72-SBE-015

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
BRISTOL-MYERS COMPANY)

For Appellant: Seymour Lowenstein
Counselor at Law

For Respondent: Crawford H. Thomas
Chief Counsel

A. Ben Jacobson
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 Bristol-Myers Company against proposed assessments of additional franchise tax in the amounts of $3,507.07 and $6,837.62 for the income years 1959 and 1960, respectively, and from the action of the Franchise Tax Board on the protest of Bristol-Myers Company, successor in interest to Grove Laboratories, Inc., against proposed assessments of additional franchise tax in the amounts of $160.01 and $983.91 for the taxable years 1959 and 1960, respectively.

Subsequent to the filing of this appeal, the parties reached an agreement in settlement of the issue concerning the composition of the sales factor of the apportionment formula. As a result of this settlement, the only issue remaining for decision is whether appellant is entitled to deduct from the measure of its franchise tax certain losses on its investments in a nonunitary subsidiary corporation.

The facts are undisputed. On August 4, 1955, appellant agreed to purchase all of the assets of Kimball

Manufacturing Corporation, an unrelated California corporation which produced fiberglass reinforced plastic products. At about the same time, appellant created a new California corporation also named Kimball Manufacturing Corporation (hereinafter called Kimball). Then, in exchange for all of Kimball's capital stock, appellant assigned to this subsidiary the right to receive the purchased assets. All of the negotiations pertaining to the asset acquisition took place in California, and the agreement and actual conveyance were consummated in California pursuant to the laws of this state.

After the acquisition Kimball continued the business operations of its predecessor without change. Mr. William R. Kimball, Jr., the founder and president of the predecessor company, was appointed president of Kimball. With the exception of consulting with appellant's executives on over-all policy, Mr. Kimball was wholly responsible for the subsidiary's operations. These operations, like those of the predecessor company, were conducted exclusively in California, and they were not connected in any way with appellant's unitary drug and cosmetic business.

From the outset Kimball incurred substantial operating losses. As a result appellant was compelled to loan it funds in order to keep the business going. Despite the infusion of new capital, the losses continued and appellant ultimately decided that Kimball should be liquidated. On August 1, 1959, Kimball sold all of its assets, at a loss, to the William R. Kimball Corporation, a new company organized by its namesake to reacquire his former business. Part of the consideration for the sale was purchase money notes issued by William R. Kimball Corporation and secured by the transferred assets. Later in 1959, Kimball Manufacturing Corporation changed its name to Walter Gavin Corporation, assigned the purchase money notes to appellant (its sole shareholder), and dissolved. Like appellant's purchase of the assets in 1955, this sale was negotiated and consummated in California.

The business was no more profitable in the hands of William R. Kimball Corporation than it had been in Kimball's. By 1962 appellant began to doubt the collectibility of the purchase money notes and commenced negotiations for their sale. Appellant was successful in selling them to a third party in that year, but it realized a $127,500 loss on the transaction. Once again, all aspects of the sale were conducted in California.

In addition to the 1962 loss on the sale of the purchase money notes, appellant suffered two other losses when Kimball was liquidated in 1959. These losses consisted of a $152,565 loss on its investment in Kimball's stock and a bad debt loss of $177,601 on its unrecovered loans to Kimball. On its franchise tax returns for 1959 and 1962, appellant reported the three losses as unitary losses. Respondent disallowed them, however, on the ground that they were nonunitary losses allocable to the situs of appellant's commercial domicile in New York. Appellant conceded that the losses were nonunitary but attempted, unsuccessfully, to persuade respondent that each loss had a California situs and was deductible in full from appellant's net income from California sources. Respondent's action disallowing the 1959 losses gave rise to a proposed assessment of additional taxes, and appellant has taken this appeal from respondent's denial of its protest against that assessment, After the 1962 loss was disallowed as a deduction, appellant filed a claim for refund on which respondent has not yet acted. Although appellant might have been in a position to make an appeal from the deemed disallowance of the claim (Rev. & Tax. Code, § 26076), it did not do so. The year 1962 is, therefore, not on appeal. It is the understanding of the parties, however, that the Franchise Tax Board will dispose of the claim on the basis of our decision herein concerning the 1959 losses involving the identical issues and legal principles. With that in mind, and to add continuity, we have set forth the facts and circumstances surrounding the 1962 loss.

