BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
ST. REGIS PAPER COMPANY)

Appearances:

For Appellant: Maurice E. Gibson, Attorney at Law

For Respondent: Jack Rubin, Junior 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 in denying the protest of St. Regis Paper Company to proposed assessments of additional franchise tax in the amounts of $3,878.82, $5,081.61, $5,023.75, $3,317.87, $3,940.22 and $6,099.41 for the income years 1943, 1944, 1945, 1946, 1947 and 1948, respectively.

Appellant is a New York corporation with its principal office in that state, It is engaged in the manufacture and sale of paper products such as heavy duty multiwall bags and plastic products having a paper base. It grows its own timber in part and also purchases some from outside sources. It also manufactures and leases machinery for packing the bags it produces,

Appellant's business in carried on in many states, including California, Its operations in California consist of the manufacture and sale of multiwall bags, the leasing of packaging machinery and the sale of limited amounts of paper. It has two bag factories and two sales offices here.

Appellant holds patents on several of its products, including the multiwall bags, and in addition to manufacturing these products itself, Appellant licenses the use of these patents by other manufacturers in the United States and elsewhere. It receives royalty income from the licensees.

In 1946 Appellant acquired all of the outstanding capital stock of Florida Pulp & Paper Company, a Florida corporation with its principal office in that State. In 1946 Appellant purchased some of the stock of Alabama Pulp & Paper Company, a Florida corporation, and in 1947 it acquired the remainder of the stock. During the income years 1947 and 1948 Florida Pulp & Paper Company owned all of the stock of Harvester

Homes Company, a Florida corporation, Alabama Pulp & Paper Company supplied materials to the Florida Pulp & Paper Company and Appellant purchased the majority of the output of Florida Pulp & Paper Company at prevailing market prices for use in making paper bags. Harvester Homes Company built houses for sale to employees of Appellant and its subsidiaries,

During 1947 and the early months of 1948, a new paper mill was erected in Florida by the Alabama Pulp & Paper Company on a site adjacent to the mill of the Florida Pulp & Paper Company, Appellant aided the Alabama Company in financing the new mill. In 1948 Appellant also completed construction of a large multiwall bag plant in Florida on a site immediately adjoining the plants of its subsidiaries. Pulpwood moved from forests into this "Kraft Center" where, through the operation of the three mills, it was converted into pulp, then kraft paper, and, finally, multiwall bags. On December 30, 1948, the Florida Company and the Alabama Company were merged into Appellant, the parent corporation.

Appellant's pulp producing plant at Tacoma, Washington, was closed by order of the War Production Board on November 1, 1942. The basis of the order was that pulpwood was in short supply and was required for the production of pulp for defense purposes at other mills. When the War Production Board removed the restriction in April of 1944, Appellant resumed operations there.

The questions presented herein are as follows:

(1) Whether the 1947 and 1948 income of Appellant and its subsidiaries should be combined and allocated by formula.

(2) Whether royalties from patents owned by Appellant should be included in unitary income or allocated entirely to Appellant's domicile in New York.

(3) Whether the value of Appellant's Tacoma, Washington, plant should be included in the property factor of the allocation formula during the period that plant was closed.

1. If a corporation or group of corporations is engaged in a unitary business operation its income is properly subject to formula allocation (Edison California Stores v. McColgan, 30 Cal. 2d 472). A corporation or group of corporations is engaged in a unitary business if the operation of one portion of the business is dependent upon or contributes to the operation of the other portion (Edison California Stores, supra, at page 481).

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The Franchise Tax Board contends that Appellant was engaged in a unitary business with its subsidiaries. This contention is not denied by the Appellant. The following statement from Appellant's 1947 Annual Report, discussing the effect of the acquisition of Florida Pulp & Paper Company and Alabama Pulp & Paper Company, indicates that the combined operations were unitary:

> "These two mills (Florida and Alabama) will produce paper adequate for 500 million multiwall bags annually. Pulpwood will move from adjacent forests by truck, rail and water into this new 'Kraft Center' at Pensacola, where integrated conversion into pulp, paper and multiwall bags will take place." (Page 26, emphasis added.)

