BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of

PETROLEUM RECTIFYING COMPANY
OF CALIFORNIA

Appearances:

For Appellant: L. J. F. Morison and Joseph C. Akers

For Respondent: Chas. J. McColgan, Franchise Tax

Commission<

O P I N I O N

This is an appeal under Section 25 of the Bank and Corporation Franchise Tax Act (Statutes 1929, Chapter 13, as amended) from the action of the Franchise Tax Commissioner in overruling the protest of Petroleum Rectifying Company of California against a proposed assessment of an additional tax-in the amount of $1,076.63 for the two months ending February 28, 1929. The additional tax was proposed due to the inclusion by the Commissioner in the income by which the tax on the Appellant was measured of royalties from patents granted by the United States Government.

The problem involved in this appeal is substantially the same as the problem involved in the appeal of the Vortox Manufac turing Company decided adversely to the petitioner by this Board on August 1930. As intimated in the opinion in that appeal, although the Act does not expressly include royalties from patents, nevertheless it contemplates the inclusion of such royalties in the income by which the tax is measured. This is evidenced by the fact that net income is defined in Section 7 of the Act as meaning the gross income less allowable deductions. Gross income is defined in Section 6 of the Act as including

> "gains, profits and income derived from the business, of whatever kind and in whatever form paid; gains, profits or income from dealing in real or personal property; gains, profits or income received as compensation for services, as interest, rents, commis-sions, brokerage or other fees, or otherwise received in carrying on such business; all interest received from Federal, State, municipal or other bonds, and, except as hereinafter otherwise provided,all dividends received on stocks".

Nowhere does the Act provide for the deduction from gross income of royalties from patents. Consequently, it would seem that the only argument which can be urged with any force against

the inclusion of net income of royalties from patents is that the act in providing for such inclusion is unconstitutional.

Although in certain exceptional cases this Board has passed on the constitutionality of legislation where such action was considered necessary in order to protect the revenues of the state, nevertheless we do not do so generally. Our policy in thi respect is expressed in our opinion in the Appeal of the vortex Manufacturing Corporation wherein we stated:

> "The power to declare a law unconstitutional is one of the highest attributes of judicial authority. Although we sit in these matters as a quasi-judicial body, and must decide questions of law as well as of fact, we should not lose sight of the ultimate fact that we are not a Court. but merely an administrative Board. The right of a ministerial office to question the constitutionality of a statute is generally denied. (6 R. C. L. 92)"

Even if we should depart from our general policy with respect to considering attacks on the constitutionality of legislation we are of the opinion that we should be constrained to hold valid, in view of decisions of the highest tribunals of thi state and of the United States, the inclusion of royalties from patents.

It is true, as the Appellant has pointed out, that royalties from patents may not be made the objects of direct state taxation (Long v. Rockwood, 277 U. S. 142). It is to be noted, however, that the Act does not provide for the direct taxation of royalties or any other income of corporations subject to taxation under the act, but rather it provides a tax for the privilege of doing business in one year measured by the net income of the corporation in the preceding year. Such a tax is not to be considered a tax on income. (Flint v. Stone Tracy Co. 220 U. S. 10

Thus, in Pacific Company v. Johnson, 81 Cal. Dec. 519, the Supreme Court of this State held the tax provided by the act constitutional even though nontaxable income (income from municipal bonds) was included in the income by-which the tax was measured. This case was sustained by the United States Supreme Court (U. S. Daily April 12, 1932, page 6) although the Court had held invalid in the Macallen Company v. Massachusetts, 279 629 a taxing statute of Massachusetts similar to the California Bank and Corporation Franchise Tax Act, insofar as it provided for the inclusion of income from tax exempt securities. But, even if the case of Pacific Company v. Johnson had been reversed by the United States Supreme Court, we are of the opinion that this would not preclude the inclusion of royalties from patents in the income by which the tax under the act is measured.

In Educational Films Corporation v. Ward, 282 U. S. 379,

the United States Supreme Court, in considering a question arising under the Franchise Tax Act of New York, held that royalties from copyrights, though not taxable, nevertheless could be included in the income by which the tax provided in the Act was measured. This decision was reconciled with the Macallen case on the grounds that the Massachusetts statute evinced an intent to reach nontaxable income whereas no such intent was apparent in the New York Act insofar as royalties from copyrights were concerned.

As has already been stated, the California Bank and Corporation Franchise Tax Act does not expressly provide for the inclusion of royalties from patents in the income by which the tax provided in the Act is measured. Hence, it cannot be said that the California Act evinces an intent to reach this particular form of nontaxable income to the same extent as did the Massachusetts statute with respect to income from tax exempt securities. Rather, it would seem that the situation with respect to royalties from patents under the California Act is substantially the same as the situation confronting the United States Supreme Court in Educational Films Corporation v. Ward with respect to royalties from copyrights under the New York Act.

We are unable to perceive any reason for according different treatment to royalties from patents than is accorded to royalties from copyrights. Both are exempt from taxation. If one may be included in the income by which a tax for the privilege of doing business is measured, then, it would seem that under similar circumstances, the other might be included also.

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, that the Board on file in the proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, that the action of Chas. J. McColgan, Franchise Tax Commissioner, in overruling the protest of the Petroleum Rectifying Company of California, a corporation, against a proprosed assessment of an additional tax of $1,076.63, be-and the same is hereby sustained.

Done at Sacramento, California, this 20th day of April, 1932, by the State Board of Equalization.

R. E. Collins, Chairman
Jno. C. Corbett, Member
H. G. Cattell, Member
Fred E. Stewart, Member

ATTEST: Dixwell L. Pierce, Secretary