



89-SBE-005

BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )  
A.M. CASTLE & CO. ) No. 83A-0388-CD

Appearances:

For Appellant: Kenneth H. Wennergren  
Attorney at Law

For Respondent: Jon Jensen  
Counsel

O P I N I O N

This appeal is made pursuant to section 25666<sup>1/</sup> of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of A.M. Castle & Co. against proposed assessments of additional franchise tax in the amounts of \$37,799.11, \$37,808.65, \$65,761.90, and \$101,288.83 for the income years 1975, 1976, 1977, and 1978, respectively.

<sup>1/</sup> Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as in effect for the income years in issue.

## Appeal of A.M. Castle & Co.

The issue presented by this appeal is whether appellant and its subsidiary, Hy-Alloy Steels Company (By-Alloy), were engaged in a unitary business during the years on appeal.

Appellant A.M. Castle & Co. (Castle) is a Delaware corporation whose corporate headquarters and principal place of business is located in Franklin Park, Illinois. Castle is a prominent competitor in the metals service center industry. It purchases bulk metals which it warehouses, and often processes to order, for resale to its industrial customers.

Castle provides its customers with a wide range of metals, including carbon steel, carbon alloy steel, stainless steel, aluminum, nickel and nickel alloy, and copper and brass. These metals are sold, in standard shapes and dimensions as originally purchased by Castle or as processed according to customer specifications, through service centers that are located throughout the United States, including California.

By February 1, 1973, Castle was the owner of 100 percent of the outstanding shares of the common stock of Hy-Alloy, a small corporation, also based in Illinois, which operated exclusively as a wholesaler of carbon alloy steel. By-Alloy did not offer processing services to its customers. Its sales were made from Bedford Park, Illinois, its only place of business.

During the relevant period, all five positions on the board of directors of Hy-Alloy were filled by officers, directors, or prominent management employees of Castle. The following men were directors of By-Alloy during the entire appeal period: Robert T. Heggie, who served at pertinent times as chairman of the board and president of Castle; Michael Simpson, who was also a member of Castle's board of directors; Richard A. Virzi, who was Castle's executive vice president and subsequently its president; and Leonard B. O'Connor, who was a regular vice president of Castle. The final position on Hy-Alloy's board of directors during this period was divided between John Ginda, Castle's Midwest Regional Manager and Edward F. Culliton, a vice president of Castle and also its secretary-treasurer. Michael Simpson was appointed Hy-Alloy's president and chief executive officer on October 1, 1973, and held that office throughout the entire appeal period. Michael Simpson's father was apparently Castle's controlling shareholder.

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The percentage of Hy-Alloy's total sales to Castle grew during the appeal period from approximately 31 percent to approximately 47 percent. It appears **that By-Alloy was Castle's sole supplier of carbon alloy steel.** (See App. Reply Br. at 31.) The parties appear to agree that the proportion of Castle's carbon alloy steel sales to total bulk metal sales increased seven percent during the period, although appellant states the increase was from 5 to 12 percent, while the FTB states it was from 10 percent to 17 percent. (Compare App. Reply Br., Decl. of Edward F. Culliton, at 3, with Resp. Br. at 1-2.) By the end of the appeal period, Castle's sales of carbon alloy steel were exceeded only by its sales of carbon steel.

During the appeal period, Castle and Hy-Alloy each maintained its own separate personnel, advertising, purchasing, sales, and accounting departments. They also did not share legal staffs or engage the same outside law firm. Each corporation maintained separate employee benefit plans. Except for a health and accident plan, the corporation did not share primary insurance plans or brokers. There were no intercorporate loans. Castle asserts, and the FTB apparently does not deny, that **By-Alloy's sales to Castle were made at arms-length prices.**

Appellant filed combined reports for the appeal years, but did not include the operations of Hy-Alloy. The FTB issued Notices of Additional Tax Proposed to be Assessed for the appeal years based on its determination **that Hy-Alloy was engaged in a unitary business with Castle and should have been included in the combined reports.**

If a taxpayer derives income from sources both within and without California, its franchise tax liability is required to be measured by its net income derived from or attributable **to sources** within this state. (Rev. & Tax. Code, S 25101.) If the taxpayer is **engaged in a single unitary business with affiliated corporations**, its income attributable to California 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).)

