BEFORE THE STATE BOARD OF EQUALIZATION

OF TEE STATE OF CALIFORNIA

In the Hatter of the Appeal of)
) No. 85A-429-MW
CASTLE & COOKE, INC., ET AI,.)

For Appellant: Benjamin C. Byrd, III
Director of Taxes

For Respondent: Paul J. Petrozzi
Counsel

O P I N I O N

This appeal is made pursuant to section 25666[1/] of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Castle & Cooke, Inc., et al., against proposed assessments of additional franchise tax in the amounts and for the income years as follows:

1/ Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as in effect for the income years in issue.

Appeal of Castle & Cooke, Inc., et al.

	Income Years	Proposed Assessments
Castle & Cooke, Inc.	1972	$121,112
	1973	46,497
	1974	27,531
	1975	9,539
	1976	**121,977**
	1977	**33,331**
West Foods, Inc.	1973	64,875
Pan Alaska Fisheries, Inc.	1976	**1,781**
	1977	**34,476**
Arneson Products, Inc.	**1972**	**182**
	1973	**123**
	1975	**7,447**
	1976	**19,894**
	1977	**33,052**

Three main questions are presented by this appeal: 1) Whether certain subsidiaries were engaged in a unitary business with appellant and properly included by respondent in appellant's combined report: 2) whether amounts paid for time charters and contracts of affreightment should have been included as capitalized rents in the property factor: and 3) whether appellant has shown that it should be allowed to use a special apportionment formula pursuant to section 25137.

Appellant and its subsidiaries and affiliates are primarily involved in various stages of food production, harvesting, transporting, processing, and marketing of food and food products. Appellant's headquarters were in Eawaii.

Ewa Sugar Co., Kohalo Corp., and Waialua Sugar Co. (Waialua), were subsidiaries of appellant which grew sugar cane and produced sugar from the cane. The sugar produced by these companies was sold to a sugar cooperative through the agency of appellant, which received payment from the cooperative and credited it to the sugar companies. Appellant and the sugar companies had some officers and directors in common. Appellant purchased a substantial portion of the fertilizer and some of the farm equipment used by the sugar companies and arranged some financing for them. Appellant, one of Hawaii's major land owners, leased land to the sugar companies for growing cane (from 57 percent to 70 percent of the land used by Waialua).

Appellant also owned several subsidiaries which provided transportation services, and held, operated, and developed real estate. These companies operated entirely within Hawaii.

Respondent included both the sugar companies and the transportation and real estate companies in appellant's combined reports for the appeal years, having determined that they were part of appellant's multinational unitary business. Appellant disagrees with respondent's inclusion of those companies in the combined report, arguing that the sugar companies were not unitary with appellant and that the transportation and real estate companies could not be taxed by California because to do so would result in unconstitutional double state taxation.

The existence of a unitary business may be established under either of two tests set forth by the

California Supreme Court. In Butler Bros. v. McColgan, 17 Cal.2d 664 [111 P.2d 334] (1941), affd., 315 U.S. 501 [86 L.Ed. 991] (1942), the court held that a unitary business was definitely established by the presence of unity of ownership, unity of operation as evidenced by central purchasing, advertising, accounting, and management divisions, and unity of use in a centralized executive force and general system of operation. Later, the court stated that a business is unitary if 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, 30 Cal.2d 472, 481 [183 P.2d 16] (1947).)

Respondent's determination is presumptively correct and appellant bears the burden of proving that it is incorrect. (Appeal of John Deere Plow Company of Moline, Cal. St. Bd. of Equal., Dec. 13, 1961.) Where, as here, the appellant is contesting respondent's determination of unity, it must prove by a preponderance of the evidence that, in the aggregate, the unitary connections relied on by respondent were so lacking in substance as to compel the conclusion that a single integrated economic enterprise did not exist.

We do not believe that appellant has met its burden regarding the sugar companies. It states that it was not in the same business as the sugar companies, that they were not involved in vertical steps in a process, that, although there was some central management, there were no centralized departments to handle the majority of the management functions, and that operational supervision was done principally by the sugar company personnel. Appellant admits the agency relationship for the sale of the sugar, and its purchase of fertilizer and farm equipment for the sugar companies, but contends that these were not done for operational purposes, but merely for convenience because appellant was located in Honolulu and the sugar companies were more remotely located.

From the information in the record, it appears that respondent's determination of unity was justified under either the "three unities" or the "contribution or dependency test." The statements and explanations of appellant are unsupported by any evidence and, in any case, fail to show that the connections relied on by respondent lacked substance. Therefore, we conclude that respondent was correct in its determination that the

sugar companies were part of appellant's unitary business and should have been included in the combined report.

Appellant's objection to the inclusion in the combined report of its other Eawaiian affiliates is not well founded. Appellant does not contest the fact that the affiliates were part of its unitary business. When a taxpayer derives income from sources both within and without this state, its franchise tax liability is measured by its net *income* derived from or attributable to sources within this state. (Rev. & Tax. Code, S 25101.) If the taxpayer is engaged in a single 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. (Edison California Stores, Inc. v. McColgan, supra.)

