



## Appeal of National Silver Company

The issue for determination is whether the operation of appellant, its Delaware parent, and its Massachusetts affiliate (hereinafter collectively referred to as "the affiliated group") constituted a single unitary business.

Appellant was incorporated under the laws of New York in 1904 and began doing business in California in 1928. It is engaged in the business of marketing a variety of **houseware** products. Appellant is divided into two operating divisions: a western division headquartered in the City of Commerce, California, and an eastern division headquartered in New York City. These divisions divide the United States, for purposes of appellant's marketing operations, into two broad sales territories, one east and one west of the Rocky Mountains.

F. B. Rogers Silver Company, Inc. (hereinafter referred to as "F. B. Rogers") was organized in 1883 and incorporated under the laws of the Commonwealth of Massachusetts in 1886. It is engaged in the design, manufacture and sale of various items of silverware. F. B. Rogers maintains its manufacturing plant and headquarters in **Taunton, Massachusetts**.

National Silver Industries, Inc. (hereinafter referred to as "**NSI**") was incorporated in **Delaware on February 28, 1969**. Prior to **NSI's** formation, appellant and F. B. Rogers had been principally owned by three brothers and their families. Messrs. Bernard, Milton and Morton Bernstein, the three brothers, may be deemed to be the "founders" and "parents" of NSI within the meaning of the applicable rules and regulations of the Securities and Exchange Commission under the Securities Act of 1933, as amended. NSI is a holding company which owns all of the outstanding common stock of appellant and F. B. Rogers. Its headquarters are located in New York City. Shortly after its formation in early 1969, there was a public offering of 360,000 shares of NSI's common stock. Upon completion of the sale of shares, the Bernstein family, directly or indirectly, retained ownership of approximately sixty percent of NSI's common stock.

F. B. Rogers, which, as previously noted, is engaged in the design, manufacture and sale of various items of silverware, sold, during the years in question, approximately ten percent of its manufactured items to appellant. As of December 31, 1969, **\$93,379, or 1.4**

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percent, of appellant's inventory represented products purchased from F. B. Rogers. As of December 31, 1970, \$125,644, or 2.2 percent, of appellant's inventory constituted products purchased directly from F. B. Rogers. The items sold by the two wholly-owned subsidiaries of NSI are marketed under different trademarks. The prospectus prepared for NSI's 1969 stock offering characterized the products of its two operating subsidiaries as being in the "low-to-medium" price range.

During the appeal years, all eight of appellant's directors were also directors of NSI, and four of F. B. Rogers' five directors were also directors of both appellant and NSI. Nine of NSI's ten directors were directors of either one or both of its two operating subsidiaries. In addition, six of appellant's seven officers were also officers of NSI, and three of F. B. Rogers' five officers, also held high offices in both appellant and NSI. With one exception, all of NSI's officers were also officers in either one or both of its two subsidiaries. In particular, it is **revealing** to note that Morton Bernstein was the Chairman of the Board of all three affiliated corporations, that Milton Bernstein was the President of NSI, the President, Treasurer and Assistant secretary of appellant, and the Vice President of **F. B. Rogers**, and that Bernard Bernstein was the Vice President and Treasurer of NSI, the Vice President, Secretary and Assistant Treasurer of appellant, and the President and Treasurer of F. B. Rogers.

The corporate headquarters of NSI, the eastern division headquarters of appellant, and the New York office of F. B. Rogers are all located within the same building in New York City. During the years in question, appellant maintained showrooms in from nine to eleven cities throughout the United States. The showrooms located in New York, Dallas, St. Louis and Chicago were shared by appellant and F. B. Rogers. In addition, the two affiliated subsidiaries shared overseas branch offices in Tokyo, Milan and Madrid. Employees in these offices acted as buyers on behalf of both subsidiaries. The two subsidiaries also jointly retained exclusive purchasing agents in Hong Kong, Taiwan and Germany.

During the appeal years, the New York law firm of Parker, **Chapin** and Flatteau acted as principal legal adviser to NSI. The same law firm apparently also advised the eastern division of appellant and F. B. Rogers on certain legal matters. F. B. Rogers retained

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other legal counsel in **Taunton**, Massachusetts, and the western division of appellant retained local legal counsel in Los Angeles. Monroe.Chapin, one of the partners in Parker, **Chapin** and Flatteau, was, during the years in question, a director of all three affiliated corporations. His firm performed-legal work affecting all three **corporations, for which they shared the legal, fees.**

The accounting firm of J. K. Lasser and Company performed the accounting functions for the parent corporation, NSI. Both of its subsidiaries had separate internal accounting staffs. However, J. K. Lasser and Company performed a year-end audit on both subsidiaries and the parent and prepared consolidated statements which were presented to the stockholders of NSI in its annual report.

