

BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )  
 )  
NORTON-SIMON, INC., SUCCESSOR IN )  
INTEREST TO HUNT FOODS AND INDUSTRIES, )  
INC., SUCCESSOR IN INTEREST TO HARBOR )  
PLYWOOD CORPORATION )

Appearances:

For Appellant: Hilbert P. Zarky  
Attorney at Law

For Respondent: Jack E. Gordon  
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 protests of Norton Simon, Inc., Successor in Interest to Hunt Foods and Industries, Inc., Successor in Interest to Harbor Plywood Corporation, against proposed assessments of additional franchise tax in the amounts of \$43,077.79 and \$83,909.91 for the income years ended March 31, 1961, and March 31, 1962, respectively. Since Norton Simon, Inc., and Hunt Foods and Industries, Inc., are parties to this appeal only because they are successors in interest., Harbor Plywood Corporation will hereafter be referred to as "appellant."

The sole issue for decision is whether 'appellant, a Delaware corporation, had established a "commercial domicile" in California during the' appeal years so that its income from intangibles was from sources within this state and thus properly includible in the measure of appellant's California franchise tax.

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Appellant was incorporated under Delaware law in 1929. Its main office was located in Aberdeen, Washington, where for many years it engaged in the manufacture and sale of plywood and plywood products. During those operative years appellant also owned timber rights and other production facilities in Washington and Oregon. In 1957 and 1958 appellant began to cut back on its plywood operations, selling some of its timber rights, saw mills, and equipment. In May of 1960 it sold the remainder of its plywood business to Aberdeen Plywood and Veneers Company, receiving a promissory note secured by the properties sold.

After May 1960, appellant maintained a small office located on the grounds of the plant which it had sold to Aberdeen Plywood and Veneers Company. That office was staffed the majority of the time by appellant's president and two other officer-employees, all residents of Aberdeen, Washington. Appellant's corporate books and records were kept at the Aberdeen office. Its accounts were audited there and its federal income tax returns were filed with the District-Director of Internal Revenue in Tacoma, Washington. Appellant still had interests in some timber cutting rights in Washington after May 1960. Also, the properties securing appellant's sales of its plywood operations were located in Washington and appellant's president was assigned the duty of overseeing those remaining property interests. Annual meetings of appellant's shareholders were reportedly held in Washington.

As of April 1, 1960, approximately 74 percent of appellant's stock was owned by Hunt Foods and Industries, Inc., a California corporation. This had come about as a result of the merger in 1958 of Hunt Foods, Inc., and The Ohio Match Company, the latter having acquired a substantial stock interest in appellant between 1952 and the merger date. At a meeting held July 14, 1955, in Aberdeen, Washington, Mr. Norton Simon, chairman of the board of directors of Hunt Foods, was elected chairman of appellant's board of directors. Mr. Simon was a resident of Los Angeles, California. At that same meeting an "Executive Committee" was established. Excerpts from the minutes of the meeting are set forth below.

BE IT RESOLVED AS FOLLOWS:

\* \* \*

- (2) That pursuant to Article III of the by-laws there is hereby created a committee of

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Harbor's directors, the official designation of which committee shall be the "Executive Committee". Said committee shall consist of the Chairman of the Board, the President; and two other members of the Board who shall be chosen by the vote of a majority of the whole Board. . . . The Executive Committee (except during such periods as the whole board may actually be in session) shall have and may exercise all of the powers of the board of directors in the management of the business and affairs of the corporation and may authorize the seal of the corporation to be affixed to all papers which may require it. A majority of the committee [3] shall constitute a quorum for the transaction of business....

\* \* \*

In the adoption of the foregoing resolution it was emphasized in the discussion and it was fully acknowledged by all of the directors present that, in delegating all of the powers of the full board to the Executive Committee, it was the very definite intention that said delegated powers, along with any and all other powers which might legally be delegated, would include all such power and authority as is vested in the full board to act in the case of major acquisitions, dispositions or transactions of comparable nature and regardless of magnitude involving all or any part of the corporation's assets, properties or investments of any description whatsoever.

From the time of that meeting until March 5, 1962, the Executive Committee consisted of three residents of California and appellant's president, a Washington resident. One California member besides Mr. Simon was also a director of Hunt Foods. Only one meeting of the Executive Committee was held in the two-year period commencing April 1, 1960, and that meeting was held in Los Angeles.

