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the stock to the other shareholder before selling to a third party. The primary purpose of Interaero was to manufacture aircraft products developed by The Garrett Corporation, and to sell these items to European customers. Appellant and GISA sold technical assistance, equipment, and parts to Interaero; Mr. Liebherr became manager of the new company and in that position had complete authority to negotiate on behalf of Interaero. Also, he obtained manufacturing facilities for the corporation.

Interaero entered into contracts with a group of European countries. Appellant states that due to errors in cost estimates the fixed contract prices were too low, and consequently Interaero operated at a loss into November of 1961. At this time the company was close to insolvency and Mr. Liebherr wanted to resign from his managerial position and dispose of his stock interest. However appellant and GISA wanted to continue operation of Interaero and their relationship with Mr. Liebherr. [Appellant explains that the two companies were making substantial profits from their sales to Interaero, and these profits were significant even when set against Interaero's losses.] Also, appellant states that in view of the political climate in West Germany appellant believed that it was important to have Mr. Liebherr, a German citizen with government contacts; remain as an owner of the company. Therefore several new agreements, effective January 1, 1962, were entered into by The Garrett Corporation, GISA, Interaero, and Mr. Liebherr.

Under these agreements GISA was "conceded a decisive influence on the commercial and technical treatment of the contractual matter." Such matter included all the activities engaged in by Interaero at that time. GISA appointed an additional manager to direct operations, and Mr. Liebherr's executive functions were changed to public relations. Appellant states that he assumed a passive role in regard to the operation of Interaero. In exchange for the above concession, and public relations services, appellant and GISA agreed to pay Mr. Liebherr a commission of 1 1/2 percent of the sales prices of orders entered with The Garrett Corporation or Interaero. To the extent that Interaero earned a profit, Mr. Liebherr's commissions would be reduced by his 50 percent share. Such profit was evidently very, improbable due to the fixed contract prices discussed above. Appellant and GISA agreed to bear any losses realized by Interaero. The agreements stated that appellant would

GISA sets contract

Pay = Salary Based on Interaero

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sell various products to Interaero at prices to be mutually agreed upon. If additional capital was needed the shareholders would contribute equally. Arbitration provisions were included and the agreements were not to cover new commercial activities which might be developed by Interaero. Operations continued pursuant to these agreements until August 9, 1963, when Mr. Liebherr sold his Interaero stock to GISA.

In respect to the years in question, appellant filed franchise tax returns on the basis of that corporation alone being engaged in a unitary enterprise operating both within and without California. After audit the Franchise Tax Board determined that GISA and all of its affiliates, except Interaero, should have been included in the unitary business. Interaero was excluded on the ground that GISA's 50 percent stock interest in the German subsidiary did not satisfy the requirement of unity of ownership. [Whether appellant is correct in its contention that this exclusion was improper is the sole issue presented by this appeal.] Respondent states that the assessments in question also reflect a sales factor allocation for prime contract sales made by appellant to the United States Government. However, the appellant has not contested this allocation.

When a 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 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-J.]

If several taxable entities are involved, unity of ownership is a prerequisite to the existence of a single unitary business. (Edison California Stores, Inc. v. McColgan, 30 Cal. 2d 472 [183 P.2d 16]; Appeal of Jack Harris, Inc., Cal. St. Bd. of Equal., Jan. 3, 1967.) This board has characterized the above unity as a common controlling ownership over the various entities involved. (Appeal of Jack Harris, Inc., supra.) Such status has been found on the basis of ownership of over 50 percent of a corporation's outstanding stock. (Appeals of Eljer Co. and Eljer Co. of Calif., Cal. St. Bd. of Equal., Dec. 16, 1958.) The instant appeal raises the question of whether there are circumstances where controlling ownership can exist in the absence of such majority ownership.

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In order to obtain guidance for decision of the Instant appeal It is necessary to examine provisions of statutes whose purpose and procedure are somewhat analogous to those of the unitary business concept of section 25101. Such similarity is present in sections 24725 and 25102 of the Revenue and Taxation Code which are concerned with clearly reflecting the income of affiliated taxable entities, and authorize the use of allocation of income to accomplish this purpose. The scope of both sections is defined in terms of taxable entities. "... owned or controlled directly or indirectly by the same interests.. .." (Emphasis added.)

