BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
ALLIED EQUITIES CORPORATION)

For Appellant: Lawrence A. Aufmuth
Attorney at Law

For Respondent: Crawford H. Thomas
Chief Counsel

John D. Schell
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 Allied Equities Corporation against a proposed assessment of additional franchise tax in the amount of $27,499.79 for the income year 1966.

The issue presented is whether a dividend paid to appellant by its wholly owned foreign subsidiary is income derived from California sources and thus subject to the California franchise tax.

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Appellant is a Nevada corporation which has done business in California since its incorporation in 1935. Appellant's principal business activity, the manufacture of metal products, was conducted in California prior to and during 1966. Its business offices, accounting records, and manufacturing plants were located in this state, and all of its officers and directors resided in California, There is no evidence that appellant conducted any business during 1966 in Nevada, the state of its incorporation,

By the year on appeal appellant had commenced a diversification program which consisted of acquiring other operating companies. In July of 1965 it contracted to purchase Isbrandtsen Tankers, Inc. (hereafter called Tankers), a Delaware corporation, from Isbrandtsen Company, Inc., a New York corporation. Both of these companies operated out of New York and neither appears to have done business in California during 1966. In exchange for all of Tankers' stock, appellant agreed to transfer 40 percent (400,000 shares) of its outstanding stock, a warrant for the issue of additional shares, and a promissory note for $2,500,000, which was secured by a pledge of all of Tankers' outstanding capital stock to, the seller, Isbrandtsen Company, Inc., in New York, Under the terms of the pledge and stock purchase agreements, appellant owned the Tankers stock and was entitled to voting -rights, but in the event of appellant's default in repayment of the note the seller, Isbrandtsen Company, Inc., was authorized to sell the pledged Tankers stock. Eighty percent of all dividends paid on the Tankers stock were to be applied against the note,

In 1966 Tankers paid a $500,000 dividend, 80 percent going to the seller in New York pursuant to the above mentioned agreements. Appellant excluded the entire dividend from California income, contending the Tankers stock had a New York business situs and the source of the dividends was therefore out of state, Respondent determined that the dividend was includible in appellant's California income because appellant's commercial domicile was in California.

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As a general corporation doing business in this state, appellant is subject to tax for the privilege of exercising its corporate franchise within this state. (Rev, & Tax, Code, § 23151.) Section 25101 of the Revenue and Taxation Code provides that when a corporation's income is derived from sources within and without California, its tax liability shall be measured by the net income derived from or attributable to California sources, Under section 23040 of the Revenue and Taxation Code, income from intangible property located or having a situs in this state is considered to have been derived from California sources.

Intangible property is generally considered to have its situs for tax purposes at the domicile of its owner and, in the case of a corporation, that situs would normally be the state of incorporation.. (Newark Fire Ins. Co. v. State Bd. of Tax Appeals, 307U.S. 313 [83 L. Ed. 13123; Southern Pacific Co. v. McColgan, 68 Cal. App. 2d 48 [156 P.2d 81].) An exception to this rule has developed, however, in the situation in which a corporation concentrates its corporate functions in a state other than the one in which it was legally created, thereby creating a commercial domicile in that other state. (Wheeling Steel Corp. v. Fox, 298 U.S. 193 [80 L. Ed, 1143]; First Bank Stock Corp. v. Minnesota, 301 U.S. 234 [81 L. Ed. 1061]; Southern Pacific Co. v. McColgan, supra; Pacific Western Oil Corp. v. Franchise Tax Board, 136 Cal. App. 2d 794 [289 P.2d 287].) In developing this concept in the Wheeling Steel case, the Supreme Court stated:

> The [Delaware] Corporation established in West Virginia what has aptly been termed a "commercial domicile," It maintains its general business offices at Wheeling and there it keeps its books and accounting records.. There its directors hold their meetings and its officers conduct the affairs of the Corporation. There, as appellant's counsel well says, "the management functioned."

> The Corporation has manufacturing plants and sales offices in other States. But what is done at these plants and offices is determined and controlled from the center of authority at Wheeling., The Corporation has made that the actual seat of its corporate government.
> (298 U.S. 193, 211-212.)

