



BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )  
GROLIER SOCIETY, INC. )

For Appellant: William O. Lenihan  
Vice President, U. S. Taxes

For Respondent: Crawford H. Thomas  
Chief Counsel

Joseph W. Kegler  
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 Grolier Society, Inc. against a proposed assessment of additional franchise tax in the amount of \$17,912.35 for the income year 1964.

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The sole question for determination is whether five Canadian subsidiaries and four Latin American subsidiaries were engaged in a single unitary business with Grolier Society, Inc. , its parent Grolier Incorporated, and other subsidiaries.

Grolier Society, Inc. (appellant), The Richards Company, Inc. , R. H. Hinkley Co., Americana Corporation, and Spencer International Press, Inc. are wholly owned domestic subsidiaries of Grolier Incorporated (Grolier-parent). Each of the domestic subsidiaries is a separate sales organization, and each filed a separate California return for the income year 1964. As the result of an audit, respondent determined that the domestic subsidiaries, the Canadian and Latin American subsidiaries and Grolier International, Inc. (Grolier International) were engaged in a single unitary business with Grolier-parent. <sup>1/</sup>

### Grolier-Parent and the Domestic Subsidiaries

Grolier-parent, a Delaware corporation, was formed in 1936. It is headquartered in New York City. Its principal business activities are the publication and distribution of various encyclopedias, educational materials, and reference works. These products, including translations into French and Spanish, are sold to the ultimate purchasers in the United States, Canada, and other Western Hemisphere countries, as well as in England, and other European countries through Grolier-parent's network of wholly owned domestic and foreign subsidiaries.

Grolier-parent's principal literary properties include: the Rook of Popular Science; Lands and Peoples; the Rook of Knowledge; the Encyclopedia Americana; the Encyclopedia International; the American Peoples Encyclopedia; Our Wonderful World; Richards Topical Encyclopedia; and Grolier Classics. In 1960, it entered the programmed learning field with the introduction of the Min/Max

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<sup>1/</sup> Initially, certain other foreign and domestic subsidiaries were involved. However, their status has been resolved and is not at issue in this appeal.

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teaching machine. By 1963, it had placed 32 programmed learning courses on the market, some of which had been translated into Spanish and French for the Latin American and Canadian markets.

The substance of -what is being sold in these publications and educational materials is information organized, displayed, and disseminated in various ways to meet the specific needs of educational, library, business, or family purchasers. The overall responsibility for the organization,, content, and quality of this information rests with the editorial department of Grolier-parent. The department's operations were summarized in the 1964 Annual Report of Grolier-parent:

The Editorial Department's functions are in three general categories: continuous revisions program to assure that all of Grolier's reference works are kept up-to-date; responsibility for the publication of Grolier's six yearbooks, or annuals; and development of new publications. (1964 Annual Report, p. 6.)

**The marketability of Grolier-parent's products is** evidenced by the fact that domestic and foreign net sales over a 10-year period increased from \$40 million in 1955 to \$116 million in 1964, while net income increased from \$2. 5 million to \$7. 9 million during the same period. Foreign operations contributed almost 24 percent of the 1964 sales compared to approximately 20 percent for 1963.

The significant effort of the editorial department and the investment cost to Grolier-parent involved in the creation of a major new product are exemplified by the development of the Encyclopedia International. This 20 volume set which was introduced in 1963 contained more than 100,000 indexed entries. It was the work of more than 2,000 men and women, and represented an investment in excess of \$4,000,000 in research, development and production. This new English language publication was marketed both in the United States and abroad.

The editorial department of Grolier-parent incurs substantial additional annual product development costs in the regular editorial planning, research, and production work for

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the annual revisions and yearbooks for the major reference works. These supplemental products are made available through Grolier-parent's subsidiaries to prior purchasers in all domestic and foreign market areas.

Prior to the appeal year, management of Grolier-parent decided to expand the market area of some of its more popular works by making them available in languages other than English. In 1962, the translation into Spanish of Richards Topical Encyclopedia (Nueva Enciclopedia Tematica) was completed. In 1963, the new French Book of Popular Science (La Science Pour Tous) was published, and marketing in French-speaking Canada commenced. It was anticipated that the new publication would be introduced throughout the French-speaking world during 1964. By 1963 the translation into French and Spanish of many of the programmed learning courses was completed or underway.

The editorial department of Grolier-parent regularly consults, advises, and coordinates with the editorial staffs at the Canadian and Latin American subsidiaries. The purpose of these contacts is to insure product quality and the inclusion of appropriate material in the periodic revisions to the translated publications.

