

IN THE OREGON TAX COURT  
MAGISTRATE DIVISION  
Corporate Excise Tax

NABISCO BRANDS, INC. AND AFFILIATES, )  
 )  
 Plaintiff, ) TC-MD 010109A  
 )  
 v. )  
 )  
 DEPARTMENT OF REVENUE, )  
 STATE OF OREGON, )  
 )  
 Defendant. )  
 ) **DECISION**

Nabisco Brands, Inc. and its affiliates (Nabisco) have appealed corporate excise tax assessments for the periods ending December 31, 1988; April 28, 1989; and December 31, 1989.

Nabisco's case was presented by Paul H. Frankel, with the assistance of Craig B. Fields, Roberta Moseley Nero, Edwin Antolin, and Carol Vogt Lavine. The Department of Revenue was represented by Marilyn Harbur and Doug Adair.

The question is whether Oregon statutes and the Due Process Clause of the federal constitution permit Oregon to tax a portion of the capital gains that Nabisco received from the sale of foreign subsidiaries that did no business in Oregon.

I

Nabisco is a Delaware corporation, authorized to do business in Oregon, and is the parent of an affiliated group of domestic and foreign subsidiaries. (Form 20, 1989 Oregon Corporation Excise Tax Returns.) Nabisco manufactures and sells food products. (*Id.*) Its principal place of business is New Jersey. (*Id.*) In 1989 Nabisco

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manufactured and sold its products in Oregon. (*Id.*) During 1989 Nabisco chose to liquidate its holdings in foreign corporations.<sup>1</sup> (Ptf's Ex 1.) Those corporations also manufacture and sell food products.

On its Oregon Corporation Excise Tax Returns for the periods ending April 28, 1989 and December 31, 1989, Nabisco reported respective gains from the sale of the foreign corporations of \$990,539,939 and \$741,544,229. (Form 20, 1989 Oregon Corporate Excise Tax Returns.) All of that gain was reported as nonbusiness income, none of which was allocable to Oregon. (*Id.*)

On audit the Department of Revenue recharacterized the gain from the foreign corporations in which Nabisco had 100 percent or majority ownership as business income subject to apportionment. (Ptf's Ex 2.) This appeal followed.

## II

A state may apply its apportionment formula to the intangible income of a nondomiciliary corporation only if the corporation is engaged in a unitary business with the payor corporation, or if the capital transaction serves an operational rather than an investment function. *Mobil Oil Corp. v. Comm'r of Taxes of Vt.*, 445 US 425, 100 S Ct 1223, 63 L Ed 2d 510 (1980); *Allied-Signal, Inc. v. Director, Div. of Taxation*, 504 US 768, 112 S Ct 2251, 119 L Ed 2d 533 (1992). A unitary business is a corporation or

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<sup>1</sup>Nabisco Brands Group 1989 Nonbusiness Gains Summary of Investments sold:

Italy: Saiwa S.p.A.

South Africa: Royal Beechnut Pty Ltd.

Scandinavia: Oxford Biscuits Fabrik A/S.

Singapore: Kuan Enterprises Private Ltd.

United Kingdom: W & R Jacobs, Nabisco Holdings Ltd.- Walkers Crisps, Smith's Crisps Ltd., Jacob's Bakery, and Associated Biscuits Int'l. Ltd.

France: Nab France, S.A., Nab Brands France, S.A., Galletas Artiach, S.A., and France Feuilletes, SA.

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group of corporations engaged in a single trade or business. ORS 317.705(2).<sup>2</sup> The distinguishing element of a unitary business is its sharing or exchange of value between the members of the enterprise, demonstrated by a centralized management or common executive force, centralized administrative services or functions, and a flow of goods,

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<sup>2</sup>All references to the Oregon Revised Statutes (ORS) are to 1989.

"As used in this section and ORS 317.710 and 317.715:

"(1) 'Affiliated group' means an affiliated group of corporations as defined in section 1504 of the Internal Revenue Code.

"(2) 'Unitary group' means a corporation or group of corporations engaged in business activities that constitute a single trade or business.

"(3)(a) 'Single trade or business' means a business enterprise in which there exists directly or indirectly between the members or parts of the enterprise a sharing or exchange of value as demonstrated by:

"(A) Centralized management or a common executive force;

"(B) Centralized administrative services or functions resulting in economies of scale; and

"(C) Flow of goods, capital resources or services demonstrating functional integration.

