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: George D. Wick, Jr., Attorney at Law

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 protests of American President Lines, Ltd., to proposed assessments of additional franchise tax in the amounts of $38,650.32, $32,469.56 and $50,860.59 for the income years 1946, 1947 and 1948, respectively. Subsequent to the filing of this appeal, Appellant and Respondent have agreed to certain revisions in the sales factor of the allocation formula resulting in a reduction of the assessments to $38,563.66, $29,315.18 and $48,041.92 for the income years 1946, 1947 and 1948, respectively.

The Appellant is a Delaware corporation engaged in the business of providing world-wide steamship services for the transportation of passengers, property and mail in interstate and foreign commerce. Its executive offices are maintained in San Francisco, California. In addition, it maintains administrative, accounting, and sales offices in six other states and in foreign countries. Its shipping operations are carried on between United States ports and ports of foreign countries, between ports in foreign countries, between ports in one state or possession of the United States and ports in different states or possessions. It maintains no intrastate transportation services between California ports.

The questions presented by this appeal are listed below and will be considered in the same order:

1. -Whether Appellant is subject to tax under the Corporation Income Tax Act or under the Bank and Corporation Franchise Tax Act;

2. If Appellant is subject to tax under the Bank and Corporation Franchise Tax Act, whether certain interest income from investments in United States securities is allocable wholly to California.

3. Whether a payment received in 1946 on the sale of a vessel is includible as income in 1945 or 1946.

4. In the event the payment involved in question 3 is determined to be 1946 income, whether any part of the basis is to be charged against 1946 income.

5. Whether income derived from the sale of a vessel and from bareboat charter hire to the United States is includible in Appellant's unitary business income,

6. Whether certain real property in New York owned by Appellant, but not used in Appellant's income producing operations, should be included in the property factor of the allocation formula.

7. Whether war risk bonuses paid to vessel personnel should be apportioned for purposes of the payroll factor in the allocation formula.

8. Whether receipts from bareboat charter hire should be included in the numerator of the sales factor of the allocation formula.

Further facts relevant to each question are set forth hereinafter in conjunction with the discussion of each of the above questions presented in this appeal.

1.

Appellant performs "husbanding" services for various steamship companies operating vessels engaged in interstate and foreign commerce. These services include arranging for stevedores; arranging necessary vessel repairs; obtaining bunker fuel and ships stores from suppliers; obtaining crews for the vessels; and attending to similar in-port details of vessel operation. Appellant also undertakes to solicit passengers and freight for the vessel-operator and in connection therewith to issue tickets and bills of lading and make collections. In performing the services, Appellant acts as an agent of the vessel-operator, with authority to make contracts in the name of and binding upon the operator. The operator paysia fee to Appellant,. The services are performed in California ports. They are similar to activities which Appellant engages in with respect to its own vessels.

Appellant contends that the husbanding services performed for other vessel-operators are an inseparable part of interstate and foreign commerce and that the franchise tax may not be imposed on the privilege of engaging in that business. Appellant concedes that it is subject to the corporation income tax. Respondent

contends that the husbanding services performed for other vessel-operators are a local business incidental to interstate and foreign commerce and not directly a part of that commerce. It concludes that the franchise tax may be imposed on the privilege of engaging in that business.

If Appellant is doing any intrastate business within this State it is subject to the franchise tax, measured by its net income attributable to sources within the State, regardless of whether the income is derived from intrastate, interstate or foreign commerce. (Matson Navigation Co. v. State Board of Equalization, 3 Cal. 2d 1.) When performed by independent contractors, the servicing in port of ships engaged in interstate and foreign commerce, other than loading and unloading cargo, is regarded as a local activity upon which a privilege tax may be imposed. (Puget Sound Stevedoring Co. v. Tax Commission, 302 U.S. 90; Martin Ship Service Co. v. City of Los Angeles, 34 Cal. 2d 793.) The substance of Appellant's argument, however, is that it acts as the agent of the interstate-and foreign steamship companies for which it performs services-and in that relationship its activities constitute interstate and foreign commerce.

Appellant relies upon Texas Transport & Terminal Co. v. City of New Orleans, 264 U.S. 150. There the court invalidated a business license tax in a flat sum as applied to a steamship agent representing operators of vessels engaged exclusively in interstate and foreign commerce. The service rendered was described by the court, at page 151, as:

> "... soliciting and engaging cargo, nominating ships for carrying it, arranging for its delivery on the wharf, issuing bills of lading under the name of shipowner or charterer, arranging for stevedores for loading and discharging cargo, collecting freight charges, paying ships' disbursements, attending to immigration service, and assisting generally in matters of local customs and regulations. Freight moneys collected, after deducting commissions, were remitted to the owners or charterers. As such agent, defendant was authorized to solicit cargo and quote freight rates, and to issue receipts in the name of its principal for cargo delivered on the wharf."