Grolier-parent insures the protection of its works and their current revisions by obtaining United States copyrights and registering trademarks. When required it obtains such protection through its foreign subsidiaries. For example, the Encyclopedia International was copyrighted in the United States by Grolier-parent and in Canada by Grolier of Canada, Limited.

Financial decisions involving all major publication projects affecting either Grolier-parent or any of its domestic or foreign subsidiaries are made by the management of Grolier-parent through its finance committee. Examples of such decisions include both the completion of the French translations for marketing in French-speaking Canada and the Spanish translations for marketing in Latin America. The principal source of the necessary capital for such major projects was often Grolier-parent. Although the Canadian group was well established prior to 1964 so that it could handle its routine financial needs internally, in earlier years the necessary capital for major new Canadian projects approved by Grolier-parent was furnished by it.

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Door-to-door selling is the major technique utilized for the sales of Grolier-parent's reference works. Members of the public are contacted by door-to-door sales representatives of the sales subsidiaries who utilize various brochures, pamphlets, and other sales materials, developed primarily by Grolier-parent, to explain each reference work. This same basic sales technique is utilized in the Canadian market, and the same sales materials are available for the use of the door-to-door salesmen in Canada.

The general public, both at home and abroad, is made aware of the wide variety of reference works through extensive magazine advertising. During 1964, advertisements for Grolier-parent's reference works appeared in such popular magazines as McCall's, Life, Saturday Evening Post, Good Housekeeping, and Better Homes & Gardens, as well as in foreign publications.

In order to provide coordination and control, Grolier-parent establishes the general accounting policies to be followed by all of its domestic and foreign selling subsidiaries. Grolier-parent determines what type of periodic reports are to be submitted to it for evaluation. These reports are used in formulating general operating policy and in the preparation of consolidated income and financial reports for each year.

Grolier-parent owns all the common stock of all the domestic and foreign subsidiaries. The ownership of the domestic and some foreign subsidiaries is direct while other foreign subsidiaries are owned by a wholly owned subsidiary of Grolier-parent. Grolier-parent exercises general management and control over the entire group of domestic and foreign corporations through key common officers or directors. Day -to-day operations of the subsidiaries are managed and directed by their own personnel.

Appellant and the other four wholly owned domestic subsidiaries are all sales organizations operating in the United States. Each has the primary marketing responsibility for a particular reference work. Each subsidiary has a sales manager charged with the duties of distribution, maintaining local books of account and collections. Monthly financial reports' are submitted to Grolier-parent. A common pension plan is maintained by Grolier-parent .

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### The Canadian Subsidiaries

Grolier of Canada, Ltd. (Grolier-Canada) is wholly owned by Grolier -parent. It, in turn, is the parent of four other Canadian corporations that operate as sales organizations in a manner similar to the domestic subsidiaries. These four Canadian subsidiaries sell, primarily, Grolier-parent's reference works and programmed learning courses published in either, or both., English and French. There is a substantial interlocking of officers and directors among the Canadian group.

The five Canadian subsidiaries own their own plates and publish various reference works in both the English and French language. These plates were originally produced and are maintained by the Canadian companies. Each subsidiary hires and trains its own personnel, maintains its own books of account, performs all other functional tasks, and is directly responsible to Grolier-Canada.

Although the details for conducting normal business operations were left to the direction and control of Grolier-Canada, major policy decisions involving product development, copyright protection, financing, and the development of new market areas emanated from Grolier-parent. For example, it was the decision of Grolier-parent that certain reference works be translated into French in order to expand sales of its products into French-speaking Canada. It authorized the preparation and publication of these translations in coordination with its own editorial department. It provided necessary financial and technical assistance on these and other major Canadian activities.

The president of Grolier-parent; its executive vice president and vice chairman of the board of directors were directors of both Grolier-parent and Grolier-Canada. The first vice president and chairman of the finance and editorial committees of Grolier-parent was also a director of Grolier-Canada. The vice president and general counsel of Grolier-parent was also the secretary of Grolier-Canada. Periodic visits by officers or directors of Grolier-parent and of the Canadian subsidiaries were made to the other country in order to coordinate various operational matters.

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In 1964, Canada was the principal foreign market area for Grolier-parent's English language reference works and other materials. These works were printed in the United States and shipped to Canada as ordered by the Canadian affiliates. The sales price for the intercompany sales was set by Grolier-parent. Of the \$4,000,000 cost of goods sold for the Canadian group in 1964, \$564,000 was purchases from Grolier-parent. This represented more than 12 percent of Canadian cost of goods sold.

