BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
AMP INCORPORATED)

For Appellant: Albert F. Skelly
Attorney at Law

For Respondent: Crawford H. Thomas
Chief Counsel

Peter S. Pierson
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 AMP Incorporated against proposed assessments of additional franchise tax in the amounts of $6,431.15, $7,439.09 and $10,661.50 for the income years 1960, 1961 and 1962, respectively.

Appellant AMP Incorporated is a New Jersey corporation, organized in 1941, and is in the business of manufacturing and selling certain electrical components. Appellant has sales offices in various parts of the United States, including Hawthorne, California, which solicit orders principally from original equipment manufacturers. The orders are accepted at appellant's home office in Harrisburg, Pennsylvania, and the products are shipped from manufacturing plants located in Central Pennsylvania and North Carolina. A wholly owned subsidiary of appellant, American Pamcor, Inc., sells the same products to the maintenance and repair market in the United States. One of its sales offices is also located in Hawthorne, California. The subsidiary obtains all of its goods from appellant or Pamcor, Inc., which will be described below. Another wholly owned subsidiary, Aircraft-Marine Products of Canada, Ltd., is also only a selling corporation and obtains its goods from the same two sources, but sells in the Canadian market.

Appellant has additional wholly owned subsidiaries in Holland (which in turn has a wholly owned sales subsidiary in West Germany), England, Italy, Prance, Mexico, Australia, and Japan. Under license agreements with their parent, these corporations manufacture and sell, in their respective countries, products similar to appellant's, During the years in question the Dutch, English, and Italian subsidiaries paid royalties of 5 percent of net sales, averaging $186,585, $150,145 and $51,499 per year, respectively. Local restrictions limited the French subsidiary to the payment of 3 percent royalties, averaging $78,781 per year, and prevented the payment of any royalties by the Mexican, Australian, and Japanese subsidiaries.

Pamcor, Inc., is a Puerto Rican corporation'which manufactures and sells appellant's products under a license agreement which provides for royalty payments to appellant measured by 2-1/2 percent of sales. During the years in question these payments averaged $56,116 per year. Pamcor's main customers are the two subsidiaries of appellant mentioned above, and an independent California distributor. During the years in question approximately 16 percentof Pamcor's stock was owned by appellant, approximately 57 percent was held in trust, and approximately 27 percent was held by other shareholders.- No information has been submitted concerning what percentage of the last-mentioned group were also shareholders of appellant. Respondent has submitted a copy of the 1962 combined financial statements of appellant, its subsidiaries, and Pamcor, Inc. A note to the statements explains that they were combined because each company had substantially identical shareholders, and states that the above Pamcor stock held in trust was being held "for the benefit of those AMP common shareholders whose certificates are endorsed to show they are entitled to a proportionate interest in the Pamcor common stock....'

Appellant and its subsidiaries have some officers and directors in common. Respondent states that appellant maintains coordinators at each subsidiary who report to appellant on local operations and help prepare information for the combined annual financial statements. However, appellant denies that coordinators are maintained at the subsidiaries. It does state that a European staff office is located in London which employs an office manager and two specialists in sales and production. Appellant also states that the subsidiaries control their own day-to-day management and also control financing, purchasing, production, quality control, marketing, advertising, accounting, personnel and pensions, and the acquisition of insurance and legal services. Although all the subsidiaries, except the Canadian, English, and Australian, *carry* the AMP trade name, appellant states that the name is *not* advertised in foreign countries and potential foreign customers are completely unfamiliar with it.