A reading of the Texas Transport decision clearly reveals that the court did not attach any importance to the status of the taxpayer as agent of the steamship companies it represented. That the taxpayer was conducting its own business was recognized in the court's statement that the agent "neither did, nor held itself out as ready to do, a general business, partly local and partly interstate and foreign, but confined itself exclusively to the latter."

In other words, the taxpayer limited itself to doing what the court construed to be strictly an interstate and foreign business.

It may be noted that the activities which the court there considered to be interstate and foreign business, with the possible exception of paying ships disbursements, all related to the handling, expediting and clearance of cargo and passengers. Upon the facts before it the court viewed the tax as imposed upon the taxpayer "for securing or seeking to secure the transportation of freight or passengers in interstate or foreign commerce." In this posture it said the earlier case of McCall v. California, 136 U.S. 104, "controls the present case." In the latter case the taxpayer was exclusively engaged in soliciting passengers to travel over the lines of the interstate railroad company which he represented.

Appellant performs the same services which were considered by the court in the Texas Transport case and in addition thereto arranges for necessary vessel repairs, arranges for the purchase of fuel and ships stores, and obtains crews. These activities are well beyond the business of securing or seeking to secure the transportation of freight or passengers in interstate or foreign commerce and therefore Appellant's business falls outside the holding in Texas Transport.

There is no case directly decisive of the issue before us and our decision must be based on an extension of the principles set forth in related cases. In Puget Sound Stevedoring Company v. Tax Commission, supra, the court distinguished the taxpayer's principal business of loading and unloading vessels engaged in interstate and foreign commerce from its occasional service of furnishing stevedores to the ship, the taxpayer not directing or controlling the work of loading or unloading. As to the latter, the court likened the services to that of an employment bureau and found the activities to "be no part of interstate or foreign commerce," although essential to such commerce. The court specifically declined to state whether the performance of similar services by a person acting as agent for the steamship-company would have altered the result. In deciding that the business of loading and unloading vessels engaged in interstate or foreign commerce was itself an interstate or foreign commerce business, however, the court said: "The fact is not important that appellant does business as an independent contractor as long as the business that it does is commerce immune from regulation by the state. What is decisive is the nature of the act not the person of the actor."

In the recent case of Scripto, Inc. v. Carson, 362 U.S. 207, the court said:

> "True, the 'salesmen' are not regular employees of appellant devoting full time to its service, but we conclude that such a fine distinction is without

> constitutional significance. The formal shift in the contractual tagging of the salesman as 'independent' neither results in changing his local function of solicitation nor bears upon the effectiveness of local solicitation in securing a substantial flow of goods into Florida.... To permit such formal 'contractual shifts' to make a constitutional difference would open the gates to a stampede of tax avoidance."

Similarly, it is not significant that under its husbanding contracts Appellant is appointed the agent of the steamship companies for which it performs the services. What is significant is that Appellant performs the services for a fee. Those services are performed wholly in this State and do not directly involve the transportation of passengers or freight in interstate or foreign commerce. The husbanding services performed by Appellant, accordingly, constitute an intrastate business and Appellant is subject to tax under the Bank and Corporation Franchise Tax Act.

2.

Appellant is an American flag steamship operator receiving operating-differential subsidies from the United States Government under the provisions of the Merchant Marine Act of 1936. As a subsidized operator, Appellant is required to make deposits in a "Special Reserve Fund." With the consent of the Maritime Administration, the funds may be invested in United States bonds. Amounts in the Special Reserve Fund may be released only with the consent of the Maritime Administration and only to replace vesselsin Appellant's fleet.

During the years in question, amounts in Appellant's Special Reserve Fund were invested in United States bonds on which Appellant received interest income. Respondent determined that the interest income did not arise from Appellant's unitary business and allocated the entire interest income to California as the commercial domicile of Appellant. Appellant contends that the interest income arose from its unitary business and should be allocated within and without the State together with its other business income.

Appellant's contention is answered by our opinions in Appeal of American Airlines, Inc., Dec. 18, 1952 (CCH, 1 Cal. Tax Cases, Par, 200-195), (P-H, St. & Loc. Tax Serv., Cal., Par. 13,120); Appeal of Crown Zellerbach Corp., Feb. 17, 1959 (CCH, 2 Cal. Tax Cases, Par. 201-244) (P-H, St. & Loc. Tax Serv., Cal., Par. 13,197); and Appeals'of Fibreboard Products, Inc., Feb. 17, 1959 (CCH, 2 Cal. Tax Cases, Par. 201-245) (P-H, St. & Loc. Tax Serv., Cal., Par. 13,198.) As in those case;, the source of the interest received by Appellant here was its investment in government

securities and not the operation of its business. This interest income is identical in character to interest income of a corporation whose management decides as a matter of sound business practice, though not required by law, to accumulate funds over a period of time for future capital acquisitions and in the interim to invest the idle funds in bonds. The character and purpose of the transaction are not changed merely because the accumulation is required by law,

3.