Appellant's position on appeal is based on Revenue and Taxation Code section 23040, which provides in pertinent part:

> Income derived from or attributable to sources within this State includes income from tangible or intangible property located or having a situs in this State,. ..

Appellant argues first that the losses in question were on tangible property (the assets acquired in 1955) located in' California. If we decide, however, that the losses were on intangibles, as respondent would have us do, then appellant maintains that the intangibles had a situs in California either because appellant's commercial domicile, with respect to this part of its business, was in California or because the intangibles had acquired. a "business situs" in this state.

'The crux of appellant's first contention, that the losses were on tangible property located in California, is that the separate corporate entity of Kimball should be disregarded and appellant deemed the actual owner of Kimball's assets at all times. Appellant says that Kimball's existence served no purpose except to allow appellant to segregate a nonunitary enterprise. Thus, Kimball assertedly operated the business as the agent of appellant, its sole stockholder. The general rule is, of course, that a corporation and its shareholders are separate entities for tax purposes, and the corporate. form will be disregarded only in unusual circumstances. (Burnet v. Commonwealth Improvement Co., 287 U.S. 415 [77 L. Ed. 399].) This rule applies whether there are many shareholders or only one. (id.) in a case where the taxpayer corporation sought to have certain of its income taxed to its sole stockholder, the United States Supreme Court said the following:

> The doctrine of corporate entity fills a useful purpose in business life. Whether the 'purpose [of incorporating] be to gain an advantage under the law of the state of incorporation or to avoid or to comply with the demands of creditors or to serve the creator's personal or undisclosed convenience, so long as that purpose is the equivalent of business activity or is followed by the carrying on of business by the corporation, the corporation remains a separate taxable entity. (Footnotes omitted and emphasis added.) (Moline Properties, Inc. v. Commissioner, 319 U.S. 436, 438-9 [87 L. Ed. 1499].)

Since Kimball did actively operate its business during the four years of its corporate existence, it must be regarded as a separate taxable entity rather than as an empty shell or mere agent of its parent. Having voluntarily elected to separately incorporate the acquired assets, appellant must accept the consequence that its investment thereafter was no longer in tangible assets but in intangibles, its stock in Kimball. Similarly, the purchase money notes and the notes evidencing appellant's loans to Kimball were intangibles in appellant's hands. We hold, therefore, that the losses in question were losses on intangibles.

With respect to the taxation of stocks, bonds, and other intangibles , the general rule is that such property and its fruits have a taxable situs, under the doctrine of mobilia seouuntur personam, at the domicile of the owner of the intangibles. (Miller v. McColgan, 17 Cal. 2d 432 [110 P.2d 419]; Holly Sugar Corp . v . Johnson, 18 Cal. 2d 218 [115 P.2d 8]; Southern Pacific Co. v. McColgan, 68 Cal. App. 2d 48 [156 P.2d 81].) in the case of a corporation, legal domicile is generally in the state of incorporation, (Southern Pacific Co. v. McColgan, supra.) There are , however, two well established exceptions to the mobilia rule which permit other states to tax the intangibles of a foreign corporation operating its busine ss within their boundaries. Under the "business situs" exception, intangibles may acquire taxable situs other than at the domicile of their owner if they have become an integral part of the business activities carried on by their owner in the state asserting business situs. (Holly Sugar Corp. v. Johnson, supra; Southern Pacific Co, v. McColgan, supra,) Under the other exception, the state where a foreign corporation has established its "commercial domicile" may tax the intangibles owned by that corporation, (Southern Pacific Co. v. McColgan, supra,) Since appellant is incorporated. in Delaware, the intangibles here at issue cannot have taxable situs in California unless business situs exists or appellant has its commercial domicile in this state. As we indicated earlier?, appellant has argued that both exceptions to the mobilia rule apply in this case.