In reference to the ownership or control required by section 25102, section 25105 of the Revenue and Taxation Code states:

Direct or indirect ownership or control of more than 50 percent of the voting stock of the taxpayer shall constitute ownership or control for the purposes of this article.

Section 482 of the Internal-Revenue Code of 1954 is the almost identically worded federal counterpart of section 24725. Treasury regulation section 1.482-1(a)(3) provides in part:

The term "controlled" includes any kind of control, direct or indirect, whether legally enforceable, and however exercisable or exercised. It is the reality of the control which is decisive, not its form or the mode of its exercise....

In Charles Town, Inc. v. Commissioner, 372 F.2d 415, cert. denied, 389 U.S. 841 [19 L. Ed. 2d 104], two shareholders controlled one of the two relevant corporations but only owned 2 percent of the stock of the other. The United States Court of Appeals held that notwithstanding this minority ownership the above stockholders were in effective control of the latter company, and application of section 482 was sustained. A primary source of this effective control was found in an agreement executed by the majority shareholder. In Revenue Ruling 65-142, 1965-1 Cum. Bull. 223, the Internal Revenue Service takes the position that two nonaffiliated

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parent corporations may have sufficient control over a jointly and equally owned subsidiary so that section 482 will apply to prevent each parent from shifting income to the subsidiary.

In the instant situation the agreements executed by appellant, GISA, Interaero, and Mr. Liebherr substantially changed the relationship between the shareholders of Interaero. Mr. Liebherr received guaranteed income in the form of commissions and consequently did not have to rely, through his stock interest, on the profitability of the company. Also he was assured, that Interaero's functioning would not be hindered by further losses. In exchange Mr. Liebherr agreed to perform certain public relations services and he relinquished his interest in operational control of Interaero.

The Franchise Tax Board argues that certain provisions of the agreements indicate significant retention of control by Mr. Liebherr. That board specifies that prices of products sold by appellant to Interaero had to be mutually agreed upon, that new commercial activities developed by Interaero were not within the scope of the agreements, that if additional capital was required it was to be contributed equally by the shareholders, and that arbitration provisions existed. However, GISA's operational control of Interaero indicates that the parent would also control price negotiations. Further, Mr. Liebherr's new compensation arrangements probably eliminated his interest in these prices. The provision relating to possible new commercial activities of Interaero appears to have been an attempt to cover an unlikely event, and has not been shown to have been of any subsequent significance. The capital contribution and arbitration provisions involved here have little relevance to control.

We must conclude that in the instant circumstances the agreements discussed above, when added to GISA's 50 percent stock ownership, gave that corporation controlling ownership over Interaero. Therefore unity of ownership existed and Interaero G.m.b.H. should have been included in the unitary business in question. *Control*

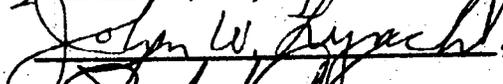
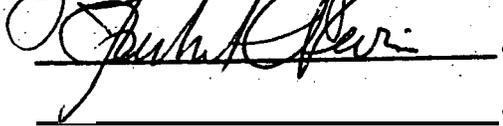
O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

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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 Signal Oil and Gas Company, successor in interest to The Garrett Corporation, against proposed assessments of additional franchise tax in the amounts of \$369.35 and \$28,517.41 for the income years ended June 30, 1961 and 1963, respectively, be and the same is hereby modified in that Interaero G.m.b.H. should be included as a member of the unitary business in question. In all other respects, the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this 14th day of September, 1970, by the State Board of Equalization.

  
\_\_\_\_\_, Chairman  
  
\_\_\_\_\_, Member  
  
\_\_\_\_\_, Member  
\_\_\_\_\_, Member  
\_\_\_\_\_, Member

ATTEST:

  
\_\_\_\_\_, Secretary