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Products and materials are sold by appellant to its subsidiaries and are also sold between the subsidiaries themselves. However, appellant purchases very few products from the other corporations because differences in design make the foreign products generally unmarketable in the United States. During the years in question the total Intercompany sales of appellant, Pamcor, Inc., and the French, Dutch (and West German), and English subsidiaries were as follows:

Buyers	Sellers				
	Appellant	Pamcor, Inc.	French sub.	Dutch & W.German sub.	English sub.
Appellant	$ ----	$ 0	$ 6,987	$ 761	$ 369
American Pamcor, Inc.	3,818,807	4,896,986	951	1,638	42
Canadian sub.	2,258,276	646,071	0	0	31,244
Pamcor, Inc.	176,607	----	0	11,242	336
French sub.	1,052,442	23,425	----	181,160	294,831
Dutch & W. German sub.	1,979,539	209,901	471,134	----	431,688
English sub.	1,369,346	72,951	173,775	240,500	----
Italian sub.	309,975	6,571	178,990	218,070	183,648
Japanese sub.	1,003,849	236,975	5,385	39,164	3,988
Australian sub.	94,022	0	6,990	21,883	50,026
Mexican sub.	139,655	54,538	3,150	30,833	10,613
	$12,202,518	$6,147,418	$847,362	$745,251	$1,006,785

The Japanese and Italian subsidiaries made intercompany sales totalling $192,549 and $172,233, respectively, during the years in question. The Japanese subsidiary's main buyers were the Dutch and West German subsidiaries and appellant, while the Italian subsidiary's primary buyers were the Japanese, Dutch, and West German subsidiaries. Intercompany sales made by American Pamcor, Inc., and the Canadian, Australian, and Mexican subsidiaries were negligible during the years in question.

Respondent states that appellant's 1962 Annual Report shows that this corporation had 583 employees engaged in research, development, and engineering. American Pamcor, Inc., had 15 employees engaged in these functions, while the European subsidiaries had 105 and the Japanese and Australian subsidiaries had 39. During the years 1960, 1961 and 1962 the combined group of corporations spent $6,230,890, $7,197,336 and $8,810,719, respectively, in these areas. Appellant's share of these amounts was $5,681,121, $6,489,067 and $7,985,584, respectively. Respondent concludes that these figures imply that appellant does the original product development and the subsidiaries confine their activities to adapting the products to their local markets.

Appellant responds that approximately 75 percent of its research, development, and engineering expenses are attributable to product engineering, i.e., the engineering required to manufacture products pursuant to specific orders of its own customers. Also, appellant adds that a substantial part of its research and development is devoted to very complicated products which are not sold in the less sophisticated foreign markets. Although the foreign subsidiaries generally manufacture and sell products similar in nature to those produced by their parent, appellant states that due to a number of factors the foreign products must be engineered quite differently from appellant's. Appellant points out that it designs products only for the North American market and the military. These products must conform to minimum standards set by the U.S. Underwriters' Laboratories or the specifications of the Department of Defense. In contrast, products manufactured by the subsidiaries are subject to minimum standards set by the government where the subsidiary is operating. Also, the types of current used and the availability of raw materials vary throughout the world. In addition, appellant states that the foreign subsidiaries become involved in projects which are unique to their particular marketing areas, and periodically are called upon to produce completely original items.

Respondent determined that appellant, its subsidiaries, and Pamcor, Inc., were engaged in a unitary business and therefore appellant must compute its tax accordingly. Whether this determination is correct is the sole issue of this case,

When a taxpayer derives income from sources both within and without California, its tax shall be measured by the net income derived from or attributable to sources within this state. (Rev. & Tax. Code, § 25101.) If a business is unitary, the income attributable to California must be computed by formula allocation 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 above cited cases developed two tests for determining whether a business is unitary. Under one test such status is found if the unities of ownership, operation, and use exist. (Butler Bros. v. McColgan, supra.) Under the other test, a business is unitary when operation 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, supra.)

Recent decisions of the California Supreme Court have re-affirmed these tests. (Superior Oil Co. v. Franchise Tax Eoard, 60 Cal. 2d 406 [34 Cal. Rptr. 545, 386 P.2d 33]; Honolulu Oil Corp. v. Franchise Tax Board, 60 Cal. 2d 417 [34 Cal. Rptr. 552, 386 P.2d 40].)