We may dispose first of appellant's commercial domicile argument . As we understand it, appellant's position is that it had at least two commercial domiciles., one in New York for its unitary drug and cosmetic business. and *one in* California for its nonunitary investment activi tie s relating to Kimball . This is essentially the same argument advanced by the taxpayer in Southern Pacific Co. v. McColgan, supra, wherein Southern Pacific conceded that the commercial domicile of its unitary transportation business was in California but contended that the commercial domicile of its holding company activities was in New York. The court did not reject outright the proposition that a single corporation could have more than one commercial domicile, but it held that New York was not a separate commercial domicile as to holding company activities which did not even consti tute a doing of business and which were not truly separate and disconnected from the unitary transportation business. (68 Cal. App. 2d at p .79.) Appellant di stingui she s Southern Pacific on. the basis that the intangibles involved in that case were linked with Southern Pacific's unitary business, whereas the intangibles here at issue were not connected with appellant's unitary business. Since Kimball constituted a separate, nonunitary operation conducted entirely in California, it should follow, says appellant, that the commercial domicile of this nonunitary portion of appellant's business was in California.

Disregarding the question whether appellant has adequately distinguished Southern Pacific, we believe appellant once again has confused its own business with Kimball's. Although California clearly provided more benefits and protection to Kimball than did any other state, the same has not been shown to be true for appellant. So far as appears from the record, New York is the only state which could realistically claim to be appellant's commercial domicile for any purpose. That is where appellant's management controlled the business, both unitary and nonunitary. There appellant maintained the actual seat of its corporate government. (Wheeling Steel Corp. v. Fox, 298 U.S. 193 [80 L. Ed. 1143].) Nothing in the record indicates that the decisions relating to appellant's investments in Kimball were made in any state other than New York. The fact that Kimball's management functioned in California does not mean that the same holds true for appellant.

Appellant fares no better with its theory that the intangibles had a "business situs" in California. The basis of this theory is that business situs existed because the intangibles were inextricably linked with the business activities carried on by Kimball in California. Thus, appellant relies on the localization of Kimball's business and properties in California to establish the requisite integration of the intangibles with appellant's activities in California. As we read the cases, however, appellant's reliance is misplaced. In order for the intangibles to have a business situs in this state, they must be connected with the California activities of appellant. This governing principle was well stated in Southern Pacific Co. v. McColgan, supra, 68 Cal. App. 2d 48 [156 P.2d 81]:

> In all the business situs cases it was held that the intangibles were so tied in with the activities of their owner carried on in the foreign state and under the protection of the law and government provided by the

> foreign state, that they had acquired a taxable situs, described as a "business situs" in the foreign state, (Emphasis added,) (68 Cal. App. 2d at p. 71.)

The evidence presented in this appeal reveals no tie between the intangibles and appellant's California business activities. The investments giving rise to these intangibles could accurately 3e described, in the words of the California Supreme Court, as "extraneous investments separate and apart from the California business" of appellant, and as investments made "for the purpose of passive participation" in Kimball* s affairs "in the customary and usual manner." (Holly Sugar Corp. v. Johnson, supra, 18 Cal, 2d 218, 224 [115 P.2d 8].) Investments so described in that case were distinguished from the type of stock investment held to have a business situs in California. The court thus implicitly held that a foreign corporation's extraneous, passive investment in a California corporation is not sufficient to give the. intangibles a business situs in California.

Since the intangibles in question have not been shown to have taxable situs in California, we must sustain respondent's action allocating the subject losses to the situs of appellant's commercial domicile in New York.

O R D E R

Pursuant to the views es-pressed 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 Bristol-Myers Company against proposed assessments of additional franchise tax in the amounts of $3,507.07 and $6,837.62 for the income years 1959 and 1960, respectively, and from the action of the Franchise Tax Board on the protest of Bristol-Myers Company, successor in interest to Grove Laboratories, Inc., against proposed assessments of additional franchise. tax in the amounts of $160.01 and $983.91 for the taxable years 1959 and 1960, respectively, be and the same are hereby modified in accordance with the agreement of the parties on the sale's factor issue. In all other respects, the action of the Franchise Tax Board is sustained.

Bone at Sacramento, California, this 11th day of May , 1972, by the State Board of Equalization.

John W. Lynch, Chairman

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ATTEST: W. W. Dunlop, Secretary