



Appeals of Servomation Corp., et al.

<u>Appellant</u>	<u>Taxable Year Ended</u>	<u>Assessment</u>	<u>Refund Claim</u>
Servomation Western, Inc.	6-30-63	\$2,554.03	
Servomation Witbeck, Inc.	6-30-63	223.95	
Servomation Steuber, Inc.	6-30-62		\$4,494.06
	6-30-63		4,494.06

**The sole issue raised by these a-peals is whether Servomation Corp. and the other appellants were engaged in a single unitary business during the years in question.**

Servomation Corp. (formerly named United Servomation Corp., and referred to hereafter as "Servomation" or "the parent") was incorporated under Delaware law on October 18, 1960. Its headquarters are in New York City. On December 28, 1960, it issued one million shares of its common stock to the owners of 1.3. business enterprises which were engaged in the operation of automatic vending machines in various parts of the kited States. In return for the stock issued, Servomation received all of the stock and assets of those companies.

Since that tine Servomation 'has become sole owner of 43 other companies also engaged in the automatic vending machine business. in addition Servomation owns all of the stock of several corporations which engage in manual food operations, such as food concessions) cafeterias and restaurants. Appellants are the parent company and those Servomation subsidiaries which do business in California.

For several years prior to the formation of Servomation, there had been some cooperative activity among this nationwide group of separate owners of automatic vending machine businesses. In 1957 they had formed a corporation called Federated Vendors, Inc., which thereafter engaged in central purchasing of a portion of the products sold through the machines of these various independent operators. After Servomation was formed, Federated Vendors, Inc. became a wholly-owned subsidiary of Servomation and continued to engage in purchasing activities for the other Servomation subsidiaries.

Since its formation one of Servomation's primary organizational objectives has been to retain the established management of those companies which it acquired. In pursuit of this objective Servomation has obtained long-term employment contracts from many of those experienced executives, 1-t also has approved an incentive compensation plan for those individuals based upon the net income of their particular subsidiaries.

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Servomation's operating companies are grouped into a system of six geographical regions. Each region has a regional management board and regional coordinator, all selected from the various company executives. The coordinator analyzes problems arising in his region but he has no direct control over the actions of the individual operators within the region. Servomation has also organized a system of eight national committees which act in an advisory capacity only and which are composed of executives of the various subsidiaries. Servomation's board of directors is composed of its president and a number of the chief executives of the subsidiary companies.

Within this overall scheme of coordination Servomation has encouraged the chief executive and former owner of each subsidiary to continue his personal concern and initiative with respect to the business of that subsidiary. The basic responsibility and authority to make operating decisions lies with those executives, and they operate their respective subsidiaries with a considerable degree of autonomy.

Shortly after its incorporation the parent company negotiated a large loan from an insurance company for use by the operating companies. Subsidiaries are required to obtain financing from the parent unless a better arrangement can be made elsewhere, and for the most part the subsidiaries do all their borrowing from the parent.

Servomation has set up a standard system of accounting which most of its subsidiaries follow in keeping their records. A nationwide advanced management training program was initiated by the parent company during the period on appeal, and most of the chief executives of the various subsidiaries have participated in that program.

Each subsidiary retains its own legal counsel. Also the parent company has a general counsel who represents it in problems arising with relation to the entire group of corporations.

Utilization by the various operating subsidiaries of the central purchasing facility provided by Federated Vendors, Inc. is optional. A little less than 20 percent of the total merchandise handled by the group, on the basis of sales price, is acquired through central purchasing. Also available on a voluntary basis is a group insurance plan for all employees of Servomation and its subsidiaries.

Appellants may be divided into three groups, such grouping being made on the basis of distinctions in the products handled and the operation of the corporations within each group:

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1. Appellants Servomation Bay Cities, Inc., Servomation Central California, Inc., Servomation Western, Inc., Servomation Wilbeck, Inc., and Servomation Steuber, Inc. are all in the "full-line automatic vending service business," i.e., the distribution and sale of food products, hot and cold beverages, and tobacco products through coin operated machines. The great majority of the machines handled by these corporations are placed in industrial plants, schools, and other institutional buildings. Sales by these five companies and other Servomation subsidiaries operating similarly throughout the United States produce about 80 percent of Servomation's total revenue. These companies utilize all or most of the centralized facilities previously described.

2. Appellants Arrowhead Vending Machine Co., Servomation Tri-Counties, Inc. (formerly General Cigarette Service, Inc.), and 20th Century Cigarette Vendors are principally engaged in the distribution and sale of cigarettes from automatic vending machines throughout California at numerous "off-street" locations, i.e., in service stations, restaurants, bars, etc. Arrowhead Vending Machine Co. sells only cigarettes. Cigarettes constitute 82.5 percent of Servomation Tri-Counties, Inc.'s sales and 87.5 percent of 20th Century Cigarette Vendors' sales. The remainder of their business consists of machine sales of confections and hot and cold beverages at these "off-street" locations.

