BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter 'of the Appeal of)
)
PARAMOUNT PICTURES CORPORATION)

For Appellant: George F. Elmendorf and
Stanton H. Zarrow
Attorneys 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 Paramount Pictures Corporation against a proposed assessment of additional franchise tax in the amount of $90,326 for the income year 1958.

Appellant Paramount Pictures Corporation is engaged in the business of producing motion pictures and distributing them on a worldwide basis. It was organized under the laws of New York, and has its principal place of business in that state. Prior to February of 1958, appellant's assets included 770 motion pictures, 238 of which had been produced during the period 1928 through 1932, 248 during the period 1933 through 1937, 176 during the period 1938 through 1942, and the remaining 108 during the period 1943 through 1948. After these films had been originally issued, 15 were reissued prior to February of 1958, 9 were in reissue at that time, and 8 were reissued thereafter. Seven hundred and thirty-one of the motion pictures were in black and white and were stored in New York, while the remaining color films were stored in California.

On February 21, 1958, appellant agreed to sell the above films to Emka Ltd. for television use. The sales agreement was executed in Wilmington, Delaware, and specified a minimum sales price of $35 million, with $10 million of this amount immediately payable. An additional $15 million was made contingent upon Emka Ltd.'s revenues from the motion pictures. Title was to pass only upon delivery of the negatives. Since Emka Ltd. had no facilities for the theatrical distribution of films; a concurrent license agreement was executed giving appellant the right to continue this type of distribution. The negatives were subsequently delivered at Fort Lee, New Jersey.

In its return for the income year 1958 appellant did not include the $10 million payment in the computation of unitary business income subject to apportionment. Whether the payment should have been so included, as respondent contends, is the primary issue of this case. Appellant has argued that if the above issue is decided in respondent's *favor,* then the sales and property factors in the allocation formula must be adjusted to reflect the out-of-state sale and *the* out-of-state location of most of the films. Respondent now concedes that if its position on the primary issue is sustained, then the sales factor should be adjusted. This would reduce the above proposed assessment to $88,818. Whether the property factor should also be adjusted is the second issue of this case.

When a taxpayer derives income from sources both within and without California, its tax shall be measured by the net income derived from or attributable to sources within this state. (Rev. & Tax. Code, § 25101.) If a business is unitary, as is appellant's, the income derived from or attributable to California must be computed by formula allocation rather than by the separate accounting method. (Butler Bros. v. McColgan, 17 Cal. 2d 664 [111 P.2d 334], aff'd 315 U.S. 501 [86 L. Ed. 991]; Edison California Stores, Inc. v. McColgan, 30 Cal. 2d 472 [183 P.2d 16].) The formula used to allocate unitary business income is generally based upon the three factors of tangible property, payroll and sales. (Cal. Admin. Code, tit. 18, reg. 25101, subd. (a).)

Appellant *first* contends that subdivisions (a) and (d) of regulation 25101, title 18, California Administrative Code, permit the exclusion of the film sale proceeds from unitary business income. These subdivisions state in part:

> (a) Methods of Allocation . . . . If the property is permanently withdrawn from unitary use, it should be excluded from the property factor.
>
> * * *

> (d) Income From Property. (1) Non-unitary Income. Income from property, which is not a part of or connected with the unitary business, is excluded from the income of the unitary business which is allocated by formula.

We agree that subdivision (d), above, is directly relevant to the primary issue of this case. However subdivision (a), above, is concerned with the composition of the allocation formula which is used to apportion unitary business income once such income has been computed, and therefore this subdivision becomes relevant only after the primary issue involved here has been resolved. Consequently we will confine our consideration to subdivision (d) of regulation 25101.

Additional guidance is provided by the Appeal of W. J. Voit Rubber Corp., Cal. St. Bd. of Equal., May 12, 1964, where this board stated:

> The underlying principle in these cases is that any income from assets which are integral parts of the unitary business is unitary income. It is appropriate that all returns from property which is developed or acquired and maintained through the resources of and in furtherance of the business should be attributed to the business as a whole. And, with particular reference to assets which have been depreciated or amortized in reduction of the unitary income, it is appropriate that gains upon the sale of those assets should be added to the unitary income.

The above language was partially repeated in the Appeal of Steiner American Corp., Cal. St. Bd. of Equal., Aug. 7, 1967. It also should be noted that appellant has the burden of establishing the facts necessary to support its position. (Cal. Admin. Code, tit. 18, § 5036; Appeal of Universal Services, Inc., of Texas, Cal. St. Bd. of Equal., Feb. 8, 1966.)