During each of the income years in question, appellant's full board of directors was composed of ten individuals, six of whom were residents of California, four of Washington. Five of the Californians were also

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directors of Hunt Foods. Between April 1, 1960, and March 5, 1962, appellant's board of directors met eleven times, three times in Washington and eight times in Los Angeles at the offices of Hunt Foods.

In 1955 appellant had begun a program of investing its surplus funds in government bonds and stocks and securities of other corporations. From time to time it held notes receivable resulting from sales of its operating assets. On March 5, 1962, when appellant was merged into Hunt Foods, its investment in such intangible assets had grown to about \$30,000,000. In the income year ended March 31, 1961, appellant's income from those intangibles totalled approximately \$891,000 and in the following year it had income from intangibles of \$922,000 plus gain from its securities transactions of \$785,000. The State of Washington imposed no tax on any of that income.

During the years on appeal all of appellant's stock and securities transactions were handled through brokers in Los Angeles and New York. Securities purchases were made with funds drawn on Los Angeles banks and dividends received were deposited in those same accounts. As of March 31, 1961, appellant's accounts in three Los Angeles banks showed balances totalling \$975,316; its one account in a Washington bank contained \$77,307. On March 5, 1962, appellant had \$114,770 in California bank accounts and \$2,405 in its Washington account.

All decisions as to the purchase and sale of securities were made by the Executive Committee in California. A statement of account with one stockbroker in Los Angeles showed that during December 1960, 49 purchases and 11 sales of stocks were made by appellant. One or more transactions occurred on every business day of the month. Appellant's brokers were instructed to send the records of all securities transactions to the office in Aberdeen, Washington, with a copy addressed to appellant at the Los Angeles office of Hunt Foods. An accounting clerk employed by Hunt Foods, would summarize the monthly securities transactions as well as all receipts and all disbursements from the Los Angeles bank accounts and transmit a copy of that information to Aberdeen, where it was checked with appellant's books there.

On February 12, 1960, appellant filed a registration statement with the Securities and Exchange Commission as an investment company, pursuant to Section 8 of the Investment Company Act of 1940. (15 U.S.C.A. §§ 80a-1 et seq.) Prior to and upon filing the statement, appellant contended it was excepted from the registration requirements by Section 3(b) of that act which provides:

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...none of the following persons is an investment company within the meaning of this subchapter:

(1) Any issuer primarily engaged, directly or through a wholly-owned subsidiary or subsidiaries, in a business or businesses other than that of investing, reinvesting, owning, holding, or trading in securities. (15 U.S.C.A. § 80a-3(b).)

In a letter to the Securities and Exchange Commission dated August 18, 1959, appellant argued that it was still primarily engaged in the plywood business. The Director of the Securities and Exchange Commission rejected that contention and on September 4, 1959, directed appellant to register as an investment company.

On March 14, 1960, appellant's Executive Committee met in Los Angeles. An excerpt from the minutes of that meeting, attended by Mr. Simons and the two California directors, follows:

The Chairman [Simon] informed the meeting that at present all of Harbor Plywood Corporation's non-bearer securities were regularly kept in the corporation's safe deposit box in the Bank of America National Trust and Savings Association, Wiishire-Mariposa Branch, Los Angeles, and that the corporation has been advised that retention of some of the securities in California might subject the corporation to additional California taxes. It was felt that such tax costs could be materially reduced if a number of the non-bearer securities were physically kept in a safe deposit box in Aberdeen, Washington, where the company has an office.

As a result of the Executive Committee's action, most of the certificates representing appellant's non-bearer securities were transferred to a bank in Aberdeen in March 1960. Appellant's government bonds and some stock certificates were retained in Los Angeles. In January 1962, the certificates in Washington were returned to Los Angeles preparatory to appellant's merger with Hunt Foods.

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Upon examination of appellant's records, respondent determined that during the income period commencing April 1, 1960, and ending March 31, 1962, appellant was commercially domiciled in California and that therefore its intangible income was includible in the measure of its California franchise tax for those two years. The resulting proposed assessments of additional franchise tax gave rise to this appeal.

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 that code, income from intangible property having a situs in this state is considered to be income from California sources.

