



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
WILLIAMS FURNACE CO.

Appearances:

For Appellant: John H. Hall
Attorney at Law

For Respondent: Peter S. Pierson
Counsel

O P I N I O N

This appeal is made pursuant to section 26077 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claim of Williams Furnace Co. for refund of franchise tax in the amount of \$18,550.28 for the income year 1962.

Appellant is a Delaware corporation whose principal place of business is located in Buena Park, California. It is engaged in the manufacture and sale of gas heating equipment and since 1758 has been a wholly owned subsidiary of Continental Materials Corporation (hereafter referred to as Continental). This parent company was organized in 1954 by Gerald Gidwitz and his brothers to engage in the mining business. Since its formation the Gidwitz family has retained a controlling interest in Continental. As the parent corporation became successful it expanded and diversified through the creation and acquisition of wholly owned subsidiaries. In general, the following facts describe the operation of this corporate group both during the period at issue and at present.

Continental's subsidiaries were divided into three divisions during 1962. The mining division included

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Continental Uranium Company of Wyoming, Woodmont, Inc., Lodestar Uranium, Inc., Texas Continental Uranium, Inc., and Northern Continental, Inc. The first three of these subsidiaries operated mines while the latter two were engaged in exploration. The mining division headquarters was located in Colorado, and its immediate supervisors were Mr. Sidney M. Gunther, a director and general counsel of the parent, and Mr. C. H. Reynolds, General Superintendent of Mines. The building materials division included appellant; Edens Industrial Park, Inc., which developed commercial real estate; Transmix Concrete Co., which produced ready-mix concrete and sand; and Calsi-Crete, Inc., which produced precast lightweight cellular concrete roof slabs and panels. The educational and school supply division included Feldco-Major, Inc., which manufactured and sold items such as binders, notebooks, and carrying cases; Arlington Seating Co., which manufactured and sold desks, chairs, and public seating; and the latter corporation's two subsidiaries, Arlington Distributors, Inc., which sold in Northern California products made by its parent, and Arlington Installations, Inc., created to install its parent's seats in New York's Shea Stadium.

Continental's home office is in Chicago and this is where almost all director and shareholder meetings of the parent and subsidiaries are held and where the records and minutes of these corporations are kept. Mr. Gidwitz is the Chairman of Continental's board and the chief executive officer of the company. He selects all the directors and officers of the parent and the various subsidiaries, and chooses the key personnel of Continental. When an existing company is acquired by the parent, the standard procedure is to replace most of the directors and officers with Continental personnel. For example, at the time of its acquisition by Continental four of appellant's five directors were replaced by directors, officers, or attorneys of the parent, and five of its eight officers were replaced by employees of Continental. A significant interlocking of directors and officers continued through the year in question.

Appellant states that Continental and its subsidiaries are centrally managed by Mr. Gidwitz, who formulates all policies and makes all significant decisions affecting these corporations. He is also actively involved in the search for new business opportunities, product and operations development, and marketing. Mr. Gidwitz closely supervises Continental's home office personnel and the operating managers of the subsidiaries. Certain of these managers, along with executives from the

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Chicago office, assist Mr. Gidwitz in his central management duties either on a full-time or a part-time basis. All of the subsidiary managers frequently meet in Chicago where they exchange information and confer with officers of Continental in an informal management committee. Appellant has submitted numerous examples and exhibits which illustrate the extensiveness of the above-described central management, and the key role it plays in the success of these corporations.

During the year in question a certain amount of intercompany sales took place among the subsidiaries. Feldco-Major, Inc., sold 10,000 loose-leaf binders to appellant; the latter corporation sold an unspecified amount of space heaters to some of the mining subsidiaries; Calsi-Crete, Inc., sold roof panels and wall sections worth \$200,000 to Edens Industrial Park, Inc., during the period 1960 through 1967; and Arlington Seating Co: sold \$228 000 of its products, or approximately 10 percent oh its total sales to Arlington Distributors, Inc. (These products were'the latter corporation's total purchases for the year.) Centralized purchasing for the corporate group during 1962 included various insurance programs which were also centrally administered and saved appellant \$8,372 per year; standard business forms and payroll checks; copying paper and supplies, under a 10 percent volume discount; Hertz rental services, under a 20 percent volume discount; air travel cards; and some hotel services. Wherever possible centralized credit applications were used.

