

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
) No. 89A-1016-MC
PPG INDUSTRIES, INC.)

Appearances:

For Appellant: Paul H. Frankel
Charles J. Moll, III
Attorneys at Law

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 PPG Industries, Inc., against proposed assessments of additional franchise tax in the amounts of \$351,056, \$201,278, \$403,966, and \$645,849^{2/} for the income years 1977, 1978, 1979, and 1980, respectively.

^{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.

^{2/} Appellant and respondent have made concessions on various non-unitary issues, including incorporation of federal adjustments, and the proposed assessments have been revised downward by \$57,613, \$37,175, \$91,237 and \$22,399 for 1977, 1978, 1979, and 1980, respectively.

The basic issue is whether appellant was engaged in a single worldwide unitary business with all of its majority-owned affiliates. Also, appellant argues, only for purposes of preserving its rights, the issue of whether worldwide combination in this case violates either the due process clause or the foreign commerce clause of the U. S. Constitution.

During the appeal years, appellant was a Pennsylvania corporation which was qualified to do business in California. It manufactured a variety of industrial materials and was divided internally into four main divisions: Glass, Chemicals, Coatings and Resins, and Fiber Glass. Appellant was also the majority shareholder of numerous affiliates doing business in the U.S., Canada, and Europe. For the years in question, appellant filed a separate California franchise tax return which excluded all of its foreign and domestic affiliates. The return treated appellant itself as engaged in a single unitary business involving the four product lines noted above, and the unity of these four divisions is conceded by both parties. After audit, respondent determined that the majority-owned affiliates were also part of the unitary business and should not have been excluded from appellant's return, and issued proposed deficiency assessments in accord with its conclusion. Appellant has conceded that the majority-owned domestic affiliates were part of its unitary business (Tr., at 7), leaving in dispute the issue of unity of the majority-owned foreign affiliates.

Each of the foreign affiliates, except allegedly one, was engaged in the same business as appellant and its domestic affiliates. In addition to this fact, respondent based its conclusion on the following factual findings: appellant coordinated all of the operations of the subsidiaries; some of appellant's executives sat on the board of directors of each affiliate; appellant controlled all major policy decisions; appellant licensed technology to some of the affiliates for a fee; there was some product flow between appellant and its affiliates and between affiliates; all research and development was carried out by appellant, and technical information was passed to the affiliates through the appropriate division of appellant; there were some transfers of key personnel from appellant to the affiliates and among the affiliates; appellant and all of the affiliates used the same trademark logo; and there was some centralized purchasing, some use of common marketing procedures, and substantial similarity in the accounting and financial reporting systems of appellant and the affiliates.

Appellant disputes the accuracy or significance of all of these factual findings by the Franchise Tax Board (FTB). The appellate record contains little specific evidence on any of these findings. FTB says it can't be more helpful because appellant was uncooperative in providing requested information. Appellant, on the other hand, says it gave FTB more than enough documentation, but FTB is simply disgruntled because the evidence supplied does not support its determination in this case. The briefs of both parties have discussed the affiliates as a group instead of describing the relationships each affiliate had, individually, with appellant's unitary business. It seems clear that each affiliate had at least some important unitary ties to appellant, such as the use of appellant's proprietary technology and the transfer of goods to appellant. The taxpayer's briefs have, in general, sought to minimize such connections by lumping all of the affiliates together and arguing that on average such connections were minimal.

If a taxpayer derives income from sources both within and without California, its

franchise tax liability is required to be measured by its net income derived from or attributable to sources within this state. (Rev. & Tax. Code, § 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, 30 Cal.2d 472 [183 P.2d 16] (1947).)

Respondent's determination regarding the existence of a unitary business is presumptively correct, and appellant bears the burden of showing that it is incorrect. (Appeal of Kikkoman International, Inc., Cal. St. Bd. of Equal., June 29, 1982.) The California Supreme Court has held that the existence of a unitary business may be established by the presence of unity of ownership; unity of operation as evidenced by central accounting, purchasing, advertising, and management divisions; and unity of use in a centralized executive force and general system of operation. (Butler Bros. v. McColgan, 17 Cal.2d 664 [111 P.2d 334] (1941), *affd.*, 315 U.S. 501 [86 L.Ed. 991] (1942).) It has also stated that a business is unitary if the operation 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.) More recently, the United States Supreme Court has emphasized that a unitary business is a functionally integrated enterprise whose parts are characterized by substantial mutual interdependence and a flow of value. (Container Corp. v. Franchise Tax Board, 463 U.S. 159, 178-179 [77 L.Ed.2d 545], *rehg. den.*, 464 U.S. 909 [78 L.Ed.2d 248] (1983).)

