BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
CECIL B. DeMILLE PRODUCTIONS, INC.)

Appearances:

For Appellant: Neil S. McCarthy, its Attorney

For Respondent: Chas. J. McColgan, Franchise Tax Commissiont

OPINION

This is an appeal pursuant to Section 25 of the Bank and Corporation Franchise Tax Act (Stats. 1929, Chapter 13, as amended) from the action of the Franchise Tax Commissioner in overruling the protest of Cecil B. DeMille Productions, Inc., a corporation, against a proposed assessment of additional tax in the amount of $21,416.88, with interest.

The Appellant contends that in computing its net income for the year 1928 upon which the above assessment was based, the Commissioner (1) erred in disallowing as a deduction the sum of $893,006.94, representing a loss alleged to have been sustained during said year as the result of the cancellation of a certain contract in existence on January 1, 1928; (2) erred in disallowing as deductions the sum of $238,012.92, and the sum of $36,784 received during the said year either under the above contract or under the agreement by which the contract was cancelled; (3) erred in disallowing as deductions the sum of $706,100.96, being the amount of a loss alleged to have been sustained from Pathe Exchange, Inc., stock acquired prior to January 1, 1928, and the sum of $10,000, being the amount of a loss alleged to have been sustained from California Construction Co. stock also acquired prior to January 1, 1928; (4) committed a clerical error in subtraction with the result that Appellant's net income after disallowing the foregoing items as deductions, was determined to be $668,112.07, whereas, it should have been $658,112.07; and, finally, (5) erred in attributing 100% of Appellant's net income as computed by the Commissioner, to California business.

On April 11, 1927, the Appellant entered into a contract with Pathe Exchange, Inc., Cecille B. DeMille Pictures Corporation, hereinafter referred to as the "companies," and Cecil B. DeMille, hereinafter referred to as "DeMille". Under the terms of the contract, the companies were to produce at least one, but not more than three motion pictures a year for a period of five years. These pictures were to be produced under the personal direction of DeMille. In addition, the companies were". to produce at least fifteen, but not more than forty motion pictures a year for five years under the supervision of DeMille.

For his services in directing and supervising the above pictures, DeMille was to receive the sum of $2,500 weekly. The Appellant, as consideration for relinquishing all claims which it had on the services of DeMille, was to receive the sum of $5,000 weekly, and, in addition, a percentage of the gross receipts from the pictures produced pursuant to the contract.

For reasons unknown to us, the above contract was cancelled by a cancellation agreement entered into between the parties on April 18, 1928. As a result of this cancellation, Appellant claims it sustained a loss of at least $893,006.94.

Section 8d of the Actprovides that from gross income there shall be deducted "losses sustained during the taxable year and not compensated for by insurance or otherwise." Section 19 of the Act provides that:

> "For the purpose of ascertaining the gain derived or loss sustained from the sale or other. disposition of property, real, personal or mixed, * * * * acquired prior to January 1, 1928, and disposed of thereafter, the basis shall be the fair market value thereof as of said date."

Inasmuch as the contract in question came into existence prior to January 1, 1928, the fair market value thereof on said date must be established before it can be determined whether loss was sustained by Appellant as the result of the cancellation of said contract,

The Appellant seeks to establish this value by computing the total of the amount remaining to be paid to Appellant under the contract on January 1, 1928. This total was obtained by taking the sum of $1,300,000, representing the payments of $5,000 per week for five years, and adding to it the sum of ~500,000 representing the amount which Appellant expected to receive as its percentage of the gross receipts from the pictures to be produced pursuant to the contract. From the sum thus obtained, i.e., $1,800,000, Appellant deducted the sum of $188,898.09, which was received prior to January 1, 1928. The balance of $1,611,101.91 Appellant contends represents the fair market value of the contract on January 1, 1928.

We cannot agree with the Appellant in the above contention. In our opinion, the fair market value of property can be established only by satisfactory evidence as to what price the property will bring if offered for sale in an open market by a person willing, but not compelled, to buy. (See Appeal of San Christina Investment Co., et al, decided by this Board on August 4, 1930; Appeal of Rockford Malleable Iron Works, 2 B.T.A. 817; and Appeal of Hart Cotton Mills, 2 B.T.A. 973. See also, Walter vs. Duffy, 287 Fed. 41; Wall vs. Platt, 169 Mass 398; and Montgomery County vs. Schuylkill Bridge Co., 110 Pa. St. 54.) Simply computing the amount due under a contract of the nature of the one involved herein is not such evidence.