### Grolier International and the Latin American Subsidiaries

Grolier International is Grolier-parent's wholly owned domestic subsidiary. It is the parent of: Editorial Richards S. A. (Richards S. A. ), a Panamanian corporation; Grolier Corporation (Grolier-Panama), a Panamanian corporation; Grolier S. A. (Grolier-Mexico), a Mexican corporation; and Grolier de Venezuela C. A. (Grolier-Venezuela), a Venezuelan corporation. Each of the Latin American subsidiaries is engaged, primarily, in the sale of the Spanish translation of Grolier-parent's Richards Topical Encyclopedia (Nueva Enciclopedia Tematica). The plates used in printing this reference work are owned by Richards S. A. and are located in Mexico. Richards S. A. does not publish any other reference work. Its entire income is derived from the inter-company sale of this encyclopedia to the remaining Latin American subsidiaries. The Latin American subsidiaries hire and train their own personnel, administer their own employee benefit plans, and are responsible for their own advertising, accounting, and collections. The president of both Richards S. A. and Grolier-Panama was transferred from Grolier-parent's New York headquarters to Panama to direct operations in the newly developing Spanish language market. The president of Grolier-Mexico was also transferred by Grolier-parent from New York for the same purpose.

Although the Latin American subsidiaries direct and control their own day-to-day operations, the overall operation of these subsidiaries is directed by Grolier International. In turn, Grolier International is wholly owned and controlled by Grolier-parent. This interrelation is reflected in Grolier-parent's 1963 Annual Report:

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Our foreign activities expanded during 1963. Sales in this category accounted for approximately 20 percent of total volume, as against 15 percent in 1962. A new wholly owned subsidiary, Grolier International, Inc. , was formed in 1963 to consolidate foreign operations. Grolier International, Inc. also will provide a vehicle for the coordinated financing necessary to the continued growth of our foreign activities. (1963 Annual Report, p. 3. )

It was the management decision of Grolier-parent that its products be extended into Spanish speaking foreign market areas. It authorized the translation and publication of Richards Topical Encyclopedia by Richards S. A. in coordination with its editorial department. Grolier-parent decided in which countries the several Latin American subsidiaries were to be incorporated. Grolier-parent authorized the Spanish translation of certain of its programmed learning courses for the Latin American market. It was also Grolier-parent who provided the initial financing for these subsidiaries,

In 1964, six of the seven directors of Grolier International were directors of Grolier-parent, including the board chairman, the vice chairman, and the president of Grolier-parent. The president, a vice president, the secretary, and the treasurer of Grolier International were, respectively, the executive vice president, a vice president, the general counsel and vice president, and a vice president of Grolier-parent.

The five-man. board of directors of Richards S. A. included the president, a vice president and general counsel, and another vice president of Grolier-parent, all of whom were also directors of Grolier International. The six directors of Grolier-Panama included the president, a vice president, and the treasurer of Grolier-parent; the first two were also directors of both Grolier International and Richards S. A. The eight directors of Grolier-Mexico included the president, executive vice president, another vice president, and the treasurer of Grolier-parent. The first three were directors of both Grolier International and Richards S.A., and the first two were also directors of Grolier-Panama. The president of Richards S. A. and Grolier-Panama was also a director of those corporations as well as a director of Grolier-Mexico. The treasurer of Grolier-parent was also the treasurer of all the Latin American subsidiaries.



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Grolier-parent's 1964 Annual Report indicated that, although most of the Latin American sales were of Grolier's several Spanish language works, the English language sets were also distributed. The portion of total Latin American sales represented by English language products is not precisely known. Presumably, such sales were small in relation to the sales of the Spanish language works.

When a taxpayer derives income from sources both within and without California it is required to measure its California franchise tax liability by the net income derived from or attributable to sources within this state. (Rev. & Tax. Code, § 25101. ) If the taxpayer's business is unitary, the income attributable to California must be computed by formula apportionment rather than by the separate accounting method. (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, Inc. v. McColgan, 30 Cal. 2d 472 [183 P. 2d 16].)