"(b) 'Single trade or business' may include, but is not limited to, a business enterprise the activities of which:

"(A) Are in the same general line of business (such as manufacturing, wholesaling or retailing); or

"(B) Constitute steps in a vertically integrated process (such as the steps involved in the production of natural resources, which might include exploration, mining, refining and marketing).

"(c) Whether two or more corporations that are included in the same federal consolidated return are engaged in a single trade or business may be determined by making reference to corporations that are doing business in the United States and are subject to federal income taxation, whether or not those corporations are includable in the consolidated return. No other corporations may be taken into consideration in making such a determination, except in a case in which the transactions or relationships between such corporations are made in an attempt to evade or avoid taxation."

ORS 317.705.

capital resources, or services. ORS 317.705(3)(a). Similarly, federal due process protections dictate that the hallmarks of a unitary corporation are its functional integration, centralization of management, and economies of scale. *Allied-Signal*, 504 US at 781, 788.

### III

Nabisco, as either a 100 percent owner or majority owner, certainly might have integrated the corporations whose sale generated the gain at issue here into its unitary business. However, the point at issue is not whether Nabisco had the potential to operate the companies as part of a unitary business. *F. W. Woolworth Co. v. Taxation & Revenue Dept.*, 458 US 354, 362, 102 S Ct 3128, 73 L Ed 2d 819 (1982). Instead, definitive events in each organization's history must be analyzed and contrasted.

In this respect Defendant makes the point that at one time Nabisco filed a combined report with the foreign subsidiaries at issue here. Those tax years are not under appeal. This act does not have a preclusive effect. Instead, the court will focus its analysis on determining whether the parties have demonstrated the presence, or absence, of the functional integration, centralization of management, and economies of scale found in a unitary group.

Functional integration: The court finds, as a matter of fact, that there was not the requisite flow of goods, capital resources, or services between the foreign corporations and Nabisco to create a unitary business and that the foreign corporations were not otherwise functionally integrated with Nabisco to create a unitary relationship.

These foreign corporations were not created as new ventures by Nabisco. Instead,

they were acquired as independent businesses which operated in existing markets by catering to local tastes with their own products and which sold under brand names more familiar to their customers than Nabisco's labels. (Def's Ex LLLLLLLL at 1-3 and Ex PPPPPPP at 10, 11, 22, 23. That the foreign subsidiaries were permitted under Nabisco's ownership to produce products different than Nabisco's, tailored to suit the tastes of their countries, is directly analogous to *Woolworth's* emphasis that each retailer-subsiidiary was free to determine its own inventory and had autonomy to determine its own retail policies. *Woolworth*, 458 US at 367.

Defendant makes the point that there was some exchange of products, as with Walker's Crisps, a UK subsidiary, selling Planter's Nuts, and Biscuits Belin, a French cookie, on one occasion being sold at K Mart. (Def's Ex A at 29; Ex B at 28-29; Ex H at 4; and Merola testimony.) However, the test does not require that the corporations impose a quarantine on each other's products. The court in *Woolworth* specifically found no unitary relationship when the inventory of the retailer-subsiidiary consisted **in large part** of home country produced items. *Woolworth*, 458 US at 367 (emphasis added). Occasional common products would be permitted under this language. Although Defendant has pointed to references in the reports which speak as to the globalization of Nabisco products (Def's Ex A at 6, 21, 23; Ex B at 2, 5, 6, 28, 33; and Ex H at 4), this is matched by other references in the reports which speak of a decentralized approach to the subsidiaries which emphasizes the expertise of local managers (Def's Ex B at 24). There was no evidence of a training program to transmit the Nabisco idea of food manufacturing to the subsidiaries. *Woolworth*, 458 US at 367.

Defendant makes the point that there were common logos, trademarks, and brand

names between the products produced by Nabisco and the subsidiaries. (Def's Ex A at 21-28 and Ex M at 23.) However, use of the logo was not universal, and testimony established that the Nabisco name and trademark were comparatively unknown in the subsidiaries' markets. (Def's Ex A at 20, 21, 23, 24, 25, 28, 30-32 and Merola testimony.) Unless the name, trademark, or logo is of value in the markets in which the subsidiaries are active, this item does not create a flow of value between the parent and its subsidiaries. In this respect it is noteworthy that the *Woolworth* opinion attached no importance to the parent's and subsidiaries' common use of the Woolworth name. *Woolworth*, 458 US at 369 n 22.

