

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
PFIZER, INC.)

Appearances:

For Appellant: Neil Papiano
Dennis A. Page
Attorneys at Law

For Respondent: Brian W. Toman
Joseph W. Kegler
Counsel

O P I N I O N

This appeal is made pursuant to section 25666 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Pfizer, Inc., against proposed assessments of additional franchise tax and penalties in the total amounts of \$98,254, \$104,090, \$92,306, and \$111,810 for the income years 1965, 1966, 1967, and 1968, respectively.

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There are three issues presented by this appeal: (1) Whether appellant and its domestic and foreign subsidiaries were engaged in a single unitary business during the appeal years; (2) Whether certain sales should be excluded from the numerator of the sales factor for 1965 and 1966; and (3) Whether respondent properly imposed a 25% penalty for failure to provide requested information. Each of these issues will be dealt with separately.

Unitary Business Issue

Appellant was incorporated in 1900 and is headquartered in New York City. Appellant itself has a number of divisions which were grouped in appellant's 1966 annual report as Pharmaceuticals Operations (Pfizer Laboratories Division, J. B. Roerig Division, and Pfizer Diagnostic Division), Consumer Products Operations (Coty Division and Leeming/Pacquin Divisions), Chemicals and Materials Science Products Operations (Chemical Division, Minerals, Pigments, and Metals, and Quigley Company Inc.), and the Agricultural Division.

During the appeal years, appellant also had numerous foreign subsidiaries. Organizationally at the head of most of the foreign subsidiaries were three corporations: Pfizer Corporation (Panama) (hereinafter "Panama"), a wholly owned foreign subsidiary of appellant; Pfizer Overseas, Inc. (hereinafter "Overseas"), a wholly owned domestic subsidiary of appellant; and Pfizer International Inc. (hereinafter "International"), a second-tier subsidiary which was owned 87.5% by Panama and 10% by Overseas during the appeal years (the remaining 2.5% was owned by another first-tier foreign subsidiary of appellant). Most of the remaining foreign subsidiaries were second- or third-tier subsidiaries of Panama. The officers and directors of Panama, Overseas, and International were identical, and a number of them were also officers and/or directors of appellant. These officers and directors were all located at appellant's New York headquarters.

Appellant's subsidiaries were engaged in the same product areas as appellant's divisions and most manufactured or sold products in more than one of the four divisional product areas mentioned above. Of the worldwide sales made by appellant and its affiliates, 45-47% were pharmaceuticals, 16-18% were in the chemicals area, 12-13% in the agricultural products area, and 15-18% were consumer products. (App. Br. at 285.)

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Intercompany sales occurred from appellant to Panama and Overseas, and from them to the second- and third-tier subsidiaries. Overseas made all of its purchases from appellant and, in turn, sold from 64.4% to 77.4% of its products to the foreign subsidiaries. Panama's purchases during these years from appellant composed from 28.6% to 42.1% of its total purchases, and its intercompany sales to other foreign subsidiaries ranged from 50.7% to 56.3% of its total sales.

Substantially all of appellant's subsidiaries used the Pfizer name. **Common product** lines worldwide accounted for 64% of the pharmaceutical products produced and/or sold by appellant and its affiliates; 97% of chemical products, 59% of agricultural products, and 35% of consumer products were also common worldwide product lines. (App. Br. at 286.)

Uniform packaging was used worldwide for Pfizer pharmaceuticals, and packaging for Coty perfumes and fragrances was apparently standardized for international markets.

Royalty payments to appellant from its foreign subsidiaries (other than Panama and International) totaled more than \$8.6 million during the appeal years. Although neither Panama nor International paid royalties as such for their use of appellant's patents and trademarks, they did pay a total of more than \$8.4 million to appellant in "patent amortization" charges. Panama, Overseas, and **International also** paid substantial amounts to appellant for centralized services provided by appellant at its New York headquarters.