NSI is a **holding** company which has no manufacturing or sales functions of its own. Those functions, as previously noted, are conducted by appellant and F. B. Rogers. NSI, however, apparently provides services of significant importance to both of its **wholly-owned** subsidiaries. Although each subsidiary maintains its own bank accounts and lines of credit, NSI makes its financial resources available to them by acting, when necessary,, as guarantor of their loans. NSI also contributes to the affiliated group by maintaining good relations with its shareholders and the public and by providing a common identity for the affiliated corporations. **It** prepares annual reports to its shareholders in which it tells of the business prospects for the affiliated group and presents combined year-end financial statements. It is also responsible for handling securities transactions affecting the affiliated group and for insuring compliance with regulatory requirements.

When a taxpayer derives income from sources both within and without **California**, it is required to measure its California franchise tax liability by its net income derived from or attributable to sources within this state. (Rev. & Tax. Code, § 25101.) If the taxpayer is engaged in a unitary business with an affiliated corporation or corporations, the amount of business 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. (See Edison California Stores, Inc. v. McColgan, 30 Cal.2d 472 [183

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P.2d 16] (1947); John Deere Plow Co. v. Franchise Tax Board, 38 Cal.2d 214 [238 P.2d 569] (1951), app. **dism.**, 543.s. 939 [96 L.Ed. 13451 (1952).]

The California Supreme Court has determined that a unitary business is conclusively established by the existence of: (1) unity of ownership; (2) unity of operation as evidenced by central purchasing, advertising, accounting and management divisions; and (3) unity of use in a centralized executive force and general system of operation. (Butler Bros. v. McCordigan, 17 Cal.2d 664 [111 P.2d 334] (1941), affd. 315 U.S. 501 [86 L.Ed. 991] (1942).) The Supreme Court has also held that a business is unitary when the operation of the business within California contributes to, or is dependent upon, the operation of the business outside the state. (Edison California Stores, Inc. v. McCordigan, supra, 30 Cal.2d 472, 481.) These principles **have been** reaffirmed in later cases. (Superior Oil Co. v. Franchise Tax Board, 60 Cal.2d 406 [34 Cal.Rptr. 545, 386 P.2d 33] (1963); Honolulu Oil Corp. v. Franchise Tax Board, 60 Cal.2d 417 [34 Cal.Rptr. 552, 386 P.2d 40] (1963).)

The existence of a unitary business may be established if either the three unities or the contribution or dependency test is satisfied. (Appeal of F. W. Woolworth Co., Cal. St. Bd. of Equal., July 31, 1972; Appeals of Browning Manufacturing Co., et al., Cal. St. Bd. of Equal., Sept. 14, 1972; Appeals of the Anaconda Company, et al., Cal. St. Bd. of Equal., May 11, 1972.) Respondent, in concluding that appellant, NSI and F. B. Rogers were engaged in a single unitary business, relied most heavily upon the contribution or dependency test. In reaching that conclusion, respondent relied on the following factors: total ownership of appellant and F. B. Rogers by their parent, NSI; intercompany sales from F. B. Rogers to appellant; intercompany financing through the parent's guarantees of its subsidiaries' loans; an integrated executive force which controlled the major policy decisions of the affiliated group; the operation of similar businesses by appellant and F. B. Rogers and the sharing of know-how between the two subsidiaries; common use of facilities; common employees and agents; common professional advisers; and centralized services provided by the parent on behalf of its two subsidiaries.

Since February 28, 1969, the entire outstanding stock of both affiliated subsidiaries has been owned by NSI. As to the entire period in question, however,

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there is no dispute **as to** the ownership of the **two sub-**sidiaries. Appellant readily acknowledges that prior to the formation of NSI, appellant and F. B. Rogers were owned by the Bernstein family. Consequently, there existed unity of ownership **as to** appellant and F. B. Rogers both prior to, and after, the formation of NSI. (Appeal of Shaffer Rentals, Inc., Cal. St. Bd. of Equal., Sept. 14, **1970.**)

Appellant either acknowledges, or does not dispute respondent's contention, that: (i) during the years in question it purchased approximately ten percent of F. B. Rogers' production; (ii) it shared facilities, employees and agents with F. B. Rogers; and (iii) NSI acted, when necessary, as a guarantor **on loans** to its two wholly-owned subsidiaries. Appellant asserts, however, that: (i) its purchases of F. B. Rogers' products were relatively insignificant and were conducted on an **arm's-length basis**; and (ii) the facilities it shared with F. B. Rogers were outside California and that a fair fee was charged for the use of such facilities.