Other points raised by Defendant are that Nabisco has planned cash infusions to the subsidiaries (Def's Ex B at 6), arranged to meet the subsidiaries' temporary seasonal cash needs (Def's Ex A at 40, 51), capitalized newly formed subsidiaries (Def's Ex UUU at 2), and formed a plan for reorganizing and capitalizing the subsidiaries (*Id.*) These points only demonstrate that Nabisco, as owner of the foreign corporations, invested, or planned to invest, money into its subsidiaries. These acts in themselves do not show that this investment achieved a degree of functional integration sufficient to create a unitary relationship. However, Defendant's other arguments as to the financial integration of Nabisco and its subsidiaries are less equivocal.

Defendant has asserted that Nabisco engaged in related party transactions at less than the prevailing market rate with its foreign subsidiaries (Def's Ex M at 19), arranged for central financing of its subsidiaries (Def's Ex ZZZ at 1-3 and Ex FFFF at 1-4), guaranteed subsidiary loans (Def's Ex M at 118-19, 123-24), assigned subsidiary's debt (Def's Ex PPP at 2) and had centralized financial controls through banking authority

(Def's Ex V at 1-2 and Ex FF at 1-5). While these assertions can be important indicia of functional integration, the sticking point in the analysis is that the evidence does not establish that the actual events referenced were of particular consequence.

Defendant's evidence of central financing for the foreign subsidiaries consisted of a loan to Nabisco, the proceeds of which were to be used in furtherance of the corporate purposes of the company. (Def's Ex ZZZ and Ex FFFF.) Any pledge or guarantee of the assets of the subsidiaries involved in the transaction was compensated by a fee. (Def's Ex FFFF at 2.) The proofs offered as to centralized banking consist of minutes stating that Nabisco officers were authorized to engage in banking activities, and do not show that the foreign subsidiaries' banking was controlled by Nabisco. (Def's Ex V and Ex FF.) The same material presented to show related party transactions took place at less than the prevailing market rate also states that if the prevailing rates were paid there would be no material adverse effect. (Def's Ex M at 19.) Defendant's strongest point was that Nabisco did guarantee the loans of two of its subsidiaries (Def's Ex M at 118-119), and assigned the debt of another (Def's Ex PPP at 2). While this is some evidence of functional integration, it is too minor to demonstrate a unitary relationship, as would be the case, for example, if Defendant had shown that Nabisco had daily swept cash from its subsidiaries into its banking system, or that operating funds and capital expenditures required by the subsidiaries were controlled and advanced by Nabisco. *Maytag Corp. v. Dept. of Rev.*, 12 OTR 502, 508-09 (1993).

Centralized management: The evidence does not support the finding that there was centralized management or a common executive force with Nabisco and its subsidiaries to a degree sufficient to support a unitary relationship. The foreign subsidiaries each had

their own management, which exercised control over the day-to-day operations, and who could make almost all business decisions without the approval of Nabisco. (Def's Ex LLLLLLL at 2, 6 and Ex P P P P P P P at 14-15.) That is an important point. *Woolworth*, 458 US at 365-66, 369. Nabisco did not train or rotate its personnel to operate the foreign subsidiaries. (Def's Ex LLLLLLL at 3 and Merola testimony) While occasional transfers of personnel did occur between Nabisco and a foreign subsidiary, their relative paucity is indicative more of the absence, rather than the presence, of a unitary relationship given the number and size of the foreign subsidiaries. (Def's Ex LLLLLLL at 6; Ex P P P P P P P at 62; and Merola testimony.) There was some review of the decisions of the foreign subsidiaries when decisions involved millions of dollars, or were as to personnel at their highest level of senior management. (Def's Ex P P P P P P P at 59, 63.) However, this is not necessarily indicative of a unitary business. *Woolworth*, 458 US at 368-69.

Defendant observed that in the United Kingdom, Nabisco authorized the directors of Walker Crisps to act for Nabisco in the purchase of Smith's Crisps, and restructured its Italian operations to delegate authority to the subsidiaries' directors. (Def's Ex CC and Ex II at 3.) Those acts certainly demonstrate Nabisco might potentially operate as a unitary business, in that the same mechanisms that permit a power to be delegated also allow that power to be taken away. However, what might potentially be done is not the test, especially when Nabisco's choice was to allow the foreign corporations their autonomy.