The United States Supreme Court has long upheld the formula apportionment method of apportioning the income of multijurisdictional unitary businesses. most recently in Container Corp. v. Franchise Tax Board, 463 U.S. 159 (77 L.Ed.2d 545] (1983). To the extent that appellant's argument is based on constitutional grounds, it is addressed to the wrong forum, since this board is precluded from declaring a statute unconstitutional. (Cal. Const., art. III, S 3.5.) Since appellant's affiliates were part of appellant's unitary business, respondent properly included them in appellant's combined report.

Appellant, through some of its subsidiaries, buys, ships, and sells tropical fruit, predominately bananas. The fruit is shipped from &tin America in refrigerated vessels under either time charter arrangements or contracts of affreightment. In a time charter, a contract is made with a vessel owner to supply a vessel, crew, and supplies for a specific period of time. A contract of affreightment is basically the same as a time charter, except that the contract is for a specified amount of space on a vessel. The amount charged for a contract of affreightment is based on the assigned space on the vessel. Under both time charters and contracts of affreighment, the charges to appellant were payable regardless of whether the space on the vessel was actually used.

Appellant contends that the amounts it pays for time charters and contracts of affreightment are actually

rent and should be capitalized for purposes of the property factor pursuant to section 25130. The respondent argues that these costs are transportation expenses, not the rental of assets to be used by appellants in its unitary business. We agree with the Franchise Tax Board that the expenses were for the provision of transportation services.

In Xerox Corp. v. United States, 656 F.2d 659 (1981), the United State Court of Claims was asked to determine whether copy machines were leased to governments and-tax-exempt organizations or supplied as an integral part of a service. The court focused on two areas in making its determination: 1) the possessary interests of the parties and 2) the degree to which the property was part of an integrated operation. (Xerox Corp. v. United States, supra, 656 F.2d at 674-675.) Regarding the possessary interests of the parties, the court stated:

> Thus, in a lease, the customer (lessee) acquires a legal interest of some specified duration in the property itself, which enables it to exercise substantial control over the property including the right to deny access to others including the owner. By contrast, a service contract typically allows the owner access to its property and the right to freely substitute property in order to meet its contractual obligations.

(Xerox Corp. v. United States, supra, 656 F.2d at 675.)

Appellant contends that, through its time charters and contracts of affreightment, it has control over loading dates and schedules, departure and arrival dates, and unloading times. However, we do not believe that this corresponds with the type of control over the property itself (i.e., the ship) which was delineated by the court in Xerox, supra. Clearly, the owners of the vessels not only retained access to the property, but physical control over the vessel, its operations, and its crew.

It appears that, despite appellant's insistence that a rental of property was involved, appellant was interested in more than just space on a boat. What appellant was really contracting for was an integrated package providing adequate space and conditions for its produce while being transported, with payment being for

the end result -- delivery at the port of destination. The fact that tangible personal property was used in achieving this end result does not change a transportation contract into a lease. We disagree with appellant's contention that its arrangements were so distinct from "mere transportation of goods" (App. Response at 7) that it was justified in including these expenses in the property factor as capitalized rental. We have seen no convincing evidence in the record which would support such a distinction.

Appellant also contends that it should be allowed, pursuant to section 25137, to modify its payroll factor because the wage differentials between California and foreign countries causes distortion if the normal payroll factor is used. The same argument has been raised before and rejected. (See, e.g., Appeal of Kikkoman International, Inc., Cal. St. Bd. of Equal., June 29, 1982.) Appellant's mere allegations of distortion, based on separate accounting principles, are insufficient to persuade us that the normal factors should not be used.

Based on the foregoing, the action of the Franchise Tax Board 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,

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 Castle & Cooke, Inc., et al., against proposed assessments of additional franchise tax in the amounts and for the income years as follows:

	Income Years	Proposed Assessments
Castle & Cooke, Inc.	1972	$121,112
	1973	46,497
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	197s	9,539
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	1977	34,476
Arneson Products, Inc.	1972	182
	1973	123
	197s	7,447
	1976	19,894
	1977	33,052

be and the same is hereby sustained.

Done at Sacramento, California, this 17th day of June , **1987**, by the State Board of Equalization, with Board Members Mr. Collis, Mr. Dronenburg, Mr. Bennett, Mr. Carpenter and Ms. Baker present.

Conway H. Collis , Chairman

Ernest J. Dronenburg, Jr. , Member

William M. Bennett , Member

Paul Carpenter , Member

Anne Baker* , Member

*For Gray Davis, per Government Code section 7.9

87-SBE-043-A

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
) No. 85A-0429
Castle & Cooke, Inc., et al.)

ORDER DENYING PETITION FOR REHEARING

Upon consideration of the petition filed July 21, 1987, by the appellants for rehearing of their appeal from the action of the Franchise Tax Board, we are of the opinion that none of the grounds set forth in the petition constitute cause for the granting thereof and, accordingly, it is hereby ordered that the petition be and the same is hereby denied and that our order of June 17, 1987, be and the same is hereby affirmed.

Done at Sacramento, California, this 5th day of January, 1988, by the State Board of Equalization, with Board Members Mr. Dronenburg, Hr. Carpenter, Mr. Bennett, Mr. Collis, and Mr. Davies present.

Ernest J. Dronenburg, Jr., Chairman

Paul Carpenter, Member

William M. Bennett, Member

Conway H. Collis, Member

John Davies*, Member

*For Gray Davis, per Government Code section 7.9