On January 9, 1942, Appellant's vessel S. S. President Tyler was requisitioned for use by the United States. The United States was in continuous possession of the vessel and operated it from that date until March 30, 1945. On March 30, 1945, the United States requisitioned the title to the vessel pursuant to Section 1242 of Title 46 of the United States Code.

On September 28, 1945, Appellant entered into an agreement with the United States for immediate payment of $331,000 as part of the compensation to be paid for the sale of the vessel with the balance to be paid pursuant to the Maritime Administrator's determination of just compensation. This determination was made in 1946 and on November i, 1946, a balance of $344,000 was paid to Appellant. Appellant maintains its books on an accrual basis. Respondent determined that the amount received in 1946 could not have been reasonably ascertained in 1945 and was therefore income in 1946.

As indicated in the following cases which the parties have cited, an item of income is accrued when liability is fixed and the amount can be determined with reasonable accuracy. Here liability was fixed in 1945 and the controversy turns on whether the amount was determinable with reasonable accuracy,

In Continental Tie & Lumber Co. v. United States, 286 U.S. 290, the court held that an award to a railroad pursuant to the Transportation Act of 1920 accrued in 1920, the year in which the act was passed and initial administrative regulations were issued, rather--than in- 1923, the year in which the award was made. The act provided, among other things, that railroads not under Federal control during World War I, which lost business due to Federal control of the major railroads, would be compensated. The compensation was to be based on the railroad's net earnings during the period of Federal control as compared to its net earnings during an earlier base period, Adjustments were to be made for increases in costs of labor and materials and to allocate charges for maintenance and reserves to the correct year. All facts necessary to the correct determination were in the railroad's records by 1920.

In Patrick McGuirl, Inc., v. Commissioner, 74 Fed. 2d 729, title to taxpayer's land was taken by the City of New York in 1926. Taxpayer did not contest the taking but did contest the amount of the award. Litigation ensued and the amount was fixed by a court decree in 1929. It was held that the gain on the sale accrued in 1929.

In Globe Corporation, 20 T.C. 299, the taxpayer had a contract to manufacture certain assemblies for the United States. By a change order, taxpayer agreed to package the completed assemblies for a fair andreasonable-price to be later negotiated. It was held that the income from the change order did not accrue until the taxpayer-and the United States had reached an agreement on the price to be paid.

In the Continental Tie & Lumber Co. case, the amount of the award could be predicted with reasonable certainty merely by examining existing accounting records. On the other hand, as illustrated by the cases of Patrick McGuirl, Inc., and Globe Corporation, such certainty of the income depends upon a valuation by another person.

From a review of the cases annotated under Section 1242 of Title 46 of the United States Code Annotated, it is clear that there is often a wide difference of opinion concerning the value of a vessel requisitioned by the United States. The most striking case is American-Hawaiian Steamship Co. v. United States, 133 Fed. Supp. 369, in which the values contended for by the owner were 2-1/2 to 4 times the values contended for by the United States. Other cases illustrating wide variations in values and in methods of valuation are De La Rama S. S. Co. v. United States, 206 Fed. 2d 651; National Bulk Carriers, Inc. v. United States, 169 Fed. 2d 943; Baltimore Steam Packet Co. v. United States, 81 Fed.. Supp. 707; and Seven-Up Bottling Co. v. United States, 68 Fed. Supp. 735.

We, therefore, conclude that the amount to be awarded Appellant as just compensation for the S. S. President Tyler could not be predicted by Appellant with reasonable certainty in 1945 and that Respondent was correct in treating the 1946 payment as income in 1946.

4.

Appellant's adjusted basis for the S. S. President Tyler at the date of sale, March 30, 1945, was $104,452.64. In view of the fact that in 1945 the total compensation to be paid for the vessel could not reasonably be ascertained, Respondent charged the entire basis to the payment of $331,000 received by Appellant in 1945. The result was that Respondent treated the entire 1946 payment of $344,000 as a gain.

Appellant contends that Respondent's action is erroneous, but cites no authority and suggests no alternative method of charging the basis. Respondent cites Burnet v. Logan, 283 U.S. 404, in support of its action. In that case the taxpayer sold an interest in a lease of an iron ore mine for cash, plus 60¢ per ton of ore mined during the remaining 76 years of the lease term. It was held that the taxpayer's basis should be charged against the first moneys received until the basis was exhausted and that subsequent payments would constitute income. (See, also, Estate of Raymond T. Marshall, 20 T. C. 979.)