However, appellant contends that instead of applying the above tests, formula-allocation should be used only if the operations of the business within and without California are "necessary and essential" to each other. This approach was rejected recently in Superior Oil Co. v. Franchise Tax Board, supra. We do not agree with appellant's argument that the factual differences between the instant case and the Superior Oil Co. case, supra, justify adoption of the proposed test.

Applying the above established tests to the instant situation, we think that respondent's determination was correct. Appellant, its wholly owned subsidiaries, and Pamcor, Inc., are all engaged in the same business, manufacturing and selling or just selling certain electrical components. The manufacturing subsidiaries and Pamcor, Inc., are patent licensees of appellant and pay substantial royalties, when local law permits, for this privilege. Without these licenses, the businesses of these corporations would probably be seriously hindered, and appellant would lose a significant source of revenue. (See Appeal of Anchor Hocking Glass Corp., Cal. St. Bd. of Equal., Aug. 7, 1967.) Considering the similarity of the products of these corporations, it is also very likely that product refinements and inventions developed by one company's engineering department would be made available to the other corporations. (See Appeals of Simonds Saw and Steel co., et al., Cal. St. Bd. of Equal., Dec. 12, 1967.) This and other beneficial exchanges of information would be facilitated by the directors, officers, and other employees which these companies share. (Appeal of Anchor Hocking Glass Corp., supra.)

Substantial amounts of intercompany sales were made among these corporations during the years in question, thus providing availability of, and markets for, products and materials. (Appeals of Simonds Saw and Steel Co., et al., supra; Appeal of Wm. Wrigley, Jr. Co., Cal. St. Bd. of Equal., Dec. 15, 1966.) These intercompany sales were especially significant in relation to Pamcor, Inc., American Pamcor, Inc., and Aircraft-Marine Products of Canada, Ltd., as the latter two corporations provided the main market for Pamcor, Inc., while it was one of only two sources for them. (Appeal of Cutter Laboratories, Cal. St. Bd. of Equal., Nov. 17, 1964.)

Appellant contends that Pamcor, Inc., cannot be considered part of the unitary business because it was not owned or controlled by appellant as prescribed by sections 25102 and 25105 of the Revenue and Taxation Code. However the authority for the use of formula allocation is not derived from these sections but rather from section 25101 of the Revenue and Taxation Code. (Edison California Stores, Inc. v. McColgan, supra, 30 Cal. 2d 472 [183 P.2d 16]; Appeals of Eljer Co. and Eljer Co. of Calif., Cal. St. Bd. of Equal., Dec. 16, 1958.) During the years in question appellant owned approximately 16 percent of Pamcor's stock while approximately 57 percent was held in trust for certain of appellant's shareholders. The 1962 combined report for these corporations stated that each company had substantially identical shareholders, Appellant, who has the burden of proof (Appeal of Halliburton Oil Well Cementing Co., Cal. St. Bd. of Equal., April 20, 1955), has not submitted any information concerning the characteristics of the trust or the identity of the remaining 27 percent of the shareholders. Under these circumstances we think that at least 73 percent of Pamcor, Inc.'s ownership, i.e., that stock held by appellant and by the- trust for appellant's shareholders, must be considered substantially the same as that of the other corporations.This is sufficient to satisfy the unity of ownership. (Appeal of The Weatherhead Co., Cal. St. Bd. of Equal., April 24, 1967.)

We must conclude that. appellant, its subsidiaries, and Pamcor, Inc., were engaged in a unitary business during the years in question and consequently formula allocation must be used to compute the income of these corporations which was attributable to California.

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, Appeal of AMP 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 AMP Incorporated against proposed assessments of additional franchise tax in the amounts of $6,431.15, $7,439.09 and $10,661.50 for the income years 1960, 1961 and 1962, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 6th day of January.,, 1969, by the State Board of Equalization.

John W. Lynch, Chairman

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Attest:

Ronald B Welch, acting Secretary