The California Supreme Court has developed two general tests for determining whether a business is unitary. In Butler Bros. v. McColgan, *supra*, the court held that the existence of a unitary business is definitely established by the existence of: (1) unity of ownership; (2) unity of operation; and (3) unity of use. Subsequently, in Edison California Stores, Inc. v. McColgan, *supra*, the court 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. More recent cases have reaffirmed these general tests and given them broad application. (Superior Oil Co. v. Franchise Tax Board, 60 Cal. 2d 406 [34 Cal. Rptr. 545, 386 P. 2d 33J; Honolulu Oil Corp. v. Franchise Tax Board, 60 Cal. 2d 417 [34 Cal. Rptr. 552, 386 P. 2d 40J; RKO Teleradio Pictures, Inc. v. Franchise Tax Board, 246 Cal. App. 2d 812 [55 Cal. Rptr. 299]. ) The California courts have yet to clearly delimit the unitary business concept, except to state, "It is only if [a foreign corporation's] business within this state is truly separate and distinct from its business without this state, so that the segregation of income may be made clearly and accurately", that the separate accounting method may properly be used. " (Butler Bros. v. McColgan, *supra*, 17 Cal. 2d 664, 667-668. )

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Application of either of the above stated tests to the facts presented in this appeal leads us to the conclusion that the five Canadian subsidiaries and the four Latin American subsidiaries were engaged in a single unitary business with Grolier-parent, appellant, and the other domestic subsidiaries.

In this case our conclusion is based on the existence of the following major factors which indicate the existence of a unitary business under the established tests: (1) common ownership by Grolier-parent of all the stock of the affiliated corporations either directly or through wholly owned subsidiaries; (2) interlocking directors and officers; (3) Grolier-parent's control over the major policy decisions of the affiliated corporations; (4) substantial product flow from Grolier-parent to the Canadian subsidiaries; (5) creation and development by Grolier-parent's editorial department of the major works which were translated into French or Spanish for ultimate distribution by the Canadian and Latin American subsidiaries; (6) substantial centralized financing by Grolier-parent; and (7) shared expertise or "know-how" by Grolier-parent with its Latin American and Canadian subsidiaries, as well as with its domestic subsidiaries. When these factors are considered it is apparent that respondent's determination is supported by sufficient evidence.

In support of its contention that the Canadian and Latin American subsidiaries are not part of the unitary business of Grolier-parent and its domestic subsidiaries appellant advances two arguments.

First, appellant relies on the absence of any intercorporate relationships between the Canadian and Latin American subsidiaries and the California operations of the domestic affiliates. It is not disputed that the foreign sales subsidiaries had no direct connection with the sales activities of the California domestic subsidiaries since each operated in separate marketing areas. However, a determination that a business is unitary does not require an interdependence between one segment of that business and every other segment of it. This same argument was considered and rejected by this board in Appeal of Monsanto Company, decided November 6, 1970, where it was stated:

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The argument misconceives the unitary business concept. All that need be shown is that during the critical period Chemstrand formed an inseparable part of appellant's unitary business wherever conducted. By attempting to establish a dichotomy between appellant's California operations and Chemstrand, appellant would have us ignore other parts of appellant's business which cannot justifiably be separated from either Chemstrand or the California operations. ...

In the instant appeal we believe the evidence amply supports the determination that the Latin American and Canadian subsidiaries formed an inseparable part of Grolier-parent's business wherever conducted.

Next, appellant maintains that the operational independence of the Canadian and Latin American subsidiaries prevent a determination that they were part of Grolier-parent's single unitary business. However, it appears from the record that the alleged independence relied upon by appellant involves only the day-to-day operations of the Latin American and Canadian subsidiaries. It is the formulation of major policy decisions that is important in determining whether affiliated corporations are integral parts of a unitary business. (Chase Brass and Copper Co. v. Franchise Tax Board, 10 Cal. App. 3d 496 [87 Cal. Rptr. 239], appeal dismissed and cert. denied, 400 U. S. 961 [27 L. Ed. 2d 381]; Appeal of F. W. Woolworth Co., Cal. St. Bd. of Equal., July 31, 1972; Appeals of Marbison-Walker Refractories Co., Cal. St. Bd. of Equal., Feb. 15, 1972; Appeal of Monsanto Co., Cal. St. Bd. of Equal., Nov. 6, 1970. ) We believe the evidence indicates that major policy decisions were chiefly the concern of Grolier-parent .

For the reasons set out above, respondent's action in this matter must be sustained.

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ORDER

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 protest of Grolier Society, Inc. , against a proposed assessment of additional franchise tax in the amount of \$17,912.35 for the income year 1964, be and the same is hereby sustained.

Done at Sacramento, California, this 19 day of August 1975, by the State Board of Equalization.

John W. Lynch, Chairman  
William W. Bennett, Member  
Steve R. Green, Member  
Paul H. Hori, Member  
\_\_\_\_\_, Member

ATTEST: W. W. Davenport, Executive Secretary