By conceding that the domestic subsidiaries were unitary with appellant, but disputing that the foreign subsidiaries were unitary, appellant is essentially arguing that its connections with the foreign subsidiaries are not as strong as those with the domestic subsidiaries. However, except with respect to two subsidiaries discussed at the oral hearing, appellant has presented little evidence or argument, other than broad generalizations, to distinguish its relationship with its foreign subsidiaries from its relationship with its domestic subsidiaries. Therefore, with regard to all foreign subsidiaries except Vernante-Pennitalia, S.P.A., and the Kalium Division of PPG Industries Canada Limited (Kalium), we conclude that the foreign subsidiaries were unitary with appellant. We discuss Vernante-Pennitalia, S.P.A., and Kalium separately.

Kalium, during the years in question, was a wholly owned Canadian subsidiary engaged in potash mining. Potash was an essential plant nutrient. Kalium used solution mining to extract the potash from under ground. This method is commonly used to mine other minerals, but apparently Kalium was the only company using the technique for underground potash mining. The modifications to the general solution-mining method developed by Kalium were apparently developed in the 1960's and Kalium was awarded many patents for them. By the years involved in this appeal, Kalium's use of solution mining for potash was well developed, and Kalium was a fully operating mining company.

Kalium was part of appellant's Chemical Division. The Industrial Chemical Division produced many raw chemicals, such as chlorine, caustic soda, chlorinated solvents, vinylidene chlorine, vinyl chloride monomer, and silica products. The Agricultural and Performance Chemical Division

produced potash, biochemicals, "CR-39 monomer," initiators, chloroformates, and flame-retardant additives. Appellant basically asserts that Kalium was run independently of the other subsidiaries, and bases its argument primarily on Kalium's unique mining method for extracting the potash.

We are not convinced. Although the potash mining technique may have been developed independently of the other operations of appellant, Kalium was still a fully functioning division of appellant's Chemical group. Appellant attempts to create the impression that Kalium was a division off on its own. Viewing the record as a whole, however, including the testimony before this board, we do not see how the potash mining and selling can be considered anything but an integral part of appellant's Chemical Division. Except for its unique mining process, Kalium had substantially the same connections with appellant as all the other unitary subsidiaries.

The other company appellant focused on was Vernante-Pennitalia, S.P.A. (Vernante). This was an Italian company engaged in the glass-manufacturing business. It produced both flat glass and glass for specialized uses such as automobiles. Appellant apparently purchased 80 percent of this company because it had a license to use the Pilkington^{3/} method to produce flat glass. During the appeal years, appellant apparently completed development of a new method to produce the flat glass, and Vernante eventually adopted this proprietary method.

Appellant contends that Vernante was not part of the unitary group for two basic reasons. One is that the glass requirements for automobile glass in Europe differ from those in the U.S. The second is that, because Vernante had a 20-percent outside ownership, appellant had to run it so as not to violate the rights of the minority shareholders. We disagree. First, the mere fact that the requirements for a European windshield may be different from U.S requirements does not defeat unity. Appellant cites Appeal of Mohasco Corporation, decided by this board on October 14, 1982, to support its position that the differences in the requirements for windshields are significant. However, in Mohasco, the different requirements were only one of many factors pointing to lack of unity. Other than the different legal requirements for windshield glass, appellant has not pointed to other differences in its relationship with Vernante as compared to its other international subsidiaries. As to the fact of minority shareholders, appellant has not cited, and we cannot find, any authority which states that the mere presence of minority shareholders, even though this may force the parent to deal at "arm's length" with the subsidiary, defeats the existence of unity.

Finally, respondent agreed to a number of changes which appellant requested in the calculation of the tax. However, respondent did not accept appellant's suggested depreciation changes for the foreign subsidiaries. Appellant has the burden of proving that respondent's determinations are incorrect. We have carefully reviewed appellant's arguments regarding the depreciation and find them unpersuasive.

For the reasons discussed above, the action of the Franchise Tax Board in this matter will be modified to reflect the concessions of the parties.

^{3/} We assume this is the proper spelling, since the only mention of this method was at the hearing before this board.

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 PPG Industries, Inc., against proposed assessments of additional franchise tax in the amounts of \$351,056, \$201,278, \$403,966, and \$645,849 for the income years 1977, 1978, 1979, and 1980, respectively, be and the same is hereby modified in accordance with the concessions of the parties. In all other respects, the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this 13th day of January, 1993, by the State Board of Equalization, with Board Members Mr. Sherman, Mr. Fong, Mr. Dronenburg, and Ms. Scott present.

Brad Sherman _____, Chairman

Matthew K. Fong* _____, Member

Windie Scott** _____, Member

_____, Member

_____, Member

*Abstained

**For Gray Davis, per Government Code section 7.9