



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of }
FLEXIBLE, INC. }

Appearances:

For Appellant: R. W. Buttrey, Attorney at Law
Peter L. Ciaccio, Secretary-Treasurer

For Respondent: Lawrence C. Counts
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 Flexible, Inc., against a proposed assessment of additional franchise tax in the amount of \$1,574.99 for the income year ended October 31, 1959.

The sole issue raised by this appeal is, whether appellant, a Texas corporation, had established a "commercial domicile" in California, so that dividend income which it received from a subsidiary corporation acquired a taxable situs in this state and was thus includible in the measure of appellant's California franchise tax.

Appellant was incorporated under Texas law on September 17, 1953, and commenced doing business in California in 1954. Its principal business activity was the sale of sewer cleaning equipment manufactured by three affiliated corporations, Flexible Sewer Tool Corporation, Flexible Plumbertool, Inc., and Flexible Manufacturing Company.

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Appellant owned all of the stock of Flexible Western Export Co., a company engaged in the foreign sale of the sewer cleaning equipment manufactured by appellant's affiliates. In the year in question appellant received a \$30,000 dividend from Flexible Western Export Co. Inclusion of that dividend in appellant's income gave rise to the instant appeal.

Appellant's capital stock was owned during the year in question by R. R. Crane, president of appellant; H. R. Crane, father of R. R. Crane; the E. M. Crane Trust, for the benefit of R. R. Crane and his children; and P. L. Ciaccio, secretary-treasurer of appellant. *All of* these stockholders were residents of Los Angeles, California.

Formerly appellant's president was H. R. Power, a resident of Texas. He was in charge of appellant's sales activities and owner of 24-1/2 percent of its stock. In the latter part of 1958 Power redeemed his stock in appellant, resigned as president, and entered into a contract with appellant whereby he agreed to work as its general sales manager for a five-year period.

Appellant maintained an office in Dallas, Texas, during the year on appeal. Mr. Power spent most of his time either there or in traveling, assisting distributors or brokers through whom substantially all of appellant's sales were made. Substantially all sales orders were written by employees operating out of Dallas, *subject to approval by Mr. Power. Mr. Power* received a salary of \$50,000. An assistant sales manager, also a resident of Texas, received a salary of \$12,000.

Appellant also maintained an office in Los Angeles, California. All of its permanent accounting records were kept there. In addition, appellant's federal income tax returns for the year in question were filed with the District Director or Internal Revenue in Los Angeles. Appellant's shareholders, officers and directors all resided in California, and the meetings of the board of directors were held in Los Angeles. During the year on appeal H. R. Crane, chairman of the board of directors, devoted 100 percent of his time to appellant's affairs, and received a salary of \$26,000 for his services. In that same year R. R. Crane, then vice president of appellant, devoted 35 percent of his time to the business, and was paid a salary of \$16,000.

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During the year in question, 15 percent of appellant's total tangible assets, based on value, were located in California. Excluding assets leased to others, 5 percent of the tangible assets used in appellant's business were located here. Most of appellant's tangible assets, 84 percent in value, consisted of realty in Lima, Ohio, where one of its subsidiaries, Flexible Sewer Tool Corporation, had its plant. Of appellant's total sales, 23 percent were made through a broker in California. Forty percent of the salaries paid by appellant went to officers and employees in California.

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, 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 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

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records, Thereits 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, Eut 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.)

We review the record in the instant case with this test in mind, as well as the above quoted statement of the United States Supreme Court in the Wheeling Steel case.

All of appellant's shareholders, officers and directors resided in California, and all of their official meetings were held here. Appellant's permanent accounting records were maintained in California, and its federal income tax returns were filed in Los Angeles. Under federal law a corporation is required to file its federal income tax returns in the district "in which is located the principal place of business or principal office or agency of the corporation." (Int. Rev. Code of 1954, § 6091(b)(2).) From these facts it would appear that the actual seat of appellant's corporate government was in California.

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Appellant contends that Mr. Power was the real moving force behind appellant's business, and since he operated out of Texas, Texas was the state of appellant's commercial, as well as its legal, domicile. It is clear that appellant's directors and officers had great confidence in Mr. Power, and relied heavily on his selling, and organizational abilities, The ultimate decision on any corporate matter always rested with top management, however, and it was stationed in California. The amount of time devoted to the business by the chairman of the board of directors and the vice president, moreover, demonstrates that top management was active in exercising its authority over appellant's affairs,

Although appellant would minimize the corporate activity which occurred in California by pointing out that less than one-fourth of its total sales were here, only about 5 percent of its business assets were located here, and only 40 percent of its payroll went to California officers and employees, nowhere **does** appellant establish that any more sales, assets or payroll were made, located **or** expended in Texas or in any one other state which could possibly qualify as appellant's commercial domicile.

Under the circumstances we conclude that respondent properly treated appellant as having established a commercial domicile in California, and therefore properly included dividends which appellant received from its subsidiary in the measure of appellant's 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,

