



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of)
MONSANTO COMPANY)

Appearances:

For Appellant: Arthur G. Muegler, Jr., and
Hubbard S. Parks
Attorneys at Law

For Respondent: A. Ben Jacobson
Counsel

O P I N I O N

These appeals are made pursuant to section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of Monsanto Company against proposed assessments of additional franchise tax in the amounts of \$37,330.00, \$65,931.00, and \$8,412.00 for the income years 1960, 1961, and 1962, respectively, and pursuant to section 26077 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claim of Monsanto Company for refund of franchise tax in the amount of \$62,367.00 for the income year 1962. Since the Franchise Tax Board did not act on the claim for refund within six months after it was filed, it was deemed disallowed under the provisions of section 26076 of the Revenue and Taxation Code.

At the hearing on these matters appellant Monsanto Company withdrew its appeal with respect to the entire proposed assessment for the income year 1960 and

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with respect to a part of the proposed assessments for the income years 1961 and 1962. The sole issue remaining for decision is whether appellant was engaged in a unitary business with its wholly owned subsidiary Chemstrand Corporation during 1961 and with the Chemstrand Company Division of appellant during 1962.

Appellant, a **Delaware corporation**, was incorporated in 1933 as a successor to Monsanto **Chemical Works**. During the years here at issue, appellant operated numerous worldwide businesses involving, **the** production and sale of basic chemicals, chemical products, plastics, and the production, refining and marketing of oil, gas, and petroleum products. Appellant's operations were conducted on a divisional basis, **viz.**, Agricultural Division, Hydrocarbons Division, Inorganic Chemicals Division, Organic Chemicals Division, Plastics Division, and International Division. After April 24, 1962, the list of divisions included the Chemstrand Company Division.

Chemstrand Corporation was incorporated in Delaware on May 16, 1945, with appellant and American Viscose Corporation each owning 50 percent of its stock. In January of 1961 Chemstrand became a wholly owned subsidiary of appellant as the result of a transaction in which American Viscose relinquished its one-half interest in Chemstrand in **exchange** for stock in appellant. At this time Chemstrand's board of directors became composed entirely of officers and directors of appellant, and Chemstrand's president became one of appellant's directors. On April 24, 1962, Chemstrand Corporation was liquidated and merged into appellant **as** an operating division.

The organization of Chemstrand as a going concern began in 1949. In order to get the new company off the ground, each parent loaned it substantial funds during its formative years from 1949 to 1953. The precise amount of these advances is disputed by the parties to these appeals, but appellant and American Viscose each contributed at least **\$22,000,000**.

Other benefits flowed to Chemstrand from its parents. The basic research for Chemstrand's unique

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acrylic fiber, "Acrilan," had been performed in appellant's own central research laboratories, and American Viscose provided Chemstrand with a valuable asset in the form of the marketing knowledge which it had acquired as a producer of rayon. Each parent also transferred personnel, including executives, to Chemstrand.

While it had been **created to** produce acrylic fibers, Chemstrand soon became a **major** producer of nylon under a license agreement with Du Pont. Nylon's importance to Chemstrand is evidenced by the fact that Chemstrand's nylon sales were much greater than its sales of Acrilan in both 1961 and 1962.

As a producer of basic **chemicals**, appellant supplied Chemstrand with a substantial part of the raw materials it used in making nylon and Acrilan. In 1961 Chemstrand obtained about 18 percent of its requirements for nylon from appellant at a cost of **\$4,125,912**. The 1962 figures for nylon were 18 percent and **\$4,582,534**. Chemstrand relied on appellant to a much greater extent for its raw materials for Acrilan. In 1961 appellant supplied, at a cost of **\$5,230,000**, nearly 85 percent of Chemstrand's materials for Acrilan. Appellant furnished a like percentage in 1962 at a cost of **\$6,462,000**. During both years appellant **was Chemstrand's** sole source for acrylonitrile, the principal raw material for Acrilan. On the whole appellant supplied approximately **33** percent of Chemstrand's total raw material purchases in 1961 and 1962. All of these transfers allegedly were made at fair market value.

In its day-to-day operations Chemstrand appears to have functioned as a separate and distinct entity both as a subsidiary and as a division of appellant. Chemstrand maintained a full complement of staff services, and all department heads reported to Chemstrand's president or to its vice president for organization. No department head reported to his counterpart at appellant. Since Chemstrand had its own sustaining staff organization in 1962, it did not receive a charge for any of the cost of maintaining the centralized staff services which served every other division of appellant. Chemstrand Corporation would not in any event have received such a charge in 1961, since it was **appellant's** policy not to charge subsidiaries for any of appellant's administrative overhead.

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During both years Chemstrand had separate group insurance and pension plans for its employees. It conducted its own advertising campaigns, and it made extensive use of distinctive trademarks to identify consumer products made of **Acrilan** and Chemstrand nylon. Its accounting system and policies were different than appellant's, and it **operated** on a different fiscal year. Chemstrand's employees **were paid** by Chemstrand checks which were drawn on separate Chemstrand funds. Chemstrand invested its own excess cash and its cash policies were not the same as **appellant's**. Chemstrand **also** had its own tax department to handle state and local taxes applicable to Chemstrand operations.

Appellant and Chcmstrand did not share any manufacturing facilities in the United States. The head offices of Chemstrand were located in **New York**, near the garment and textile industries, while St. Louis was the headquarters for the rest of appellant's divisional operations. Chemstrand **also** maintained separate research facilities, and appellant alleges that Chemstrand's research efforts and results were not available to appellant and that the results of appellant's research were likewise unavailable to Chemstrand.