Uniform accounting procedures were created by Continental and instituted at all of the subsidiaries, If these procedures proved inappropriate in certain circumstances, special methods were devised by the parent." The Chicago office helps recruit and train subsidiary accounting personnel, and sometimes transfers its own accounting employees to the other corporations. At least annually the subsidiaries are required to submit proposed budgets to Continental's home office. In some cases personnel from Chicago visit the subsidiary and help in the budget preparation. The budget is reviewed by Continental's home office and by Mr. Gidwitz. Once a budget is approved, monthly reviews of actual versus budget costs are made by the Chicago office and discrepancies are investigated. Continental personnel also conduct periodic internal audits of the subsidiaries, and supervise the preparation for, and review the results. of, the annual audit conducted by an outside public accounting firm.

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All tax returns of the corporate group are reviewed by Continental, and often the returns are prepared and the tax paid by the home office. Federal and state income tax returns are prepared in Chicago by the parent's accounting firm. The Continental home office also distributes tax information. All legal problems of the subsidiaries, including labor relations matters, are referred to Continental's Chicago law firm or its home office. Continental personnel direct and sometimes negotiate subsidiary financing, and on occasion a subsidiary's credit is used to obtain funds for the parent. Centralized employee benefit plans include a common group insurance program, and executive stock option and incentive plans. Wherever possible the corporations have adopted similar vacation and holiday programs, tuition payments, and profit sharing and retirement plans. Continental generally charges the subsidiaries for the above centralized services, except for those of Mr. Gidwitz, the internal audit, and programs specifically requested by the Chicago office.

After its acquisition by Continental in 1958, appellant's annual sales approximately doubled and its pretax profits more than tripled. Appellant determined that these increases resulted from the greater operational efficiency, financial standing, and sales opportunities which accompanied membership in the Continental corporate group. Appellant concluded that during the year in question sufficient intercorporate contribution and dependence occurred among Continental and its subsidiaries to classify the entire group as a single unitary business, and therefore appellant computed its tax liability accordingly and filed an amended 1962 return. However the Franchise Tax Board disagreed and determined that appellant had to compute its tax liability separately. Whether this determination was 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. McCollgan, 17 Cal. 2d 664 [111 P.2d 334], aff'd, 315 U.S. 501 [86 L. Ed 991]; Edison California Stores, Inc. v. McCollgan, 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,

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and 'use exist. (Butler Bros. v. McColgan, supra, 17 Cal. 2d 664 [111 P.2d 334], aff'd, 315 U.S. 501 [86 L. Ed. 991].) 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 bus'incss without the state. (Edison California Stores, Inc. v. McColgan, supra, 30 Cal. 2d 472 [183 P.2d 16].) Recent decisions of the California Supreme Court have reaffirmed these tests. (Superior Oil Co. v. Franchise Tax Board, 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].)

In the instant case we think that appellant has satisfied the above tests. Within each of the three divisions of Continental the subsidiaries were for the most part interrelated in their operations or products. The evidence submitted by appellant has established that the development and success of the members of this corporate group were primarily the result of the close central management provided by Mr. Gidwitz and certain of **Continental's** executives, with assistance from a number of the subsidiary managers. (See Honolulu Oil Corp. v. Franchise Tax Board, supra.) This central management was facilitated by Mr. Gidwitz's selection of the directors and officers of the subsidiaries, usually from Continental personnel, and by the fact that many of these executives occupied key positions in more than one of the corporations. (Appeal of AMP Inc., Cal. St. Bd. of Equal., Jan. 6, 1969.)

Substantial contributions to the success of the subsidiaries were made by Continental's provision of partial or complete services in the areas of accounting, auditing, taxes, law, labor relations, **financing**, and employee benefits. (See Appeal of Union Carbide and Carbon Corp., Cal. St. Bd. of Equal., Aug. 19, 1957.) Central purchasing and intercompany sales also yielded significant contributions. (Edison California Stores, Inc. v. McColgan supra; Appeal of AMP Inc., supra. The post-acquisition increases in appellant's sales and pretax profits are evidence of the effectiveness of the above centralization of business functions. (See Appeal of The Seng Co. of Calif., Cal. St. Bd. of Equal., Mar. 7, 1967.)

We must conclude that sufficient contribution and dependence existed among appellant, its **parent, and** the parent's other subsidiaries, to classify them as a single unitary business during **1962.**