Clearly, it cannot be said that the contract in question

could have been sold in an open market for a sum equal to the amount remaining to be paid to Appellant under the contract, There would be no advantage in paying out a sum of money for the right to receive an equal sum even though it were certain that the latter sum would be received. In the instant case, it is to be noted, it was not certain,. on January 1, 1928, that all of the payments remaining to be made to Appellant under the contract would be made; -This is well evidenced by the fact that it became necessary, apparently, to cancel the contract within less than four months after January 1, 1928.

We think it could have reasonably have. anticipated on January 1, 1928, that a number of circumstances might occur which would operate to diminish the'amount of the payments to Appellant and even to extinguish such payments entirely. It might have become impossible for DeMille, due to accident, illness or death, to supervise or direct the production of the pictures, the production of which was highly essential to the propel performance of the contract, The companies might have become bankrupt, and hence become unable to perform their obligations, or they might have found it expedient to repudiate their obligations under'the contract. Or DeMille might have seen fit to exercise the option, which he apparently had under Section 14 of the contract, to terminate the contract and thus release the' companies of all obligations thereunder.

In view of the above, we cannotsay that the fair market value of the contract on January 1, 1928, was equivalent to the sum of $1,611,101.91, the total'remaining to be paid, as computed by Appellant, on said date. Further, we do not believe that this value can be determined by deducting any particular amounts from the above sum. Whether the deduction should be $50,000, $500,000, $1,000,000, or some other sum, we do not know. Regardless of the amount of the deduction, it would still remain uncertain as to whether the balance represented the price which the contract would have brought if offered for sale in an open' market on January 1, 1928.

Consequently, we must hold that the Appellant has not shown that the Commisssioner erred in disallowing the deduction of the sum of $893,006.94 as a loss sustained by Appellant during the year 1928.

The second contention of Appellant is that the Commissioner erred in disallowing as deductions the sum of $238,012.92, and the sum of $36,784.02 received during the year 1928. The first' of these items includes the sum of $103,638.92 received under the hereinbefore considered contract prior to its cancellation but subsequent to January 1, 1928. It also includes the sum of $50,000 cash, insurance policies of a value of $18,819.64, and equipment of a value of $65,554.36, all of which were received by Appellant on the cancellation of said contract. The second:- item represents royalties received by Appellant after the cancellation of the contract from pictures produced prior to its cancellation.

As above indicated, under the contract involved in this appeal, as consideration for the promise of the companies to pay

the Appellant $5,000 per week for five years, and in addition a percentage of the gross receipts from the pictures to be produced, Appellant simply relinquished all claims which it had on the services of DeMille. In other words, everything to be performed by Appellant was performed prior to January 1, 1928. Nothing remained to be performed after that date.

Inasmuch as Section 19 of the Act provides that the fair market value of property on January 1, 1928, shall be the basis for determining gain or loss from property acquired on or prior to said date, it would seem that Appellant cannot be considered as having realized a gain from the contract until the January 1, 1928, valuation thereof was returned to it. Consequently, it follows that the above items received during the year 1928 should not be considered as income insofar as they represent a return of that valuation.

However, it is to be noticed that the above items were considered by the Commissioner as income for the year 1928. We do not believe we would be justified in reversing the Commissioner's action unless it is shown definitely that he acted erroneously. Such a showing has not been made. The valuation of the contract on January 1, 1928, has not been established. Hence we are unable to say that the above items of $238,012.92 and $36,784.02 received during the year 1928 represented a return of that valuation.

A contrary conclusion could be based only on the assumption that the January 1, 1928, valuation of the contract was -as least equal to the total of amounts received by Appellant from the contract. Inasmuch as we do not know what that valuation was, we do not believe we would be justified in making any such assumption even if the above items represented all that the Appellant received from the contract. But the above items do not represent, all that Appellant received from the contract.