Neither Chemstrand nor appellant made purchases for the use of the other, and in their separate purchases from common suppliers neither benefited from volume discounts granted as a **result** of being affiliated with the other. Likewise, no division of appellant solicited or forwarded any orders for Chcmstrand products, and Chemstrand did not solicit or forward any orders for products of appellant.

From the time of Chemstrand's organization through the years here in question, there were significant transfers of personnel between Chemstrand and appellant. Two of Chemstrand's presidents, Mr. Bezanson and Mr. **O'Neal**, were former employees of appellant. During 1961 and 1962 a total of twenty or thirty Chemstrand employees **transferred** to appellant. **A witness** for appellant stated that he could not recall any transfers from appellant to Chemstrand during this same period,,

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Chemstrand did not maintain or operate any facilities or offices in California during 1961 and 1962. Its only direct connection with California was destination sales totaling less than 1% of its total sales, and these California sales were not solicited by Chemstrand. k

When a corporate taxpayer derives income from sources both within and without California, its tax liabilities 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 sources 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 established two tests for determining whether a business is unitary. Under the Butler Bros. test, a business is unitary if the unities of ownership, operation and use exist. Under the Edison test, a business is unitary when the operation of the business done within the state is dependent upon or contributes to the operation of the business without the state. These tests have been reaffirmed by recent decisions of the California Supreme Court. (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 403].)

Applying the above tests to the facts of this case, we conclude that Chemstrand was a part of appellant's unitary business during both 1961 and 1962. A principal factor leading to this conclusion is Chemstrand's dependence on appellant as the supplier of nearly one-third of Chemstrand's raw material purchases in both years. (See Appeals of Simonds Saw and Steel Co., et al., Cal. St. Ed. of Equal., Dec. 12, 1967; Appeal of Wm. Wrigley, Jr. Co., Cal. St. Bd. of Equal., Dec. 15, 1966.) This factor is particularly compelling in light of Chemstrand's total dependence on appellant: for acrylonitrile, the principal raw material for Acrilan. (See Appeal of AMP Incorporated, Cal. St. Bd. of Equal., Jan. 6, 1969.) The record shows that since Chemstrand's creation appellant

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has spent many millions of dollars to construct plant facilities specifically to produce acrylonitrile for Chemstrand. Appellant admitted that it was the only source of acrylonitrile in the quantities needed by Chemstrand, and there is evidence that until about 1957 appellant's earnings were adversely affected by Chemstrand's limited purchases of acrylonitrile while Acrilan was experiencing severe marketing problems. It is a reasonable inference that Acrilan's subsequent marketing success led directly to increased earnings for appellant as the natural result of Chemstrand's greater demand for acrylonitrile. These facts establish the type of operational interdependence which forms the very heart of the unitary business concept.

In addition to the flow of goods between appellant and Chemstrand; a number of other important unitary factors are present in this case. These include directors common to, both companies, significant transfers of key executives between appellant and Chemstrand, and appellant's substantial loans to Chemstrand. (See Chase Brass and Cooper Co. v. Franchise Tax Board, 10 Cal. App. 3d 496, appeal docketed, 39 U.S.L.W. 3116 (U.S. Sept. 22, 1970) (No. 741).) We also believe that a significant unitary benefit was derived from association of the research efforts of the two companies beginning at least in 1961. (Appeal of AMP Incorporated, Cal. St. Bd. of Equal., Jan. 6, 1969) In the proxy statement seeking approval for acquisition of American Viscose's interest in Chemstrand, appellant told its shareholders that it hoped to continue Chemstrand's -growth by combining its research efforts with those of appellant. Although appellant has stated to this board that the research efforts and results of the two companies were kept separate, it made no attempt to explain the contradiction between its assertions on appeal and the prior statements to its shareholders. Since these latter statements were made before the present dispute arose, we deem them a more reliable indication of the actual relationship between the research conducted by appellant and Chemstrand.

One final matter requires consideration. Appellant has argued at some length that Chemstrand was not part of appellant's unitary business because Chemstrand's operations did not depend upon or contribute to the part of appellant's unitary business that was

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conducted in California. In support of this argument appellant says that Chemstrand had no dealings-of any **kind** with appellant's California facilities and that none of the **products sold** to Chcmstrand by appellant had any direct or indirect connection with any of appellant's California locations.

The argument **misconceives** the unitary business concept. All that need be shown is that **during the** critical period Chemstrand formed an inseparable **part** of appellant's unitary business wherever conducted. By attempting to establish a dichotomy between appellant's California operations and Chemstrand, appellant would have us ignore other parts of appellant's business which cannot justifiably be separated from either Chemstrand or the California operations. The situation is' substantially the same as that in Appeals of Simonds Saw and Steel Co., et al., Cal. St. Bd. of Equal., Dec. 12, 1967, where we held that two Canadian corporations were a part of a unitary group even though they operated exclusively in Canada.

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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

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Code, that the action of the Franchise Tax Board on the protests of Monsanto Company against proposed assessments of additional franchise tax in the amounts of \$37,330.00, \$65,931.00, and \$8,412.00 for the income years 1960, 1961, and 1962; respectively, and pursuant to section 26077 of the Revenue and Taxation Code, that the deemed disallowance by the Franchise Tax Board of the claim of Monsanto Company for a refund of franchise tax in the amount of \$62,367.00 for the income year 1962, be and the same are hereby sustained.

Done at Sacramento, California, this 6th day of November, 1970, by the State Board of Equalization.

Bob Hume, Chairman
John W. Lynch, Member
Paul R. Lane, Member
Richard Stein, Member
_____, Member

ATTEST: [Signature], Secretary