This board has previously determined that the joint use of facilities **by commonly-owned** corporations, even where a fair fee is paid for such use, is evidence of a unitary business. (Appeal of The Weatherhead Company, Cal. St. Bd. of Equal., April 24, 1967.) The fact that the facilities so shared may be located **outside of California does not militate against this** conclusion. Similarly, this board has previously held that the volume of intercompany **sales evident** in the instant appeal is significant evidence of a unitary business. (Appeal of Williams Furnace Co., Cal. St. Bd. of Equal., Aug. 7, **1969**; Appeal of Seng Company of California, Cal. St. Bd. of Equal., March 7, **1967.**) The sharing of employees and agents by the two subsidiaries is also an indication of the unity of their operations. (Appeal of Simco, Incorporated, Cal. St. Bd. of Equal., Oct. **27, 1964.**)

Appellant pointedly disputes respondent's conclusion that the presence of the integrated executive force among the affiliated group is evidence of centralized management. It acknowledges that there is significant overlapping between the directors and officers of the affiliated group **but asserts that** Bernard Bernstein and Edward M. Levin manage F. B. Rogers independently of Milton Bernstein, who manages appellant. It further asserts that no significance should be lent to the fact that the officers and directors of NSI are almost com-

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pletely integrated into the two subsidiaries, **because** the parent is a "mere holding company." Appellant, however, has offered no factual evidence in support of its position. While it also disputes respondent's contention that NSI provided centralized services to its subsidiaries; here too, **appellant's** assertion is simply a general denial that NSI provided services to the two operating subsidiaries and no evidence is offered to counter respondent's specific allegations.

The courts and this board have repeatedly held that the integration of executive forces is an element of exceeding importance and constitutes compelling evidence of a unitary business operation. (See, **e.g.**, Chase Brass & Copper Co. v. Franchise Tax Board, 10 Cal.App.3d 496 [87 Cal.Rptr. 2391, app. dismiss. and cert. den., 400 U.S. 961 [27 L.Ed.2d 381] (1970); Appeal of Grolier Society, Inc., Cal. St. Bd. of Equal., Aug. 19, 1975; Appeal of Monsanto Company, Cal. St. Bd. of Equal., Nov. 6, 1970.) The degree of integration of the executive forces present in the instant appeal is far greater than that evident in any of the above cited cases. Likewise, the **centralized** services apparently provided by NSI on behalf of its two subsidiaries are another factor indicating unity, (Butler Bros. v. McColgan, supra; Appeal of Harbison-Walker Refractories Company (on rehearing), Cal. St. Bd. of Equal., Feb. 15, 1972.) Such compelling indications of a unitary business operation cannot be ignored when the appellant has failed to offer any factual evidence in support of either its assertion that the two subsidiaries of NSI are independently managed or of its general denial, in the face of **respondent's** specific allegations, that NSI provided centralized services to F. B. Rogers or appellant.

Appellant acknowledges that the affiliated group employs the law firm of Parker, Chapin and Flatteau, but characterizes such common use as "minimal," noting that the two operating subsidiaries use separate legal counsel for virtually all of their operating functions. Appellant also acknowledges that the affiliated group uses the accounting firm of J. K. Lasser and Company to perform year-end audits for both subsidiaries and the parent and to prepare consolidated statements for the affiliated group which are presented to the stockholders of NSI in its annual reports. The sharing of outside professional services has frequently and persuasively been cited as a **unitary** factor. (Chase Brass & Copper Co., supra; Appeal of Williams Furnace Co., supra.) Consequently, for **example**, use of the same

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law firm, for certain legal matters, by all three affiliated corporations cannot convincingly be dismissed simply by asserting that such services are "minimal."

Another issue of contention is the nature of the business engaged in by F. B. Rogers. There is no disagreement as to **what** are the actual products marketed by appellant and those designed, manufactured and sold by F. B. Rogers. Both parties agree that appellant distributes and sells flatware, dinnerware, glassware, ceramics, cutlery, and cookware, and that F. B. Rogers is engaged primarily in the design, manufacture, and sale of various **items of silverware**, principally **silver-plated holloware**. The dispute over the nature of F. B. Rogers' business arises from respondent's contention that that subsidiary, like appellant, sells "housewares." Appellant asserts that there is a distinct difference between silver-plated holloware and housewares: however, it fails to indicate what constitutes that distinction. This board is satisfied with the showing of respondent that the common usage of the term "housewares" is such that it includes those products designed, manufactured and sold by F. B. Rogers.

This board has previously held that where members of an affiliated group share common officers and directors while engaging in generally the same type of business, a reasonable inference can be drawn that the **affiliated group benefited from the exchange** of significant information. (Appeal of Maryland Cup Corporation, Cal. St. Bd. of Equal., March 23 1970; Appeal of Anchor Hocking Glass Corporation: Cal. St. Bd. of Equal., Aug. 7, 1967.) In view of the similarities evident in certain aspects of the two subsidiaries' businesses and of the high degree of integration present in the executive forces of the affiliated group, it seems impossible to avoid the inference that there was a mutually beneficial exchange of information and know-how among these executives.

In numerous prior cases the unitary features relied upon by respondent, when viewed in the aggregate, have demonstrated a degree of mutual dependency and contribution sufficient to compel the conclusion that a unitary business existed. (See, e.g., Chase Brass & Copper Co. v. Franchise Tax Board, supra; Appeal of Williams Furnace Co., supra; Appeal of Harbison-Walker Refractories Company (on rehearing), supra.) Respondent's determination that appellant is engaged in a unitary business with its parent and operating affiliate

