . v. McColgan, 17 Cal. 2d. 664 [111 P. 2d 334], aff'd, 315 U. S. 501 [86 L. Ed. 991], the court held that the existence of a unitary business is definitely established by the presence of the three unities of ownership, operation, and use. Subsequently, the court said in Edison California Stores, Inc. v. McColgan, supra, that a business is unitary when the operation of the business done within this state depends upon or contributes to the operation of the business outside the state. Later decisions of the court have reaffirmed these tests and have given them broad application. (Superior Oil Co. v. Franchise Tax Board, 60 Cal. 2d 406 [34 Cal. Kptr . 545, 386 P. 2d 33]; Honolulu Oil Corp. v. Franchise Tax Board, 60 Cal. 2d 417 [34 Cal. Rptr. 552, 386 P. 2d 40].)

In support of its position that Chase-Shawmut's business was not part of appellant's unitary business, appellant contends that the unities of operation and use were absent and that there was no interdependence between the two companies. According to appellant, Chase-Shawmut has always had an independent management with complete profit responsibility for its operations. Appellant emphasizes that there were no officers common to both corporations and no transfers of personnel between them, and that Chase-Shawmut maintained independent patent, legal, purchasing, accounting, advertising, marketing, and research functions. Chase -Shawmut assertedly operated as a separate and distinct business (see Butler Bros. v. McColgan, supra, 17 Cal. 2d at 667 -668, and Honolulu Oil Corp. v. Franchise Tax Board, supra, 60 Cal. 2d at 424) because to associate it too closely with appellant would have resulted in the loss of most of Chase-Shawmut's sales, viz. , the sales of fuse products specially designed for use, in electrical equipment

manufactured by appellant's competitors.

We may agree with appellant that centralization of a number of typical overhead or service functions does not exist in this case. We have previously held, however, that there need not be centralized performance of all service functions in a unitary business if the operations 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; Appeals of Simonds Saw and Steel Co., et al., Cal. St. Bd. of Equal., Dec. 12, 1967; see also Appeal of F. W. Woolworth Co., Cal. St. Bd. of Equal., July 31, 1972.) Upon reviewing the facts before us, we are persuaded that sufficient interdependence and contribution exists to sustain respondent's inclusion of Chase-Shawmut in appellant's unitary business.

The major factors leading to this conclusion are the integration of executive forces through interlocking boards of directors, substantial intercompany loans, and substantial intercompany transfers of goods. It is true, as appellant has pointed out, that there are no officers common to appellant and Chase-Shawmut, but appellant nevertheless provided top level executive assistance to its subsidiary in the vital areas of plant construction and labor relations. In addition, overall managerial assistance was rendered by Mr. Bosanko as vice president of appellant and as a director of Chase-Shawmut. The importance of the integration of executive forces was emphasized in Chase Brass & Copper Co., Inc. v. Franchise Tax Board, 10 Camp. 3d 496 [87 Cal. Rptr. 239], appeal dismissed and cert. denied, 400 U.S. 961 [27 L. Ed. 2d 381], where the court said:

> For a subsidiary corporation to have the assistance and direction of high executive authority of such a corporation as Kennecott [the parent corporation] is an invaluable resource. ...
> (10 Cal. App. 3d at 504.)

An equally valuable resource for a subsidiary is the ability to call on its parent for necessary financing when funds are not realistically available in the commercial marketplace. In the years immediately following its acquisition of Chase-Shawmut, appellant provided funds for both working capital and plant con-

struction. During that period of financial weakness, Chase-Shawmut could have obtained commercial financing, if at all, only on far less favorable terms than were granted by appellant. The evidence before us indicates that this intercompany financing on preferential terms played a significant role in Chase-Shawmut's transition from a financially distressed corporation in the 1950's to a profitable enterprise in the 1960's.

Intercompany sales of goods have frequently been held to be an important indicator of a unitary business. (See Chase Brass & Copper Co., Inc. v. Franchise Tax Board, supra; Appeal of Combustion Engineering, Inc., supra; Appeals of Simonds Saw and Steel Co., et al., supra; Appeal of Williams Furnace Co., Cal. St. Bd. of Equal., Aug. 7, 1969; Appeals of Monsanto Co., Cal. St. Bd. of Equal., Nov. 6, 1970; Appeals of The Anaconda Co., et al., May 11, 1972; Appeal of Browning Mfg. Co., et al., Cal. St. Bd. of Equal., Sept. 14, 1972.) Here, Chase-Shawmut's sales to appellant and its other affiliates were both substantial in amount and at preferential prices. Certainly, it was beneficial to Chase-Shawmut to have a ready market for a significant part of its output, and it was at least equally beneficial to appellant to have a ready supplier of the bulk of the. fuse products incorporated in the various types of electrical equipment that it manufactured.

In light of our finding that interdependence and mutual contribution existed between Chase-Shawmut and the rest of appellant's unitary business, the elements of independence and separateness emphasized by appellant are inconsequential. Some measure of separateness frequently exists among the component parts of a unitary business. (See, e.g., Appeal of F. W. Woolworth co., supra; Appeals of Simonds Saw and Steel Co., et al., supra.) But Chase-Shawmut's business is not "truly separate and distinct" from the remainder of appellant's unitary business. Accordingly, we must sustain respondent's determination that Chase-Shawmut was a part of that unitary business.

ORDER

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

Appeal of I-T-E Circuit Breaker Company

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 I-T-E Circuit Breaker Company against proposed assessments of additional franchise tax in the amounts of $2,458.60 and $1,585.65 for the income years 1961 and 1962, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 23rdday of September, 1974, by the State Board of Equalization.

_____, Chairman

_____, Member

_____, Member

_____, Member

_____, Member

ATTEST: _____, Secretary