BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
TWENTIETH CENTURY-FOX FILM CORPORATION)

Appearances:

For Appellant: Frederick B. Warder, Attorney at Law

For Respondent: Burl D. Lack, Chief Counsel;
Crawford H. Thomas, 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 Twentieth Century-Fox Film Corporation, to proposed assessments of additional franchise tax in the amounts of $7,209.73, $9,445.52, $10,706.59, $10,747.63, $12,017.58, $8,774.51, $9,748.91, $11,878.20, $16,328.53 and $14,448.99 for the income years 1945 through 1954, respectively.

Two taxpayers are involved in this appeal. Twentieth Century-Fox Film Corporation, a New York corporation was the taxpayer until its dissolution in 1952. Twentieth Century-Fox Film Corporation, a Delaware corporation, succeeded to the New York corporation's liabilities and part of its assets and was the taxpayer from 1952 through 1954. Collectively they will hereafter be referred to as Appellant.

During the years in question Appellant was engaged in the production and distribution of motion pictures. Its studios for the production of motion pictures were located in California. In addition to the distribution of its own films it distributed motion pictures made by independent producers. The latter will hereafter be referred to as outside products. During the years 1945 through 1952 the distribution of motion pictures to exhibitors in this country was handled through branch offices in 29 cities in the United States and in the years 1953 and 1954 through branches in 32 United States cities. Two branches were located within California. Distribution outside the United States was carried on through foreign subsidiaries. The same facilities and personnel were used for the distribution of all motion pictures, whether they were produced by Appellant or were outside products. Appellant distributed the outside products for

a predetermined portion of the receipts collected for film rentals. The balance of the receipts were paid to the producers of the outside products.

In 1943 an understanding was had between Appellant and the then Franchise Tax Commissioner to the effect that Appellant could include or exclude the income of its foreign subsidiaries in the unitary income of the business but whichever it chose to do it had to continue to report in the same manner in subsequent years. This agreement was made during World War II. It was agreed that the understanding could be changed when world conditions improved. Appellant has consistently included the income of its subsidiaries in the unitary income of the business.

Prior to 1945, pursuant to an understanding with the Franchise Tax Commissioner, Appellant had used one allocation formula for apportioning the income from production and distribution of its products and a different allocation formula for apportioning the income from distribution of outside products. In 1945 the Franchise Tax Commissioner notified Appellant that income from production and distribution of its products and distribution of outside products was thereafter to be considered as unitary income and should be apportioned to California by the usual three-factor formula, Nevertheless, Appellant continued to use a one-factor formula for apportioning to California the income from distribution of outside products.

Appellant's method of segregating and 'allocating its income from the distribution of outside products is described by it as follows:

> From the gross receipts from distribution of outside product Fox deducts the producers' share to obtain Fox's gross profit from outside product.
>
> Fox then determines the distribution expense attributable to outside product by multiplying the total distribution expense by a fraction of which the numerator is gross receipts from distribution of outside product (i.e., the receipts before deduction of producers' share) and the denominator is gross receipts from distribution of all product.
>
> Fox then deducts from the gross profit from outside product the distribution expense attributable to outside product to obtain net profit from distribution of outside product.

> Fox then allocates to California its net profit from distribution of outside product by multiplying the same by a fraction of which the numerator is gross receipts from distribution of **all** product in California (i.e., including California gross receipts from outside product before deducting the producers' share) and the **denominator** is gross receipts everywhere from distribution of all product (including gross receipts everywhere from outside product before deducting producers' share).

After making the above segregation, Appellant allocated the net income attributed to the production and distribution of its own pictures by employing the usual formula of property, payroll and sales.

Respondent has determined that Appellant and its subsidiaries engaged in a unitary business during the years in question and that the business, in addition to production and distribution of Appellant's products in the United States and foreign countries, included distribution of outside products. Respondent applied a single formula composed of property, payroll and sales to the unitary net income in order to determine net income attributable to California sources.

The first issue to be determined is whether Appellant's foreign subsidiaries are part of a unitary business. Appellant has always treated income from those sources as unitary income but asserts that it should not have done so.

We have held that where an affiliated corporation was located outside the United States and was dependent upon or contributed to the operation of the business within California it was part of a unitary business. (Appeal of American Can Co., Cal. St. Bd. of Equal., Nov. 19, 1958 2 CCH Cal. Tax Cas. Par. 201-180, 2 P-H St. & Local Tax Serv. bar. 1318'7.) There is a mutual interdependence between Appellant's foreign subsidiaries and its domestic production and distribution facilities. We conclude, accordingly, that the inclusion of the income of the foreign subsidiaries as part of the unitary income was proper.

The next issue to be determined is whether Respondent's action in disallowing the use of a separate formula for apportioning Appellant's income from distribution of outside products was proper.

In the Appeal of RKO Radio Pictures, Inc., Cal. St. Bd. of Equal., Dec. 17, 1957, 2 CCH Cal. Tax Cas. Par. 200-767, 2 P-H St. & Local Tax Serv. Cal. Par. 13173, on facts almost identical to those presented here, we held that a single formula composed of property, payroll and sales was properly applied to all income

of a taxpayer engaged in producing and distributing its own films and in distributing films produced by others, since such a business was a unitary one.

Appellant argues that, in contrast with the situation in RKO, it has demonstrated how it segregated the income from the distribution of outside products and that its formula for allocating that income gives effect to the contribution of its production property-and production payroll.

In RKO, although we pointed out that the taxpayer had not shown how it segregated its income, we also stated that:

> Even if we assume, however, that the segregation of income by Appellant was reasonably accurate, neither that fact nor the different result obtained by the use of two formulas necessarily requires the Franchise Tax Board to use more than one formula for the apportionment of the income of a single unitary business,

We concluded in that appeal that the Franchise Tax Board is vested with discretion to adopt a formula and that its decision may not be set aside "by computations which start with the assumption that property and payroll employed in one segment of the unitary business contributed nothing toward the earning of some portion of the net income derived from the unitary operations.'! Since Appellant's formula for allocating the net income from the distribution of outside products is based solely on a gross receipts factor, it does not, in our opinion, give appropriate weight to the contribution to all unitary income made by Appellant's motion picture production facilities and activities.

The use of a single three-factor formula of property, payroll and sales in the apportionment of the income of a unitary business has been consistently approved by the courts of this State and its fairness has been declared settled. (Butler Bros. v. McColgan, 17 Cal. 2d 664, aff'd 315 U.S. 501; Edison California Stores, Inc. v. McColgan, 30 Cal. 2d 472; El Dorado Oil Works v. McColgan, 34 Cal. 2d 731, appeal dismissed 340 U. S. 801; John Deere Plow Co. v. Franchise Tax Board, 38 Cal, 2d 214, appeal dismissed 343 U. S. 939.) We are not persuaded that its use in this case results in the taxation of extraterritorial values.

Appeal of Twentieth Century-Fox Film Corporation

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 Twentieth Century-Fox Film Corporation to proposed assessments of additional franchise tax in the amounts of $7,209.73, $9,495.52, $10,706.59, $10,747.63, $12,017.58, $8,774.51, $9,748.91, $11,878.20, $16,328.53 and $14,448.99 for the income years 1945 through 1954, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 10th day of July, 1962, by the State Board of Equalization.

_____, Chairman

John W. Lynch, Member

Paul R. Leake, Member

Richard Nevins, Member

_____, Member

ATTEST: Dixwell L. Pierce, Secretary