Intangible property is traditionally considered to have its situs for tax purposes at the domicile of its owner and, in the case of a corporation, that situs would generally be the state of incorporation. (Newark Fire Ins. Co. v. State Bd. of Tax Appeals, 307 U.S. 313 [83 L. Ed. 1312]; 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 establishing 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.)

In developing this concept in the Wheeling Steel case, the United States 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 [West Virginia] 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 those plants and offices is determined and controlled from the center of authority at

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Wheeling. The Corporation has made that the actual seat of its corporate government. (298 U.S. 193, 211-212.)

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

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. That is partially a question of fact and partly a question of law.

\* \* \*

We perceive the law to be that where the corporation has only a paper domicile, where the only function performed by the state of incorporation is to breathe life into the corporation, and where no substantial corporate activities are thereafter carried on in that state, then the law looks at such corporation and says that that state where, under the facts, the corporation receives its greatest protection and benefits, that state where the greatest proportion of its control exists, that state shall be the commercial domicile, with constitutional power to tax income from intangibles. (68 Cal. App. 2d 48, 80-81.)

In the instant case there can be no doubt that Delaware, the state of appellant's incorporation, was its mere "paper domicile." The only question, therefore, is whether during the years on appeal appellant's commercial domicile was in Washington or in California.

Appellant contends that its principal place of business throughout the appeal years continued to be in

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Aberdeen, Washington; where it maintained its only office, In support of this contention appellant points to the following facts: (1) -all of its officers and employees were residents of Washington; (2) its books and records were located in Aberdeen; (3) the most substantial part of its intangible assets were kept there; (4) its stockholders met in Washington; (5) it filed its federal income tax returns in Tacoma, Washington; and (6) it owned timber rights and security interests in property located in Washington. Appellant also argues that in years prior to the ones here in question, respondent concurred in appellant's treatment of Washington as its commercial domicile, and there were no essential changes in the facts during the years in controversy which would justify a conclusion that its commercial domicile had moved to California.

It is true that the facts relied upon by appellant are those often mentioned in the case law as tending to establish a corporation's commercial domicile. In this unusual case, however, we believe they are not decisive. The cases definitely establish that the physical evidences of intangible assets need not be located in the state which is asserting that those intangibles have acquired a taxable situs therein. (See Southern Pacific Co. v. McColgan, supra, 68 Cal. App. 2d 48 [156 P.2d 81], and cases cited therein.) The essence of the concept of commercial domicile is that it is the place where the corporate management functions, the place where real control exists with respect to the business activities of the corporation. We agree with **respondent that during the years in question that place was located in California.**

We do not think it can be denied that during the income period commencing April 1, 1960, and ending March 31, 1962, appellant was engaged in business as an investment company. It appears that in those years its entire income was from its intangible assets. Nor do we think it can be successfully argued that business activity in connection with those intangibles originated anywhere but in California. This was where the Executive Committee functioned and where daily investment and trading decisions were made. The unusual aspects of this case result from the obviously close association which existed between appellant, Hunt Foods, and Mr. Norton Simon. There was no need for appellant to maintain a separate office in Los Angeles because the facilities and employees of Hunt Foods were available for its use. Day-to-day decisions with respect to appellant's investment activity must have been made on an informal basis since, according to appellant, the Executive Committee met only once during the two-year period.

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In our opinion, respondent reasonably determined that appellant's commercial domicile had shifted to California in the income year beginning April 1, 1960. We cannot concur in appellant's assertion that there was no essential change in the facts which would justify that conclusion. Until that year appellant was still actively engaged in the plywood business to some degree, although it had made substantial investments in intangibles as well. In our view the sale of the remainder of its plywood business in May 1960, was a decisive indication that the nature of appellant's business had changed and that thereafter it was exclusively an investment company. Its intangible interests in Washington properties then became part of its investment portfolio. The sale would seem to be a taxable event which justified respondent's determination.

Regardless of the formal indicia of commercial domicile which remained in or were placed in the State of Washington we believe that, from a factual and realistic standpoint appellant was commercially domiciled in California during the income years ending March 31, 1961, and 1962, that its intangible assets thereby acquired a taxable situs in this state no matter where they were physically located, and that its income from those intangibles was therefore includible in the measure of its California franchise tax liability.

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,

