BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
AMERICAN PRESIDENT LINES, LTD.)

Appearances:

For Appellant: Treadwell & Laughlin, Attorneys at Law

For Respondent: Burl D. Lack, Chief Counsel; Mark Scholtz, Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to Section 25667 of the Revenue and Taxation Code (formerly Section 25 of the Bank and Corporation Franchise Tax Act) from the action of the Franchise Tax Board on the protest of American President Lines, Ltd., to a proposed assessment of additional tax in the amount of $50,928.41, the additional tax having been redetermined in the amount of $23,572.11, for the income year ended December 31, 1940.

The Appellant, a Delaware corporation, is engaged in the business of providing worldwide steamship services for the transportation of passengers, property and mail in interstate and foreign commerce. It maintains offices in California and other states, in possessions of the United States and in foreign countries and its shipping operations are carried on between United States ports and ports of foreign countries and between ports in one State or possession of the United States and ports in different States or possessions.

In its return for the income year 1940, as for several prior years,. it arrived at the amount of income derived from or attributable to California sources through the use of a three factor formula, the factors being property, wages and gross revenue. It employed the first two of these factors *in* the following manner:

(1) Property. All tangible property of the company actually situated in California was apportioned to the State. Vessels, the

principal property of the company, were apportioned to California on the basis of the percentage of days the vessels were in port in California to the total voyage days of the vessels.

(2) Wages. Wages of vessel employees were apportioned to this State on the basis of the percentage of port days in California to the total voyage days of the vessels. No other wages were apportioned to the State.

The Respondent, however, used these factors as follows:

(1) Property. All tangible property actually located in California was apportioned to California, as did the Appellant. Vessels, however, were apportioned to this State on the basis of the number of port days in California to the total port days of each vessel.

(2) Wages. All wages of executives and their staffs actually employed here were apportioned to California. Wages of vessel employees were apportioned to California on the basis of the number of port days in this State to total port days,

The use of the gross revenue factor in the apportionment formula has not been questioned herein. Furthermore? the Appellant has stated that it does not object herein to the apportionment to California of the wages of its employees actually located here.

It is at once apparent that the present controversy relates to the manner in which Appellant's operations on the high seas should be reflected in the apportionment process. The Appellant regards those operations as income producing activities carried on without this State and contends that a portion of its income is derived from those operations as well as from its activities within California or other States, possessions of the United States and foreign countries. The method of apportionment adopted by the Respondent, on the other hand proceeds upon the theory that the income derived hrom the business carried on by Appellant partly within and partly without this State should be allocated in such a manner as is fairly calculated to apportion that income among the States, possessions or countries in which that business is conducted. To this, the Appellant replies that such a construction results in the taxation

by California of extraterritorial values in violation of the due process of law clause of the Eourteenth Amendment to the Constitution of the United States in that the tax would be applied to income derived from sources outside this State.

These precise questions of statutory construction and constitutional limitation were considered by the Attorney General of this State in his Opinion NS 4344 of June 5, 1942, to the Franchise Tax Commissioner. In that Opinion the practice of arriving at the amount of mobile property and employees (steamship and employees thereon) on the basis of the so-called port day formula was upheld. While the Attorney General considered the validity of that practice under the Corporation Income Tax Act, the allocation provision of that Act is identical with that of the Bank and Corporation Franchise Tax Act so far as the present controversy is concerned. The Opinion reads as follows:

"In your letter of May 22 you request an opinion as to the validity of a practice under the Corporation Income Tax Act (Stats. 1937, p. 2184 as amended) which is described in your letter as follows:

'In computing the net income derived from sources within the State of California by a foreign steamship company engaged exclusively in interstate commerce within this State, we have used a three factor formula composed of property, payroll and revenue. In computing the property and payroll factors, where mobile property and employees (steamship and employees thereon) are involved, we have used the following formula:

$$\frac{\text{'Port days in Calif.}}{\text{Port days everywhere}} \times \text{Value of steamship} = \text{Calif. property}$$

$$\frac{\text{'Port days in Calif.}}{\text{Port days everywhere}} \times \text{Payroll} = \text{Calif. payroll}$$

"The question which you believe exists as to the validity of that formula is caused by the fact that the effect of the formula is to allocate all of the net income among the states or countries at the ports of which the vessels touch, and none to the high seas. You auestion whether that effect is justified since section 3 of the act taxes only the net income 'derived from sources within this State.'

"The effect about which you are concerned is the same as the effect of the one factor formula of gross receipts which you used under the Bank and Corporation Franchise Tax Act until recently. The gross receipts formula allocated all the net income to the states or countries in which the gross receipts originated and none to the high seas. The gross receipts formula was involved in Matson Nav. Co. v State Board, 3 Cal. (2d) 1, aff'd. 297 U. S. 441, although its validity was not the subject of the litigation.

"In my opinion it is proper to allocate the net income of a steamship company among the states or countries at the ports of which its vessels touch, and to decline to allocate any of such net income to the high seas. The language of the act to which you refer should be read in the light of the constitutional law to which it bows, that is, the principle that a state does not have territorial jurisdiction to tax income of a foreign corporation which is derived from sources within other states or countries. This principle is designed to prevent unlimited double taxation and is implied from the Constitution. It is not expressed in precise language in the Constitution. I believe that the principle does not have the effect of compelling the states between which a steamship company operates to allocate income to the high seas where it will escape taxation altogether. I believe the principle is satisfied if the states fairly apportion the income between them.

"The view that the language to which you referred in section 3 should be construed as being coextensive with the principle to which it is subservient is supported by the fact that similar language in section 10 of the Bank and Corporation Franchise Tax Act was construed to be coextensive in scope with the constitutional Bower of California to tax-foreign corporations. (Matson Nav. Co. v. State Board, supra; Butler Bros. v. McColgan, 17 Cal. (2d) 664, 677, aff'd 62 S. Ct. 701.)

"This view is also supported by the last sentence of section 13 of the Corporation Income Tax Act, the allocation section, which directs that income shall be allocated 'in such manner as is fairly calculated to apportion such income among the states or countries in which such business is conducted.' This provision clearly compels the result reached by your formula.'?

In view of the consideration set forth in the Opinion of the Attorney General, the action of the Franchise Tax Board is sustained.

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 thcrcfor,

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 American President Lines, Ltd., to a proposed assessment of additional tax in the amount of $50,928.41, the additional tax having been re-determined in the amount of $23,572.11, for the income year ended December 31, 1940, be and the same is hereby sustained.

Done at Sacramento, California, this 18th day of December, 1952, by the State Board of Equalization.

Wm. G. Bonelli, Chairman

J. H. Quinn, Member

Geo. R. Reilly, Member

_____, Member

_____, Member

ATTEST: F. S. Wnhrhaftig, Acting Secretary