The common executive force in International Nabisco Brands, Inc. and Nabisco International Inc. was also referenced by Defendant. (Def's Ex A at 59; Ex B at 58; Ex K at 1-2; Ex Z at 2; Ex Q Q Q Q at 2.) This argument would be stronger if Defendant could point to interlocking directorships between these Nabisco corporations and the foreign



subsidiaries themselves. For example, H. John Greeniaus, was identified as serving on the boards of Nabisco International, Inc., Nab Europe Holding, Inc., and Nab France Holding One, Inc. His connection with the French subsidiaries, Nab France, S.A.; Nab Brands France, S.A.; Galletas Artiach, S.A.; Nab France S.A.; and France Feuilletes, SA. was never identified. (Def's Ex K.)

Without individuals serving on both the boards of the parent and the boards of the subsidiaries, the court does not see how there is a common executive force between Nabisco and the foreign corporations. As it is, the fact that Nabisco had shared executives among its corporations holding foreign investment does not demonstrate the sharing of values between parent and subsidiary typical of a unitary relationship. For that matter, the fact that a parent may have one or several directors in common with its subsidiaries is not necessarily indicative of a unitary relationship. *Woolworth*, 458 US at 368.

Economies of scale: The evidence in this case does not support the conclusion that the relationship between Nabisco and its foreign subsidiaries was marked by sufficient economies of scale to support the finding of a unitary relationship. Nabisco and its foreign subsidiaries had separate and distinct human resource departments, training programs, and pension plans. (Def's Ex LLLLLLLL at 3, 4.) They maintained their own legal and tax counsel, advertising and marketing staff. (Def's Ex LLLLLLLL at 3, 4.) There was no centralized purchasing, manufacturing, distribution, or warehouse facilities, no shared shipping or transportation charges, and no shared buildings or labor force. (Def's Ex LLLLLLLL at 4, 5 and Ex PPPPPPP at 56, 59.) The subsidiaries had their own finance and accounting programs, bank accounts, credit card and collection procedures, and did not transfer accounts receivable to Nabisco. (Def's Ex LLLLLLLL at 3,4 and Ex PPPPPPP

at 36.) While Nabisco and its subsidiaries shared a common accounting firm, each foreign subsidiary separately negotiated and paid its fees. (Merola testimony.) All these are important indicators of the absence of any economies of scale.

Defendant raises the point that the products of Nabisco and the foreign subsidiaries were compatible with each other's distribution systems. The potential to operate with a common distribution system does not show that economies of scale were achieved in actual operations. Similarly, Defendant noted Nabisco authorized an Employee Benefits Committee to act on behalf of Nabisco and all its subsidiaries. (Def's Ex FF at 3 and Ex TT at 2-3.) However, the record indicates that there were a series of pension plans available to the foreign subsidiaries (Def's Ex M at 103, 165), and that special pension plans would, on occasion, be employed (Def's Ex M at 124). That Nabisco could act to set pensions for its subsidiaries does not demonstrate that it actually did, and lacking such proof Plaintiff's testimony that each subsidiary set its own benefits is uncontradicted. (Def's Ex LLLLLLLL at 3, 10; Ex PPPPPPP at 31; and Merola testimony.)

Defendant asserted Nabisco shared manufacturing technology and the results of its research and development facility with the foreign subsidiaries, and permitted them royalty-free licences. That point is important. However, this particular issue is a matter of degree. If Defendant's evidence is given its greatest inference, it establishes that Nabisco apparently had considerable technology in its hands which might potentially have been of benefit to the foreign subsidiaries, and that the transfer of some patents as to certain processes were negotiated during the sale of the subsidiaries which generated the gain at issue. (Def's Ex M at 125-26.) However, it does not, without more, controvert the Merola testimony that each company had its own research and development facilities, and that what technological transfers did occur did not cause a flow of value from the parent to the

subsidiaries.

Business income: Even in the absence of a unitary relationship between Nabisco and its foreign subsidiaries, Defendant asserts that gain from the sale of those

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corporations will qualify as business income under the functional and transactional tests of ORS 314.610.<sup>3</sup> *Simpson Timber Company v. Dept. of Rev.*, 326 Or 370, 953 P2d 366 (1998), concurring opinion. The court's conclusion is that the evidence does not support this result.

