



BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of                    }  
UNITED STATES PLYWOOD CORPORATION            }

For Appellant:     John P. Schlick, Treasurer  
For Respondent:    Burl D. Lack, Chief Counsel;  
                          A. Ben Jacobson, 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 in denying the protest of United States Plywood Corporation against a proposed assessment of additional franchise tax in the amount of \$8,149.77 for its income year ended April 30, 1954.

Appellant is engaged in the manufacture and sale of plywood and allied products. In addition to the products it manufactures in its own plants, Appellant sells goods which have been purchased from other manufacturers. This latter activity accounts for about one-half of Appellant's total sales.

No attempt is made to segregate the activities involved in the sale of Appellant's own products from those related to the sale of goods purchased from outside sources. The same warehousing, distribution facilities, sales offices and personnel handle both types of merchandise. Apparently no separate records are maintained for any activity beyond the point at which the goods are acquired either from Appellant's own mills or from other producers.

Appellant maintains sales offices and warehouses throughout the country and has manufacturing facilities located in several states. The bulk of its manufacturing properties are located in California.

In determining the amount of net income allocable to this State for franchise tax purposes, Appellant divided its total net income on the theory that it was engaged in two separate, distinct businesses: sale of its own products and sale of goods purchased from others. Since Appellant did not keep separate accounts for each category of income, the division was based on the proportionate costs of the two classes of goods sold. Appellant determined that the cost of the goods it manufactured constituted 44.191 percent of the total cost of goods sold in the year on appeal and that the remainder represented the cost of goods purchased for resale.

Appeal of United States Plywood Corporation

Appellant then set up separate allocation formulas for each class of business. The sales, payroll and property of the home office and sales branches were divided on the same basis as that used for dividing the net income. The sales, payroll and property of the manufacturing plants were allocated entirely to the "goods manufactured" category. The two allocation ratios thus computed were applied to their respective portions of the total net income in order to arrive at the income attributable to California for each type of activity. These last two amounts were combined and reported as the net income derived from sources within this State.

The Franchise Tax Board disallowed Appellant's allocation method and, instead, applied a single allocation formula to the entire net income on the ground that Appellant is engaged in but a single unitary business.

Appellant contends that it is engaged in two separate, distinct businesses. It argues that the inclusion of its large California manufacturing properties in the formula used to allocate the net income from the distribution of non-manufactured products does not reach a fair result. Appellant raises the identical issues decided by us in the Appeal of RKO Radio Pictures, Inc., Cal. St. Bd. of Equal., Dec. 17, 1957, 2 CCH Cal. Tax Cas. Par. 200-767, 2 P-H State & Local Tax Serv. Cal. Par. 13173. That appeal concerned a taxpayer who was engaged in producing and distributing its own films and in distributing films produced by others. We upheld the Franchise Tax Board's action in disallowing the taxpayer's method of separately allocating the income from independently produced films and in applying instead a single formula of property, payroll and sales to all of the income.

As in the RKO appeal, Appellant has failed in its attempt to establish the separate character of a portion of its business. Since the same facilities and personnel are used in the distribution of all of the products handled by Appellant, it is readily apparent that there is a mutual dependence and contribution between the distribution of Appellant's own products and distribution of the goods purchased from others. We conclude that Appellant's entire operation was properly treated as a single unitary business.

In RKO, we noted that the taxpayer had failed to show the basis upon which it initially segregated the net income derived from distribution of independently produced films from the net income attributable to its own pictures. Since all subsequent calculations were based upon this initial step, it was apparent that the taxpayer had failed to prove an essential element of its case. In contra-distinction, Appellant in the instant appeal makes the basis of its initial segregation clear; it divided its income in proportion to the relative costs of the two classes of merchandise it sold.

Appeal of United States Plywood Corporation

The Franchise Tax Board argues that such a basis for separating income is wholly arbitrary and objectionable in its application to a unitary business. It points out that the cost of goods purchased from outside sources contains an element of profit for the producer while the cost of goods manufactured by Appellant does not contain such an element of profit. Thus Appellant's method of apportionment makes no allowance for a profit from its own manufacturing process and unjustifiably weights the income attributable to the non-manufactured goods. Respondent urges that since California accounts for a large share of Appellant's manufacturing activities, this State must reject any method of allocation which does not attribute a fair share of net income to the manufacturing process. We agree.

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 in denying the protest of United States Plywood Corporation against a proposed assessment of additional franchise tax in the amount of \$8,149.77 for its income year ended April 30, 1954, be and the same is hereby sustained.

Done at Sacramento, California, this 17th day of May, 1962, by the State Board of Equalization.

Geo. R. Reilly, Chairman  
Richard Nevins, Member  
Paul R. Leake, Member  
John W. Lynch, Member  
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ATTEST: Dixwell L. Pierce, Secretary