



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
CROWN ZELLERBACH CORPORATION)

Appearances:

For Appellant: Pillsbury, Madison & Sutro,
Harry R. Horrow, Claude H. Hogan and
William A. Carroll, Attorneys-at Law

For Respondent: Burl D. Lack, Chief Counsel;
John S. Warren, Associate Tax 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 on the protest of Crown Zellerbach Corporation to a proposed assessment of additional franchise tax in the amount of \$11,430.39 for the income year ended April 30, 1952.

Appellant is a Nevada corporation with its principal office and commercial domicile in California. Together with several subsidiary corporations, it is engaged in the unitary business of manufacturing and selling paper products in California and other states.

During the years in question, the Appellant received interest income from United States securities which, in accordance with its usual practice, it had purchased with general funds of the unitary business to be held in reserve for the payment of current Federal income taxes of the business. It also incurred interest expense on certain loans which were obtained for purposes of the business. A portion of the funds so obtained was temporarily invested in United States securities.

The Franchise Tax Board determined that the interest income from the securities held for **payment** of taxes should be attributed wholly to Appellant's commercial domicile in California. It allowed the interest income from the other securities to be offset against the interest expense on the borrowed money which was used to purchase the securities and treated the remainder of the **interest** expense as a deduction in the computation of net income to be allocated among the states in which the unitary business operated.

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Appellant argues that the interest received on the working capital invested in United States obligations as a reserve for the payment of income taxes should be treated as income from intangibles which are so closely related to the operations of the unitary business that the income is subject to allocation among the various states in which the unitary business is conducted. In the alternative, it contends that if the interest income should be attributed wholly to California, then so should the interest expense.

Appellant's first contention is answered by our opinion in Appeal of American Airlines, Inc., entered December 18, 1952, in which we concluded that interest income from United States obligations which were held and used to pay Federal taxes was not subject to allocation as a part of the income of the unitary business. As we there stated:

"The source of the interest received by Appellant was its investment in government securities and not the operation of its airline business, or a related activity. In view of these considerations we conclude that the tax notes were not an integral part of Appellant's unitary business and that the interest derived therefrom was not subject to allocation. "

It is undisputed that the interest expense which was deducted by the Franchise Tax Board in computing allocable net income of the unitary business was incurred for purposes of that business. We have not been presented with a persuasive reason in support of Appellant's position that the treatment given the interest income should dictate the treatment to be given the interest expense. The two items are unrelated. The interest income was not derived from the operation of the business, but from investments. Since the interest expense in question was incurred to produce business income rather than investment income, we believe that the action of the Franchise Tax Board with respect to it was appropriate.

ORDER

Pursuant to the views expressed in the Opinion of the Board on file in this proceeding, and good cause appearing therefor,

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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 Crown Zellerbach Corporation to a proposed assessment of additional franchise tax in the amount of \$11,430.39 for the income year ended April 30, 1952, be and the same is hereby sustained.

Done at Sacramento, California, this 17th day of February, 1959, by the State Board of Equalization.

Paul R. Leake, Chairman

Geo. R. Reilly, Member

John W. Lynch, Member

Richard Nevins, Member

 , Member

ATTEST: Dixwell L. Pierce, Secretary

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Arthur Anderson & Co