The gain does not qualify as business income under the transactional test because Nabisco was not in the business of buying and selling corporations. Nabisco's business was manufacturing and selling food products. In the course of its affairs Nabisco would make purchases of other corporations in the same line of business, and sell businesses it no longer found attractive. The court does not agree that because these transactions occurred with some frequency Nabisco necessarily became a dealer in corporations. (Def's Ex A at 4, 6; Ex B at 6; Ex D at 18; and Ex F at 4.) What would be persuasive is a

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<sup>3</sup>ORS 314.610. Definitions for ORS 314.605 to 314.675.

"As used in ORS 314.605 to 314.675, unless the context otherwise requires:

"(1) 'Business income' means income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, the management, use or rental, and the disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.

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"(5) 'Nonbusiness income' means all income other than business income."

(1965 c. 152 § 2.)

showing that Defendant had purchased and sold corporations in other lines of business. The only evidence the court could see of this occurring was in 1982. (Def's Ex B at 6.) There was no showing as to whether this apparently isolated transaction occurred as a result of an expansion of corporate purpose, or instead was an incidental aspect of a larger transaction involving corporations engaged in the manufacture of food.

That the gain does not qualify as business income under the transactional test would seem to support the conclusion that the gain is captured by the functional test, for the foreign subsidiaries, as food manufacturers and sellers, were in the same line of business as Nabisco. The particular problem is that more is required for the functional test than a unanimity of corporate purpose. Instead, the gain must be generated by an asset whose acquisition, management, and disposition was an **integral** purpose of Nabisco's regular trade or business. ORS 314.610 (emphasis added); *Willamette Industries, Inc. v. Dept. of Rev.*, 331 Or 311, 15 P3d 18 (2000).

The conclusion of the previous analysis discussing functional integration, centralization of management, and economies of scale, was that the foreign subsidiaries were not integral parts of Nabisco's business. Instead, they were separate businesses. That decision has consequences here. The functional test fails, because the acquisition, management, and disposition of the foreign subsidiaries whose sale created the gain at issue were not integral to Nabisco's operations.

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While the previous discussion sets out the court's findings of fact and conclusions of law, a final point is worthy of comment. At the risk of oversimplification, there are two key reasons explaining why Plaintiff was successful in this appeal. The first is that Nabisco

acquired these corporations as existing entities, and in the balance, preserved their independent character during Nabisco's ownership. The second is that Nabisco provided credible testimony explaining away the inferences and conclusions drawn by Defendant from its reference to the annual reports, corporate minutes, various contracts, and other written materials on which the agency relied.

Stephen J. Merola was employed by one or another of the various Nabisco companies from 1951 through 1999, and served as the comptroller of Nabisco International, Inc. from 1987 through 1989. (Def's Ex LLLLLLL at 1.) He was Plaintiff's only witness. Defendant made the point that the court should take care in weighing his testimony.

The court has done so. In the process it has reflected that Merola has supplied affidavits, been deposed, and been brought before the court to have his testimony taken. He was tested by cross examination. The court finds his firsthand knowledge of the events in question to be credible, and adequate support for the resolution of the controversies in question. In this respect this case has yet another parallel to *Woolworth*, where the testimony of a tax manager was sufficient to support the Supreme Court's analysis. *Woolworth*, 458 US at n 7.

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The conclusion of the court is that the facts and arguments presented to this tribunal support the decision that Nabisco was not in a unitary relationship with its foreign subsidiaries, and that the capital gain from their sale was not business income. Now, therefore,

IT IS THE DECISION OF THIS COURT that Plaintiff's appeal is granted. Plaintiff

and Defendant shall collaborate on preparing the appropriate form of judgment.

Dated this \_\_\_\_\_ day of April, 2003.

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SCOT A. SIDERAS  
MAGISTRATE

**IF YOU WANT TO APPEAL THIS DECISION, FILE A COMPLAINT IN THE REGULAR DIVISION OF THE OREGON TAX COURT, FOURTH FLOOR, 1241 STATE ST., SALEM, OR 97301-2563. YOUR COMPLAINT MUST BE SUBMITTED WITHIN 60 DAYS AFTER THE DATE OF THE DECISION OR THIS DECISION BECOMES FINAL AND CANNOT BE CHANGED.**

**THIS DOCUMENT WAS SIGNED BY MAGISTRATE SCOT A. SIDERAS ON APRIL 3, 2003. THE COURT FILED THIS DOCUMENT ON APRIL 3, 2003.**