Appellant states that the public demands currency and immediacy in motion pictures, and points out the age of the films in question and the lack of use of most of them after their original issuance periods expired. However, we do not

think that these facts are sufficient to establish that the films were not integral parts of *or* connected with the unitary business. The films were developed and maintained through the resources of and in furtherance of that business. Their cost was very probably amortized in reduction of unitary business income. Appellant retained ownership of the films until their sale and throughout the period preceding their sale the films continued to be valuable assets of the unitary business. This value was maintained by the possibility that a change in demand would justify relssuance, and by future television use which became foreseeable at least by the late 1940's. Under these circumstances the income realized from the film sale can not be excluded from unitary business income under subdivision (d) of regulation 25101.

Appellant next contends that the business activity of selling the films for television exhibition was not within the scope of appellant's *unitary* business, which prior to the sale had been confined to the production and distribution, through lease or license, of films to, theaters. Several tests have been developed for determining whether a business is unitary. Under the more recent test, a business is unitary when operation of the business done within the state is dependent upon or contributes to the operation of the business without the state. (Edison California Stores, Inc. v. McColgan, supra, 30 Cal. 2d 472 [183 P.2d 16].) Appellant's film production and theater distribution business benefited from the sale of the films because it received the proceeds. (See RKO Teleradio Pictures, Inc. v. Franchise Tax Board, 246 Cal.App.2d 812 [55 Cal. Rptr. 299].) Also, it is certainly clear that the production and probably the theater distribution of the films contributed to their sale for television use. This dependence and contribution is sufficient basis for holding that appellant9 film sale activity was part of its unitary film production and distribution business.

Appellant also contends that even if the income in question is unitary business income it is not subject to California taxation, according to section 25101 which during the year in question stated in part:

> . Income attributable to isolated or occasional transactions in states or countries in which the taxpayer is not doing business shall be allocated to the state in which the taxpayer has its principal place of business or commercial domicile.

Appellant states that the income from the sale of the films is attributable to an isolated transaction in New Jersey, and argues that the above quoted provision directs that all of this income be allocated to New York, appellant% principal place of business.

However, this interpretation of the portion of section 25101 at issue overlooks the purpose of formula allocation of unitary business income. Such allocation is required because it is a more accurate method than separate accounting of computing the income-producing contributions of unitary business operations within a particular state. (See Edison California Stores, Inc. v. McColgan, supra, 30 Cal. 2d 472 [183 P.2d 16].) Appellant's proposed interpretation in effect uses the separate accounting method to compute the income which had its source in New Jersey. The result is nonrecognition of the fact that the operations of appellant's business in various states contributed to the income realized upon the film sale.

We think that when a unitary business is involved the provision of section 25101 at issue must be construed to apply only after unitary business income has been computed and tentatively allocated among the various relevant states. If at that time some of this unitary business income has been allocated to a state only because of isolated or occasional transactions there which were reflected in the factors of the allocation formula, and the taxpayer is not doing business in that state, then such income will instead be allocated to the state in which the taxpayer has its principal place of business or commercial domicile. This interpretation does not frustrate the purpose of formula allocation of unitary business income.

We must conclude that the proceeds from the sale of the films in question should have been included in appellant's computation of unitary business income. We do not think that the films ceased being integral parts of or connected with the unitary business. Nor do we think that the film sale activities were outside the scope of appellant's unitary film production and distribution business. The provision of section 25101 relating to isolated or occasional transactions does not, in the instant situation, affect the computation of income which had its source within California.

The remaining issue of this case is whether the tangible property factor of the allocation formula should be adjusted to reflect the out-of-state location of most of the films. Tangible property is included in the factor at its California tax base. (Cal. Admin. Code, tit. 18, reg. 25101, subd. (a); Appeal of The Sweets Co. of America, Inc., Cal. St. Bd. of Equal., June 23, 1964.) Evidently in the instant

situation the Franchise Tax Board assumed that the films' tax bases had been reduced to zero through complete amortization during their first years of existence. Appellant, who has the burden of proof (Cal. Admin. Code, tit. 18, § 5036; Appeal of Universal Services, Inc. of Texas, supra, Cal. St. Bd. of Equal., Feb. 8, 1966), has not offered any evidence to the contrary. Therefore the Franchise Tax Board was correct in refusing to adjust the tangible property factor.

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 Paramount Pictures Corporation against a proposed assessment of additional franchise tax in the amount of $90,326 for the income year 1958, be and the same is hereby modified in accordance with the concession made by respondent that the amount of the motion picture sale be included in the sales factor of the allocation formula. In all other respects, the action of the Franchise Tax Board is sustained.

Done Sacramento, California, this 6th day of January, 1969, by the State Board of Equalization.

John W. Lynch, Chairman

[illegible], Member

Richard Nevins, Member

Paul R. [illegible], Member

_____, Member

Attest: [illegible], Acting Secretary