Sub. Stock Lo

65-SBE-038

Held: N-4

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
THOMAS J. LIPTON, INC.)

Appearances:

For Appellant: Eli Gerver, Certified Public Accountant

For Respondent: Peter S. Pierson, Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Thomas J. Lipton, Inc., against proposed assessments of additional franchise tax in the amounts of $6,270.78 and $7,503.86 for the income years 1957 and 1958, respectively.

Appellant is a Delaware corporation engaged in the manufacture and sale of tea, soup and salad dressing. Its main offices are located in Hoboken, New Jersey. Appellant has plants in New Jersey, New York, Virginia, Missouri, Texas and California, and maintains sales offices throughout the United States.

In order to expand its product line, appellant acquired all of the stock of a company engaged in the manufacture and sale of dog food, Vitality Mills, Inc., (hereafter "Vitality") in January of 1956. It also purchased a feed mill, grain elevator and dog food plant located in the State of Illinois which were rented to Vitality. After conducting a consumer study and several months of research, appellant abandoned the dog food business because it was unable to develop products which had the desired promotional qualities, as compared with the products of leading competitors.

Accordingly, in 1957, Vitality ceased operations and the properties rented to it were sold by appellant at a loss of $635,762. In 1958 advances which had been made by appellant to Vitality in the amount of $398,352 were determined to be worthless, Vitality was dissolved and all of its assets turned over to its creditors. Appellant's tax basis for the Vitality stock was $559,261.

On its franchise tax returns for the years in question, appellant treated its operations and those of Vitality as a unitary business. It deducted from the combined income the loss suffered on the sale of property rented to Vitality, together with bad debt and stock losses incurred in its relationship with that corporation. The remaining net income was allocated among the places where the entire operations were conducted, a portion being assigned to California.

On the theory that Vitality and appellant were not conducting a unitary operation and, thus, that the above losses were not unitary business losses, the Franchise Tax Board disallowed the deductions. Respondent has since conceded that the operations were unitary and that the loss from the sale of property and the bad debt loss were properly deducted from allocable income. Only the question of the deductibility of the stock loss remains.

Appellant contends that Vitality was an integral part of its unitary operations and that the stock loss sustained on the liquidation must be included in the tax base used to determine the amount of net income properly allocable to California. In support of its position, appellant relies upon two of our prior decisions, Appeals of Safeway Stores, Inc., Cal. St. Bd. of Equal., March 2, 1962; and Appeal of Dohrmann Commercial Co., Cal. St. Bd. of Equal., Feb. 29, 1956. Appellant's reliance is misplaced, however, for those cases clearly oppose the result urged here. They stand in part for the proposition that dividends received by a parent from affiliated corporations engaged in a single unitary business are taxable at the situs of the stock.

In Appeals of Safeway Stores, Inc., supra, Cal. St. Bd. of Equal., March 2, 1962, we held that since the taxpayer's commercial domicile was in California, all of the intercompany dividends it had received were taxable here. We stated that:

> In Miller v. McColgan, 17 Cal. 2d 432; Southern Pacific Co. v. McColgan, 60 Cal. App. 2d 48, and Pacific Western Oil Corp. v. Franchise Tax Board, 136 Cal. App. 2d 794, dividend income was regarded as having its source in the shares of corporate stock of the declaring corporation and to be taxable at the situs of the stock. In Southern

> Pacific Co. v. McColgan, supra, the situs of stock which was integrally connected with and used to further the multi-state business of the corporate stockholder was held to be at the commercial domicile of the stockholder, that is, the place from which the business was directed and controlled and where a major part of the business was conducted.

In addition, we concluded in Safeway that inter-company stock losses, such as that sustained by appellant, should be accorded the same treatment as that given inter-company dividends. Therefore, appellant's stock loss is not deductible from allocable income. (See also, Appeal of Avon Products, Inc., Cal, St. Bd. of Equal., June 7, 1962.)

In Holly Sugar Corp. v. Johnson, 18 Cal. 2d 218 [115 P.2d 8], a New York corporation doing a substantial portion of its business in California, but with its principal office in Colorado, acquired 70 percent of the shares of a California corporation engaged in the same type of business wholly within this state. The court held that by economic integration with the owning company's operations within California the shares of stock had become sufficiently localized to acquire a business situs here. Nothing in the record indicates that the situation before us is comparable to that in-the Holly case. It has not been established that Vitality was domiciled in California or that it did business wholly within this state.

Since it has not been shown that appellant was domiciled in California or that its stock in Vitality had a business situs in this state, no part of the stock loss may be attributed to California.

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, Appeal of Thomas J. Lipton, Inc.

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 Thomas J. Lipton, Inc., against proposed assessments of additional franchise tax in the amounts of $6,270.78 and $7,503.86 for the income years 1957 and 1958, respectively, be and the same is hereby modified as follows: the loss incurred by appellant on the sale in 1957 of property rented to Vitality and the advances to Vitality determined to be worthless in 1958 are to be allowed as deductions in the determination of net unitary business income subject to allocation, In all other respects the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this 5th day of October, 1965, by the State Board of Equalization.

John W. Lynch, Chairman

Richard Nevins, Member

Paul R. Leake, Member

________________, Member

Geo. R. Reilly, Member

Attest: ________________, Secretary