BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
STANDARD BRANDS INCORPORATED)

For Appellant: M. P. Stella
Manager, State and Local Taxes

For Respondent: Tom Muraki
Acting Chief Counsel

Joseph W. Kegler
Counsel

O P I N I O N

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 Standard Brands Incorporated, against proposed assessments of additional franchise tax in the amounts of **$30,001.51, $45,930.22** and **$9,344.69** for the income years 1967, 1968 and 1969, respectively.

Appeal of Standard Brands Incorporated

The sole issue for determination is whether Beckett-Planters Nut Products, Ltd., a South African corporation (hereinafter referred to as B-P), was'engaged in the single unitary business conducted by appellant Standard Brands, Inc., and appellant's subsidiaries so that it should be included in appellant's combined report.

Appellant and its subsidiaries are engaged in manufacturing, processing and distributing food and liquor. Included among its many well-known products are Planters peanuts and other confectionery and'snack food products bearing the famous Planters label.

T. W. Beckett & Co., Ltd., a South African corporation (hereinafter referred to as Beckett), is engaged in the food marketing business in South Africa and adjoining countries. Although Beckett is not a party to this appeal, a basic understanding of its operations is helpful in properly resolving this matter. During the appeal years, Beckett was one of the leading distributors of food products in South Africa. It was also experienced in manufacturing and distributing various nuts and nut products.

Appellant was interested in marketing nuts, nut products and related items in South Africa and adjoining areas under the Planters label. Consequently, appellant and Beckett entered into an agreement (hereinafter referred to as the main agreement) in January 1966, This agreement provided for the organization of a separate corporation to tap the South African market. Pursuant to the agreement, B-P was incorporated early in 1966 under the laws of South Africa. Other principal provisions of the main agreement which were performed included the following:

Beckett sold certain manufacturing equipment, raw materials,. packaging materials and manufactured goods to B-P at a value determined by an independent appraisal. At the same time, Beckett terminated its own manufacture of nuts, nut products and confectionery items. The value of the items sold to B-P was reflected on its books as a loan to it by Beckett. Appellant immediately purchased one-half of Beckett's loan account so that Beckett and appellant were then equal lenders to B-P. Neither lender wasentitled to repayment of any part of its loan without written consent of the other.

The authorized stock of B-P consisted of 5,000 ordinary shares. Beckett and appellant were issued 2,500 shares each.

The management of B-P was vested in four directors, two of whom were nominated by Beckett and two by appellant. In the case of any vacancy, the shareholders which had nominated the prior director also nominated the successor. All shares of both shareholders were required to be voted in any vacancy election. Apparently, this requirement was to insure that no director would be elected who did not meet the approval of both shareholders.

A quorum for shareholders' meetings consisted of not less than two shareholders, one being a representative or nominee of Beckett and the other a representative or nominee of appellant. A quorum for directors' meetings consisted of not less than two directors, one being selected by Beckett and the other by appellant. Beckett appointed one of the two directors nominated by it to be the managing director of B-P. His powers and duties were limited to those authorized by B-P's board of directors.

Either shareholder could dispose only of its entire interest in B-P's stock and its loan account. The other shareholder would have the preemptive right to buy that entire interest under specific provisions for determining the price. If Beckett was ever acquired by a competitor of appellant, appellant would have the option to purchase Beckett's shares in B-P. Each shareholder had the right to subscribe to an equal number of any additional authorized shares of B-P.

The main agreement also provided specifically that nothing therein constituted appellant and Beckett members of a "partnership, joint venture, association, syndicate or other entity." The agreement provided further that neither party had express or implied authority to incur any obligation or liability on behalf of the other.

In accordance with the terms of the main agreement between appellant and Beckett, a separate "Technical Aid Agreement" was entered into between appellant and B-P. The principal provisions which were carried out included:

Appellant agreed to provide B-P with technical knowledge, know-how and trade secrets in order to enable B-P to produce fine quality products. Appellant also agreed to train B-P personnel at its United States factories, and to send a trained representative to provide on-site technical assistance at B-P's South African facilities. In exchange for this assistance, B-P agreed to pay appellant five percent of its net sales. B-P agreed that its personnel would not disclose any of the know-how, trade secrets or other confidential data provided to it by appellant.