Appellant depends primarily upon the argument that the Franchise Tax Board's reliance upon Section 10 of the Bank and Corporation Franchise Tax Act (now Section 25101 of the Revenue and Taxation Code) is misplaced and that any combination of income of the corporations must be made under Section 14 of that Act (now Section 25102 of the Revenue and Taxation Code). It argues that there has been no finding of an arrangement to improperly reflect income, a prerequisite to the operation of Section 14. We feel that the Edison California Stores case, supra, disposes of Appellant's contention. The court in that case stated, at page 480:

> "It may be assumed that Section 14 of the act, which authorizes the commissioner to require a consolidated return, contemplates two or more corporations, both or all of which are taxable as doing business within the state ... Power to apply the formula allocation in this or in the Butler Brothers case is not derived from the authority to require the filing of consolidated returns, since the latter indicates that the income of the group will be taxed as a unit. The power flows from the authorized method of ascertaining the income attributable to a taxpayer's activities within the state; and by a parity of reasoning the authority to pursue the method is present whenever activities are partially within and partially without the state (Section 10), as in the case of a unitary system, whether the integral parts of the system are or are not separately incorporated ..."

2. Appellant's argument that the income from its patents is not subject to allocation is untenable. We have repeatedly held that royalty income derived from the licensing of patents acquired and used as an integral part of a unitary business is includible in allocable income. See Appeal of International Business Machines Corporation, decided October 7, 1954; Appeal of National Cylinder Gas Company, decided February 5, 1957; and Appeal of Rockwell Manufacturing Company decided February 19, 1958. In each of these opinions we considered the cases cited by Appellant, such as Rainier Brewing Co. v. McColgan, 94 Cal. App. 2d 118, and held that they are not applicable to a taxpayer carrying on a unitary business within and without the taxing state,

Appellant states that our decisions are not persuasive because we did not there consider the fact that between the years 1939 and 1951, Section 10 and its successor included a sentence which provided: "Income derived from or attributable to sources within this State includes income from tangible or intangible property located or having a situs in this State and income from any activities carried on in this State, regardless of whether carried on in intrastate, interstate or foreign commerce." This sentence however, merely defined the sources of income for purpose; of the section and did not purport to limit the manner in which the amount of income attributable to such sources was to be determined. In our opinion, the royalties in question constituted unitary income which was subject to allocation in the same manner as unitary income attributable to Appellant's use of tangible property and its business activities.

3. With respect to the question whether the value of the Tacoma, Washington, Plant should be included in the property factor during the period of approximately 17 months that it was shut down pursuant to a directive of the War Production Board, Bank and Corporation Tax Regulation 24301 (now 25101), Title 18, California Administrative Code, provided:

> "... Also generally excluded is property owned, but not used in the unitary business, Thus, a building is not included in the factor until it is actually used in the unitary business, However, once property has been used in the unitary business, it shall be included in the factor, although temporarily unused for short periods. If the property is permanently withdrawn from unitary use, it should be excluded from the property factor... ."

The Tacoma plant is an integral part of the unitary business structure of this Appellant. Until closed by the directive of the War Production Board it was producing pulp for use in Appellant's unitary business of producing and selling paper products. Upon withdrawal of the directive, operations in the plant were promptly resumed. While the plant was idle Appellant took no action indicating an intent to abandon or dispose of it. The plant remained at all times an asset of the unitary business, available and ready to be returned to productive activity whenever wartime conditions permitted.

That the shut-down of the Tacoma plant was intended to be temporary seems obvious. It seems almost equally clear that under these circumstances the non-use of the plant for approximately 17 months cannot be regarded as even approaching a permanent withdrawal of the property from unitary use. We have little doubt that during much of this period of inactivity pulp previously produced in the Tacoma plant continued to flow through the various stages of the unitary process of converting pulpwood to the end products sold by Appellant. Whether or not this supposition is correct, however, we believe the situation in question to come squarely within the third sentence of the quoted passage from the Franchise Tax Board's own regulation. The value of the plant, accordingly, should have been included in the property factor of the formula for each of the income years 1943 and 1944.

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 in denying the protests of St. Regis Paper Company to proposed assessments of additional franchise tax in the amounts of $3,878.82, $5,081.61, $5,023.75, $3,317.87, $3,940.22 and $6,099.41 for the income years 1943, 1944, 1945, 1946, 1947 and 1948, respectively, be and the same is hereby modified as follows:

The Franchise Tax Board is directed to include the value of the Tacoma plant of the St. Regis Paper Company in the property factor of the allocation formula for each of the income years 1943 and 1944, and to compute the additional tax

due for those years on that basis. In all other respects the action of the Franchise Tax Board is hereby sustained.

Done at Sacramento, California, this 16th day of December, 1958, by the State Board of Equalization,

George R. Reilly, Chairman

Paul R. Leake, Member

J. H. Quinn, Member

Robert E. McDavid, Member

Robert C. Kirkwood, Member

ATTEST: Dixwell L. Pierce, Secretary