In addition, Appellant was to receive, under the agreement." by which the contract was cancelled, the same royalties from the pictures which had been produced that it would have received had the contract not been cancelled, and additional royalties in the amount of $200,000, less the value of certain insurance policies ($18,819.64), from the picture "The Godless Girl"; Appellant was also to receive an option on the services of certain artists, the use of certain offices, and the use of the Cecil B. DeMille insignia and trade mark.

Further, it is to be noticed that in Section' 9 of the cancelled contract it was provided that in the event of the termination of said contract the services of DeMille should revert to the Appellant, and Appellant should have the right to such services for a period of five years. We have not been able to find anything in the agreement cancelling the contract from which it could be inferred that the provisions contained therein with respect to DeMille's services were abrogated. Thus it would seem that the Appellant received on the cancellation of the contract everything it had surrendered on the making of the contract, i.e., the right to the services of DeMille. Hence, it is arguable that

everything else that Appellant received from the Contract, or from its termination, was gain to Appellant inasmuch as it does not appear that the right to the services of DeMille at the time the contract was, terminated was of less value than at the time the contract came into existence.

If gain did result to Appellant from the contract, then there is no question but that the amount of the gain should be regarded as income under the Act. In this respect, we think that the rights of Appellant under the contract are analogous to the rights of a holder of an annuity. If A should pay $4,000 for the right to receive $1,000 a year for five years, and actually received $1,000 a year for five years, A would realize a gain of $1,000 which clearly can be regarded as income. (See Appeal of Klein, 6 B.T.A. 617.)

The third contention of Appellant is that the Commissioner erred in disallowing as deductions the sum of $706,100.96, and the sum of $10,000 alleged to have been sustained as losses during the year 1928 on account of the disposition of certain stock of Pathe Exchange, Inc., and.California Construction Co. This stock was acquired prior to January 1, 1928. No attempt whatsoever has been made to show the fair market value' thereof on January 1; 1928, as is required by Section 19 of the Act. Consequently, we must hold that the Commissioner acted properly 'in disallowing the above items as deductions.

The Appellant's fourth contention is that the Commissioner committed a clerical error in computing Appellant's net income with the result that said income was determined to be in an amount $10,000 larger than it would have been had the error not been made.

Apparently, in computing Appellant's net income, the Commissioner took as a starting point net income reported by Appellant to the Federal government in the sum of $744,091.37. From this sum, the Commissioner proceeded to subtract the sum of $85,979.3 being the amount of Federal income taxes accruing during the year 1928, which is an allowable deduction under Section 8(c) of the state act. As a result of this subtraction, the Commissioner obtained a balance of $668,112.07, whereas, obviously the balance should have been $658,112.07. Unquestionably, an adjustment should be made for this error.

The Appellant's fifth and final contention is that the Commissioner erred in attributing 100% of Appellant's net income to California.

It appears that the contract hereinbefore considered was executed outside of California. Because of this, Appellant claims that 95% of the income of said contract should be attributed to business done outside the state. Appellant, however, makes no argument and cites no authority in support of this view.

It is to be noticed that Appellant was a California corporation. Hence, the rights which Appellant had under the above

contract had a situs for taxation in California. (Farmer's Loan and Trust Co. vs. Minnesota, 280 U. S. 205; Baldwin vs. Missouri; 281 U. S. 586.) Further, all of the activities which produced the income from the contract occurred in California. In view of the above, and in view of the absence of argument on Appellant's 'part, we do not see how we would be justified in holding that the Commissioner erred in considering the income from the contract as income from. California business,

ORDER

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 action of the Franchise Tax Commissioner in overruling the protest of Cecil B. DeMille Productions, Inc., a corporation, against a proposed assessment of additional tax in the amount of $21,416.88 based upon the return of said corporation for the year 1928 be and the same is hereby modified. The net income of the said corporation for said year is determined to be the sum of $658,112.07 rather than the sum of $668,112.07 as determined by said Commissioner. In all other respects the action of the said Commissioner is sustained. The said Commissioner is hereby ordered to modify the proposed assessment of additional tax and to proceed in conformity with this order.

Done at Sacramento, California, this 7th day of June, 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