There are two alternative tests that have customarily been used in California to determine whether a business is unitary. The California Supreme Court has held that the existence of a unitary business may be established by the presence of unity of ownership; unity of operation as evidenced by **central accounting, purchasing, advertising, and management divisions; and unity of use in a centralized executive force and general system of operation.** (Butler Bros. v. McColgan, 17

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Cal.2d 664 (111 P.2d 334)(1941), affd. 315 U.S. 501 (86 L.Ed. 991)(1942).) It has also stated that a **business** is unitary if the operation 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 ~~111 P.2d~~.) **More** recently, the United States Supreme Court has **emphasized** that affiliated corporations, to be considered a unitary group, must form a **functionally integrated** enterprise (Container Corp. v. Franchise Tax Board, 463 U.S. 159, 179 [77 L.Ed.2d 545], reh. den., 464 U.S. 909 [78 L.Ed.2d 248] (1983)) in which factors of profitability arise from the operation of the business as a whole (F. W. Woolworth Co. v. Taxation & Rev. Dept., 458 U.S. 354, 364 [L.Ed.2d 8191 (1982))).

Respondent's determination regarding the existence of a unitary business is presumptively correct, and appellant bears the burden of showing that it is **incorrect**. (Appeal of Kikkoman International, Inc., Cal. St. Bd. of Equal., June 29, 1982.) We find that appellant has not met this burden.

Unity of ownership, required under either California test, is clearly satisfied in this matter because Castle owned **100** percent of By-Alloy. We believe that the facts also demonstrate sufficient contribution and dependency between the two corporations to result in a single functionally integrated enterprise, i.e., a unitary business.

In By-Alloy, Castle had an assured source of carbon alloy steel which it clearly exploited during the appeal years, as is shown by the increase in its purchases and sales of that product. Correspondingly, Castle provided Eiy-Alloy with a steady market **for** a substantial portion of its product. The mutual benefits to the affiliated corporations arising from this relationship establish the contribution and dependency between them. (See Appeal of Arkla Industries, Inc., Cal. St. Bd. of Equal., Aug. 16, 1977.)

Castle attempts to detract from the evidence of contribution and dependency between it and Hy-Alloy by maintaining that they were not in the same line of business. Clearly, **how-**ever, both sold carbon alloy steel. Although Castle supplied a more extensive line **of** metals than Hy-Alloy and **also offered** processing services, which Hy-Alloy did not, Castle's more expansive metals activities do not place it in a business category separate from Hy-Alloy. The irrefutable fact is that both companies **were** engaged, to a significant degree, in the same line of business. (See Appeal of Albertson's, Inc., Cal. St. Bd. of Equal., Sept. 21, 1982.)

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Similarity **in the** lines of business and overlap of officers and/or **directors** leads **almost** inevitably to the conclusion that a mutually beneficial exchange of knowledge occurred. ~~between two entities.~~ (Appeal of Anchor Hocking Glass Corporation, Cal. St. Bd. of Equal., Aug. 7, 1967), **Castle's bare assertions** that such a conclusion is **unwarranted** in this case are simply unconvincing. Castle could have made an investment in a totally unrelated line of business and hired the expertise needed to operate it, but when **it chose** Hy-Alloy, it clearly did so because its executive force had the knowledge and expertise to deal with the types of problems and situations which would arise **in** the business. We cannot assume that the executives of Castle who made up Hy-Alloy's board of directors and its chief executive officer were in those positions **as** mere figureheads.

Castle has attempted to portray its ownership of Hy-Alloy as a mere investment, whose operations **were** unrelated to its own. However, when stripped of rhetoric and mere labeling, the record shows a classic functionally integrated unitary business relationship. The elements of independence and separateness emphasized by Castle are either unsupported or simply too inconsequential to convince us otherwise. **Therefore**, the action of the FTB must be sustained.

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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,

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 A.M. Castle & co. against proposed assessments of additional franchise tax in the amounts of **\$37,799.11, \$37,808.65, \$65,761.90, and \$101,288.83** for the income years 1975, 1976, 1977, and 1978, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 2nd day of March, 1989, by the State Board of Equalization, with Board Members Mr. Carpenter, Mr. Collis, Mr. Bennett, Mr. Dronenburg, and Mr. Davies present.

<u>Paul Carpenter</u>	, Chairman
<u>Conway H. Collis</u>	, Member
<u>William M. Bennett</u>	, Member
<u>Ernest J. Dronenburg, Jr.</u>	, Member
<u>John Davies*, **</u>	, Member

\*For Gray Davis, per Government Code section 7.9

\*\*Abstained