These companies do not purchase their cigarettes through Servomation's central purchasing facility. Some of the items other than cigarettes which are sold by Servomation Tri-Counties, Inc. and 20th Century Cigarette Vendors are centrally purchased. These three companies do obtain financing from the parent and their employees do participate in the parent's group insurance plan,

3. Appellant Servomation Duchess, Inc. (hereafter referred to as "Duchess") is one of several corporations acquired by Servomation which engage in the manual food business. It derives all of its income from the operation of snack concessions at sporting events in the San Francisco Eay area.

Duchess makes virtually no purchases through Servomation's central purchasing system. It does not participate in the uniform accounting system initiated by its parent. During the years on appeal Duchess did not borrow money from Servomation, with the exception of one advance obtained to take care of a sales tax deficiency. Duchess' chief executive is not a member of Servomation's board of directors. Duchess' employees do participate in the parent company's group insurance plan.

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Appellants filed their California franchise tax returns on the basis of separate accounting for each corporation. Respondent determined that Servomation and all of its wholly-owned subsidiaries, including appellants, were engaged in a single unitary business, and that appellants' net income derived from California sources should therefore be determined by a formula allocation of the combined income of the entire group of Servomation companies. The proposed additional assessments which resulted gave rise to these appeals.

In its decisions in Superior Oil Co. v. Franchise Tax Board, 60 Cal. 2d 406 [34 Cal. Rptr. 545, 386 P.2d 33] and Honolulu Oil Corp. v. Franchise Tax Board, 60 Cal. 2d 417 [34 Cal. Rptr. 552, 386 P.2d 40], the California Supreme Court reaffirmed the two tests which it has promulgated for determining the existence of a unitary business. The first of those tests, originally set forth in the case of Butler Bros. v. McColgan, 17 Cal. 2d 664 [111 P.2d 334], aff'd, 315 U.S. 501 [86 L. Ed. 991], provides that a unitary business exists when there is unity of ownership, unity of operation as evidenced by central purchasing, advertising, accounting and management, and unity of use in a centralized executive force and the general system of operation. Under the second test, as it was expressed in Edison California Stores, Inc. v. McColgan, 30 Cal. 2d 472 [183 P.2d 16], a business is unitary when the 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.

When these tests are applied to the facts of the instant appeals, we conclude that during the years in question all of the appellants except Duchess were engaged in a unitary business with the other Servomation companies doing business throughout the United States.

All of the appellants are wholly-owned subsidiaries of Servomation. With the exception of Duchess, all are engaged in the sale of various products through automatic vending machines. As a result of this similarity of sales method all of these companies are faced with similar sales and distribution problems. By means of Servomation's regional and committee systems of coordination, and the presence on its board of directors of the chief executives of many of these subsidiaries, their common problems can be shared and resolved.

It is true that three of the appellants are primarily involved in the sale of cigarettes, rather than in a full-line vending machine operation. However, two of those three companies do sell some confections and beverages in addition

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to cigarettes, and to that extent, they are engaged in the distribution and sale of items similar to those handled by the full-line operators. Conversely, all of the full-line vending machine businesses sell cigarettes and other tobacco products.

Substantially all of the appellants acquire some portion of their products through Federated Vendors, Inc., the parent company's central purchasing facility. The landmark Butler Bros. and Edison cases have both recognized that central purchasing and the savings thereby realized are strong indications of the existence of a unitary business. Such acquisitions by Duchess were de minimis.

In an attempt to detract from the significance of this central purchasing activity appellants contend that prior to their affiliation with Servomation they made the same use of Federated Vendors, Inc. and received the same full quantity discounts as a result of the cooperative ownership of that facility. This, however, does not alter the fact or the relevance of the fact that since Federated Vendors, Inc. and the other companies became Servomation subsidiaries the economies inherent in centralized purchasing have accrued to the group as commonly owned corporations.

All of the appellants except Duchess obtain most of their financing from the parent company and all except Duchess participate in the uniform accounting system initiated by Servomation.

We believe that all of these facts indicate a substantial degree of mutual dependency and contribution among the various Servomation companies engaged in the automatic vending machine business.

Such contribution and dependency seem to be lacking, however, where Duchess is concerned. Its manual food operation is not the same as the operations of the other appellants. Methods of preparation and handling of products, the markets served, and other problems faced by the operators of snack concessions at sporting events would seem to differ from those presented in the automatic vending machine business. When these distinctions are considered along with the almost complete autonomy of Duchess' operation and its lack of participation in its parent's centralized functions, we do not think it can be said that Duchess was a part of the unitary business to which the other appellants were attached.

The record indicates that several other Servomation subsidiaries were also engaged in manual food operations. In

