



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
INTERNATIONAL BUSINESS MACHINES CORPORATION)

Appearances :

For Appellant: M. G. Connally, Tax Counsel
For Respondent: Burl D. Lack, Chief Counsel
Hebard P. Smith, Associate Counsel

O F J I O N

This appeal is made pursuant to Section 25667 of the Revenue and Taxation Code (formerly Section 25(c) of the Bank and Corporation Franchise Tax Act) from the action of the Franchise Tax Board on the protests of International Business Machines Corporation to proposed assessments of a dditional franchise tax in the amounts of \$871.56, \$363.21 and \$3,120.93 for the income years 1944, 1945 and 1946, respectively.

Although the income year 1943 was included in this appeal, the proposed deficiency assessment for that year was withdrawn by the Franchise Tax Board after protest because of adjustments, not material herein, which decreased Appellant's income for that year. These adjustments resulted in an overpayment of tax for that year in the amount of \$472.30 which, with interest accrued thereon in the amount of \$79.97, the Franchise Tax Board credited against the deficiency for the income year 1944. For the income year 1944, accordingly, this appeal will be treated as an appeal from the action of the Franchise Tax Board on Appellant's protest to a proposed assessment of additional tax in the amount of \$319.29 and, pursuant to Section 26078 of the Code, as an appeal from the denial of a claim for refund in the amount of \$552.27, the aggregate amount of the credit against the deficiency for that year.

Appellant is a New York corporation and is qualified to do business as a foreign corporation in California. During the years in question, Appellant engaged in business throughout the United States and its principal territories and possessions and directly or indirectly (through subsidiary corporations) in various foreign countries. For many years prior to the period in question, Appellant had developed business machines and related equipment at its research and engineering facilities in New York on which it had obtained patents in the United States and in foreign countries.

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Its income was derived from the sale and rental of this equipment, the sale of supplies used therewith, and from royalties for the use of its patents in foreign countries. For the years in question Appellant received \$2,290,310.93 in royalties from the British Tabulating Machine Co., Ltd., an entirely independent company, and \$13,469.25 from a Czechoslovakian subsidiary of Appellant.

It is the position of the Franchise Tax Board that the foreign royalties are a part of Appellant's unitary income subject to allocation under Section 24301 of the Code (formerly Section 10 of the Bank and Corporation Franchise Tax Act). Appellant contends that its patents constitute intangible assets having a taxable situs at the domicile of the corporation in New York and that no portion of the income from licensing their use in foreign countries should be allocated to this State.

While it may be conceded that normally patents, trademarks, trade names, stocks and bonds and other intangibles have a situs for taxation at the domicile of the owner (Rainier Brewing Company v. McColgan, 94 Cal. App. 2d 118; Miller v. McColgan, 17 Cal. 2d 432; Curry v. McCaless, 307 U. S. 357, 59 Sup. Ct. 900), we have previously held that income from such intangibles is subject to allocation where the acquisition, management and disposition of the intangibles constitute integral parts of the owner's regular business operations. (see Appeal of Marcus-Lesoiné, Inc., decided July 7, 1942; Appeal of Houghton Mifflin Company, decided March 28, 1946.)

Here, the business machines and equipment upon which the patents were obtained were developed for use in Appellant's regular business operations. The expense of maintaining the research and engineering facilities at which they were developed, the salaries of employees engaged in research and engineering work, and the cost of securing and protecting its patents, were all expenses of its regular business operations. Under such circumstances, the exploitation of its patents by licensing their use in foreign countries also constitutes, in our opinion, an integral part of Appellant's regular business activities.

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

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of the Franchise Tax Board on the protests of International Business Machines Corporation to proposed assessments of additional tax in the amounts of \$319.29, \$363.21 and \$3,120.93 for the years 1944, 1945 and 1946, respectively, be and the same is hereby sustained: and, pursuant to Section 26077 of the Code, that the action of the Franchise Tax Board in denying the claim of International Business Machines Corporation for a refund of \$552.27 for the income year 1944 be and the same is hereby sustained.

Done at Sacramento, California, this 7th day of October, 1954,
by the State Board of Equalization.

Geo. R. Reilly, Chairman

J. H. Quinn, Member

Paul R. Leake, Member

Robert Kirkwood, Member

Wm. G. Bonelli, Member

ATTEST: Dixwell L. Pierce, Secretary.