BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
KING BROS. PRODUCTIONS, INC.)

Appearances:

For Appellant: Jack B. Campbell, Certified Public Accountant

For Respondent: A. Ben Jacobson, 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 King Bros. Productions, Inc., to a proposed assessment of additional franchise tax in the amount of $10,987.71 for the income year ended August 31, 1954.

At the time of filing the appeal Appellant conceded that the assessment of tax was correct to the extent of $4,109.20, and it has subsequently paid this amount.

Appellant, a California corporation, is an independent motion picture producer. It contracts with established distributing organizations for the distribution of the motion pictures it produces. The distributing organizations were independent contractors who established rental prices, collected the rentals from exhibitors, decided on the amounts and types of advertising and promotion and paid the expenses thereof, and remitted to Appellant an agreed percentage of the balance remaining after deducting the distribution expenses from the rentals paid by exhibitors. Appellant had no control over the rental prices or the distribution expenses.

During the period involved Appellant was deriving income from four motion pictures. These were "Drums in the Deep South," released October 17, 1951, "Mutiny," released February 28, 1952, "The Ring,++ released August 27, 1952, and "Carnival Story," released April 16, 1954. "Drums in the Deep South++ and "Carnival Story++ were distributed by RKO Radio Pictures, Inc., and "Mutiny" and "The Ring++- by United Artists Corporation.

The first question presented is whether the cost of the motion picture-s- should be amortized on the basis of the estimated total receipts to be received by Appellant from the distributor or on the basis of the estimated total receipts to be received by

the distributor from the exhibitors. The different methods of determing the amortization deduction contended for by the parties can best be expressed in formulas.

Respondent's method:

$$\frac{\text{Distributor's periodic gross receipts}}{\text{Distributor's estimated total gross receipts}} \times \text{Cost} = \text{Amortization deduction}$$

Appellant's method:

$$\frac{\text{Producer's periodic gross receipts}}{\text{Producer's estimated total gross receipts}} \times \text{cost} = \text{Amortization deduction}$$

Appellant contends that its method should be used because, first, its accounting records are based on the amounts it receives and these accounting records should be the starting point for computing the deduction, and, second, it is unable to determine the worldwide gross earnings because the distributors only give it the net figures on foreign exhibition contracts. Respondent states that it has uniformly required the use of its method and that its position has been sustained by this Board in a series of cases. Appeals of Pickford-Lasky Productions, Inc., Cal. St. Bd. of Equal. April 1, 1948 (P-H, St. & Loc. Tax Serv., Cal., Par. 13,082); Esskay Pictures Corp., Cal. St. Bd. of Equal., Dec. 18, 1952 (CCH, 1 Cal. Tax Cases, Par. 200-191), (P-H, St. & Loc. Tax Serv., Cal., Par. 13,127); Sam Katzman Productions, Inc., Cal. St. Bd. of Equal., Dec. 18, 1952 (CCH, 1 Cal. Tax Cases, Par. 200-190), (P-H, St. & Loc. Tax Serv., Cal., Par, 13,126); Address Unknown, Inc., Cal. St. Bd. of Equal., May 5, 1953 (CCH, 1 Cal. Tax Cases, Par. 200-220), (P-H, St. & Loc. Tax Serv., Cal., Par. 13,130); and Filmcraft Trading Corporation, Cal. St. Ed. of Equal., Feb. 17, 1959 (CCH, 2 Cal. Tax Cases, Par. 201-246), (P-H, St. & Loc. Tax Serv., Cal., Par. 13,199).

In the above cases we held that the estimated gross receipts method of computing the amortization deduction should be used by independent motion picture producers. Specifically, in the Pickford-Lasky appeal we held that the Franchise Tax Commissioner (the predecessor of Respondent Franchise Tax Board) could not require an independent producer to write off the costs of producing a motion picture in a two year period and we stated that the estimated gross receipts method should be used. In the other appeals cited above we held that the estimated gross receipts method was preferable to either a cost recovery method or an estimated life method. In none of the above decisions did we consider whose gross receipts should be used in the computations required under the estimated gross receipts method. Assuming a reasonably accurate estimate of gross receipts, the total deductions allowable over the life of the motion picture will be the

same under either method although there may be a variation, such as the one which gives rise to this appeal, in any given year due to the fact that distribution expenses vary from year to year.

It appears that the amount of the gross receipts from foreign exhibitions is not known by Appellant. Indeed, it appears that the Respondent used the distributor's gross receipts from domestic distribution and the producer's gross receipts from foreign distribution in making its computation. Respondent's mixed method might be justified if the receipts from foreign distribution were a very small proportion of the whole. However, such is not the case for the receipts from foreign distribution constitute a substantial proportion of the whole. We believe that the taxpayer should not be forced to use figures which are not readily available to it, and we conclude, therefore, that the Appellant's method is the proper one for determining the amount of the amortization deduction.

The second question presented concerns the allocation of Appellant's net income within and without the State by a formula composed of the factors of property, payroll and sales. Appellant contends that the sales, or gross receipts factor, should be calculated on the basis of the places where the pictures were exhibited. It would thus attribute approximately 9 percent of the sales to California. Respondent's position is that all of the sales must be attributed to California for purposes of the sales factor because Appellant engaged in no sales activity outside of California.

We have already decided this question adversely to Appellant's contention in Appeal of Screen Plays II Corp., Cal. St. Bd. of Equal., June 25, 1957 (CCH, 2 Cal. Tax Cases, Par. 200-729), (P-H, St. & Loc. Tax Serv., Cal., Par. 13,164). The statement that we made in that case, which involved facts substantially identical to those now before us, is applicable here:

> "The Supreme Court of the State of California has held that the focal point for consideration in determining the sales situs for the purpose of computing the sales factor of the allocation formula is the place where the activities of the corporation occurred which resulted in the sales and that where all of a corporation's sales activity outside of California is carried on for it by independent contractors, all of the sales are properly allocable to California. El Dorado Oil Works v. McColgan, 34 Cal. 2d 731, appeal dismissed, 340 U. S. 801; Irvine Company v. McColgan, 26 Cal. 2d 160."

Appeal of King Bros. Productions, Inc.

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 on the protest of King Bros. Productions, Inc., to a proposed assessment of additional franchise tax in the amount of $10,987.71 for the income year ended August 31, 1954, be modified as follows: the amortization of the cost of the motion pictures is to be based on the periodic receipts and the estimated total receipts of the producer rather than of the distributor; and the payment of $4,109.20 is to be applied against the assessment thus computed. In all other respects, the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this 5th day of January, 1961, by the State Board of Equalization.

John W. Lynch, Chairman

Geo. R. Reilly, Member

Alan Cranston, Member

Paul R. Leake, Member

_____, Member

ATTEST: Ronald B. Welch, Acting Secretary