Pursuant to the main agreement, another separate agreement, entitled "Administration and Distribution Agreement," was entered into between Beckett and B-P. The principal provisions which were performed included:

Beckett agreed to administer and conduct the day-to-day activities of B-P with respect to matters which did not require a decision of B-P's board of directors. Beckett further agreed to purchase from B-P all its requirements of specified products produced by B-P and to actively promote the sales of those products through its distribution system. The price paid by Beckett to B-P for these products was 13 percent less than the resale price. This price reduction constituted Beckett's full compensation for its performance under this agreement.

For all the appeal years, appellant reported its income from operations on the unitary basis and determined the California portion of that income by applying the standard three-factor apportionment formula. As the result of an audit, respondent proposed several adjustments, all of which were agreed to by appellant except one. Appellant's sole objection was that the combined report should have included B-P. Thus, our sole inquiry in this matter is whether B-P is engaged in a single unitary business with appellant.

The resolution of this question requires an application of either of two well established tests. Under one test, a business is unitary if there is unity of ownership, unity of operation, and unity of use. (Butler Bros. v. McColgan, 17 Cal. 2d 664 [111 P.2d 334] (1941), affd., 315 U.S. 501 [86 L. Ed. 991] (1942).) Under the second test, a unitary business exists when operation of the portion of the business done within the state is dependent upon or contributes to the operation of the business without the state. (Edison California Stores, Inc. v. McColgan, 30 Cal. 2d 472 [183 P.2d 16] (1947).) Implicit in the second test is an ownership requirement.

It is appellant's position that the ownership requirement is satisfied where common ownership or control can be established even where such common ownership or control is shared equally by two unrelated shareholders.

On the other hand, respondent argues that appellant cannot prevail unless it can establish that it alone has controlling ownership of B-P, and maintains that appellant has not established that it has the required controlling ownership.

Here, the record indicates that both appellant and Beckett had exactly equal ownership and control of B-P. Both owned exactly 50 percent of B-P's voting stock, and both loaned B-P exactly equal amounts. Both were authorized to nominate equal numbers of directors. Exactly equal control is also evidenced by the quorum requirements for directors' and shareholders' meetings. Neither appellant nor Beckett were authorized to undertake any substantial action with respect to B-P without the express consent of the other 50 percent shareholder. The record contains no indication that either appellant or Beckett, standing alone, could exercise controlling ownership of B-P.

In a recent decision, Appeal of Revere Copper and Brass Inc., decided by this board July 26, 1977, we were presented with the,identical question involving a similar factual situation. In Revere the taxpayer owned exactly 50 percent of the voting stock in a cost corporation. The other 50 percent was owned by Olin Mathieson Chemical Corporation who was not a party to the appeal. Like the appellant in the present controversy, Revere shared ownership and control of the cost corporation exactly equally with a third party. We believe Revere, which was decided adversely to the taxpayer, controls the instant appeal. In Revere we considered the ownership requirement in the following language:

> The ownership requirement contemplates an element of controlling ownership over all parts of the business; the lack of controlling ownership standing alone requires separate treatment regardless of how closely the business activities are otherwise integrated. (Keesling and Warren, The Unitary Concept in the Allocation of Income, 12 Hastings L.J. 42, 49 (1960).) A mutual dependence and contribution may exist between two enterprises, for example, where one enterprise supplies the raw materials for fabrication by a second enterprise. However, it would be improper to treat the two enterprises as unitary unless one owns and controls the other. In the absence of such controlling ownership, intercompany charges properly may

> be reflected by separate accounting. Generally speaking, controlling ownership can only be established by common ownership, directly or indirectly, of more than 50 percent of a corporation's voting stock.

In Revere we considered, and rejected as without merit, the identical argument advanced by the appellant in this appeal. 1/ For the reasons set out in Revere, which we adopt here, we conclude that appellant who owns exactly 50 percent of B-P's stock does not have controlling ownership of B-P. Therefore, respondent's action in this matter must be sustained.

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,

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1/ Additional arguments made by appellant and amicus in Revere which we rejected have not been advanced by appellant here. However, for the reasons set out in Revere, we also find those arguments without merit in the context of the present appeal.

Appeal of Standard Brands Incorporated

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 Standard Brands Incorporated, against proposed assessments of additional franchise tax in the amounts of **$30,001.51, $45,930.22** and **$9,344.69** for the income years 1967, 1968 and 1969, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 18th day of October, 1977, by the State Board of Equalization.

William M. Bennett, Chairman

_______________, Member

Iris Sankey, Member

Geo. R. Reilly, Member

_______________, Member