A California appellate court explored the concept of commercial domicile at some length in the case of Southern Pacific Co. v. McColgan, 68 Cal. App. 2d 48 [156 P.2d 81], and stated:

> ...The true test must be to consider all the facts relating to the particular corporation, and all the facts relating to the intangibles in question, and to determine from those facts which state, among all the states involved, gives the greatest protection and benefits to the corporation, which state, among all the states involved, from a factual and realistic standpoint is the domicile of the corporation....
> (68 Cal. App. 2d 48, 80.)

Applying this test it is clear that the State of California was appellant's commercial domicile in 1966. However, respondent's regulation provides in part:

> In the ease of . ..foreign corporations which have acquired a commercial domicile within the State, all income, . ..including...dividends on stock of both domestic and foreign... corporations ,...is income from sources within this State, unless the property is so used in connection with a business carried on outside this State as to have acquired a business situs outside this State...,
> (Cal. Admin. Code, tit. 18, reg. 23040(a).)

Therefore, appellant's dividend income from the Tankers stock is subject to the California franchise tax unless the stock acquired a business situs in New York.

We are unable to agree with appellant that its Tankers stock had acquired such a business situs in New York. The sellers possession of the stock in Mew York was for security purposes. Pledging stock as security for a loan does not, in itself, constitute the conducting of a business in a foreign state, (Stanford v. San Francisco, 131 Cal. 34 [63 P. 1453; Appeals of Finley J. Gibbs, Trustee, Cal. St. Bd. of Equal., July -22, 1958.)

Appellant has also characterized the purchase of the Tankers stock as '"only a 'holding company operation*", unrelated to the ordinary business of appellant. Noting that a "holding company operation" is not business activity for purposes of establishing a business situs, the court in Southern Pacific Co. v. McColgan, supra, stated:

> If a corporation engages in other activities, but also acts as a holding company, its holding company activities do not constitute doing business, nor are dividends paid to it income from business done. The concept that the activities of a holding company do not constitute a doing of business;, but, rather, the receipts of ownership of property, with activities incidental thereto, is a well established one, not to be E-e-examined at this date in interpreting our statute, which has been construed as perpetuating it. ...
>
> [W] hen a corporation's relations to other corporations in which it owns stock is that of a holding company only, such activity is not doing business,.,. (68 Cal, App. 2d 48, 55-56.)

On the basis of the Southern Pacific Co., case, appellant's own statement would appear to dictate the conclusion that the stock did not acquire a business situs in New York, since appellant was not carrying on any business in that state during 1966.

Appellant has placed particular reliance upon Westinghouse Co. v. County of Los Angeles, 188 Cal. 491 [205 P. 1076]. In that case the California Supreme Court stated:

> In the instance of securities. ..sent *away* as the basis for a permanent business in a foreign state, the accumulations to be there invested and reinvested, and the principal to remain as the source of income for the investments, the case is quite different from that of a temporary hypothecation *for* a loan. In the one case there is a transfer of capital from the owner's residence to the foreign state, there to be used in prosecuting a permanent business, and for the purposes of taxation for that reason is held to have a 'business situs.' In the other case, the transferis for a specific and temporary purpose that may be accomplished in a brief space of time and may be, and presumably is, to aid the business of the owner at his place of residence.
> (188 Cal: 491,496.)

While we.respect the distinction made by the court in the instant case, appellant is faced with the factual obstacle that any employment of the dividend income in New York was merely incidental to the main purpose of the pledge, Clearly this is not an instance in which appellant used the intangibles in any permanent independent business of lending money in another state. To the contrary, here we had essentially a temporary hypothecation of stock in Mew York.

Accordingly, we conclude that the stock's situs for tax purposes was at appellant's commercial domicile in California and the dividend income therefrom was income derived from a California source which was subject to franchise tax in this state.

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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 Allied Equities Corporation against a proposed assessment of additional franchise tax in the amount of $27,499.79 for the income year 1966, be and the same is hereby sustained.

Done at Sacramento, California, this 31st day of July, 1973, by the State Board of Equalization.

_____, Chairman

_____, Member

_____, Member

_____, Member

_____, Member

ATTEST: _____, Secretary