Other than the intercompany purchasing described above, there was apparently no central purchasing for the Pfizer affiliates. Advertising was not centralized beyond the uniform use of packaging and the Pfizer name. Accounting controls were imposed only as were necessary for the orderly compilation of information for appellant's annual report, quarterly report of earnings, and consolidated federal tax return. Appellant did make loans to some of its affiliates at various times, but apparently not during the appeal years. Loans to foreign subsidiaries **were** generally made by other (unidentified) Pfizer foreign subsidiaries.

On its California franchise tax returns for the years now being appealed, appellant reported the income from its own operations (presumably including all of its

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divisions) as a unitary business, determining its California income by applying the regular three-factor apportionment formula. Upon audit, respondent determined that appellant was engaged in a single worldwide unitary business with all of its domestic and foreign subsidiaries. Proposed assessments were issued based on the inclusion of these affiliated corporations in a single combined report.

When a taxpayer derives income from sources both within and without this state, its franchise tax liability is measured by its net income derived from or attributable to sources within this state. (Re-v. & 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).)

The existence of a unitary business may be established under either of two tests set forth by the California Supreme Court. In Butler Bros. v. McColgan, 17 Cal.2d 664 [111 P.2d 334] (1941), affd., 315 U.S. 501 (86 L.Ed. 991) (1942), the court held that a unitary business was definitely established by the presence of unity of ownership, unity of operation as evidenced by central purchasing, advertising, accounting, and management divisions, and unity of use in a centralized executive force and general system of operation. Later, the court stated that a business is unitary if the operation of the portion 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.)

Respondent's determination is: presumptively correct and appellant bears the burden of proving that it is incorrect. (Appeal of John Deere Plow Company of Moline, Cal. St. Bd. of Equal., Dec. 13, 1961.) Each appeal must be decided on its own particular facts and no one factor is controlling. (Container Corp. of America v. Franchise Tax Bd., 117 Cal.App.3d 988 [173 Cal.Rptr. 121] (1981), affd., -- U.S. -- (77 L.Ed.2d 545) (1983).)

Where, as here, the appellant is contesting respondent's determination of unity, it must prove by a preponderance of the evidence that, in the aggregate, the unitary connections relied on by respondent were so lacking in

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substance as to compel the conclusion that a single integrated economic enterprise did not exist.

Respondent contends that appellant was engaged in a single unitary business with its domestic and foreign subsidiaries and we must agree. The voluminous record in this case supports respondent's conclusion that there existed integrated management, substantial inter-company sales, common product lines, and the use of trademarks, patents, a common name, and uniform packaging, to the extent that a unitary business was clearly demonstrated under either the three unities or the contribution or dependency test. Indeed, this situation presents a classic example of the type of vertically (and horizontally) integrated enterprise to which the unitary concept has been applied.

Appellant does not deny that appellant itself conducted a unitary business which included its several divisions. At the hearing in this matter, appellant also conceded that the foreign operations headed by Panama, Overseas, and International were conducted "as a classic unitary business." (Trans. at 22.) To then say that appellant, Panama, Overseas, and International were not sufficiently **integrated** to be considered engaged in a single unitary business is to fly in the face of a strong and apparent "flow of value" (Container Corp. of America v. Franchise Tax Bd., supra, -- U.S. at --) between appellant and its subsidiaries. Appellant simply has not shown that, in the aggregate, the connections which existed lacked significance. The elements of independence and separateness which appellant emphasizes are simply inconsequential in light of the substantial interrelationships between appellant and its subsidiaries. We must conclude, therefore, that respondent's determination regarding the existence of a single unitary business, including all of appellant's foreign and domestic subsidiaries, was correct.

Sales Factor Issue

With regard to the sales factor issue, appellant contends that sales it made to agencies of the federal government should be excluded from the sales factor numerator since they were negotiated outside of California. Respondent offered to concede this point if appellant would provide satisfactory documentation that such sales were made, that they were negotiated outside California, and of the amounts of such sales. Appellant has not provided any documentation that **such sales**

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existed during the appeal years. Without such evidence, we must conclude that respondent properly determined the sales factor.

Penalty Issue

After the hearing in this matter, respondent withdrew the 25% penalties imposed for each appeal year. Therefore, they are no longer in issue and our order will reflect this.