We conclude that the principle of the Burnet v. Logan case is applicable here and, accordingly, sustain the action of Respondent.

5.

Respondent considered Appellant's receipts from the United States from the sale of the S. S. President Tyler and from the bare-boat charter of other vessels to be part of Appellant's unitary income--;---In--each case the United States had requisitioned the vessel and Appellant's consent was not required. Appellant had no choice but to deliver the vessel-to the United States.

In Appeal of Alaska Packers Ass'n., Cal. St. Bd. of Equal., June 18, 1943 (P-H, St. & Loc. Tax Serv., Cal., Par. 13,024), we held that income from the bare-boat charter of a vessel was part of unitary income where the vessel was regularly used in the taxpayer's business and it was chartered during the otherwise idle season.

In Appeal of American Airlines; Inc., Cal. St. Bd. of Equal., Dec. 18, 1952 (CCH, 1 Cal. Tax Cases, Par. 200-195), (P-H, St. & Loc. Tax Serv., Cal., Par. 13,120), we held that the gain from the sale of airplanes requisitioned by the United States was includible in unitary income.

The vessels in question were compulsorily chartered to the United States for an uncertain period of time with the expectation that they would be returned to the Appellant when conditions were such that they no longer were needed by the United States. Under the cireumstarices we are of the opinion that-the vessels remained a part of Appellant's business and, therefore, the income from the charters' is part of unitary income. Combining this principle with the principle developed in Appeal of American Airlines., supra, we hold that the gain on the sale of the S. S. President Tyler is part of unitary income.

6.

Appellant owns real property in New York City valued at about $1,000,000. It had been purchased for development of a terminal for Appellant's vessels at the port of New York. No terminal was actually constructed or used and, in fact, Appellant made no use of the property.

Respondent excluded the value of the land from the property factor of the allocation formula.

We can find no error in excluding from the property factor the value of real property never used in connection with Appellant's business and not contributing in any way to Appellant's income.

7.

In accordance with the decisions of the Maritime War Emergency Board, Appellant paid a bonus to crew members employed on its vessels for periods in which the vessels were in specified danger areas. Respondent determined that such wage payments should be included in the total payroll apportioned by the port-day formula and thereby allocated in part to California for purposes of the payroll factor in the three-factor allocation formula applied to Appellant's unitary business.

In Appeal of American President Lines, Ltd., Cal. St. Bd. of Equal., Dec. 18, 1952 (CCH, 1 Cal. Tax Cases, Par. 200-193), (P-H, St. & Loc. Tax Serv., Cal., Par. 13,121), we held that wages should be apportioned in such a manner as to allocate the total vessel payroll to ports at which vessels touch and that none need be allocated to the high seas. In the principal case, Respondent contends that bonus wages should be treated in the same manner. In its reply memorandum, Appellant makes the following statement:

> "We agree with this analysis [referring to the addition of bonus wages to total payroll by Respondent], of the Board if one accepts its erroneous premise, the 'port-day' formula."

As we pointed out in the previous American President Lines appeal, the constitutional protection against double taxation, which is the initial basis for the adoption of any allocation formula, does not compel states to allocate income in such a manner as to permit a party to escape any taxation upon a portion of income-actually earned. .. At that time we held that it was proper to allocate the net income of a steamship company among the states or countries at the ports which its vessels touch. Upon due consideration we reaffirm our decision in favor of the validity of the port-day formula. Accordingly, we sustain the findings of the Franchise

Tax Board on the instant question. (Cf. Section 25101 of the Revenue and Taxation Code as amended in 1957.)

8.

Respondent has included the entire receipts from bare-boat charter hire in the numerator of the sales, or gross receipts, factor of the allocation formula. Appellant protests this action but has not suggested that the receipts or any particular part of them are attributable to some other state or country.

Respondent concedes that the lack of the usual solicitation activities makes difficult the correct placement of this income in the allocation formula. Respondent justifies its action on the basis that the Appellant maintained its headquarters within this State and that administrative action by Appellant with respect to the chartering occurred here. Appellant makes a general assertion that administrative action with respect to the charter arrangements was carried on at various offices, more often in Washington, D.C., than elsewhere. Although there may be merit to Appellant's position, there are no facts in the record before us from which we can determine the proportion, if any, of charter receipts derived from out-of-State 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 of the Franchise Tax Board on the protests of American President Lines, Ltd., to proposed assessments of additional franchise tax in the amounts of $38,650.32, $32,469.56 and $50,860.59 for the income years 1946, 1947 and 1948, respectively, be modified as follows: the assessments are to be reduced in accordance with

the revisions agreed upon by the parties with respect to the sales factor. 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

Paul R. Leake, Member

Richard Nevins, Member

George R. Reilly, Member

_____, Member

ATTEST: Ronald B. Welch, Acting Secretary