BEFORE THE STATE BOARD OF EQUALIZATION

OF THE.STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
MARCHANT CALCULATING MACHINE CO.)

Appearances:

For Appellant: W. C. Kock, Secretary-Treasurer of said corporation; E, A. Herger of San Francisco
For Respondent: A. A. Manship, Franchise Tax Commissioner

O P I N I O N

This is an appeal pursuant to Section 25 of the California Bank and Corporation Franchise Tax Act (Chapter 13, Statutes of 1929) from the action of the Franchise Tax Commissioner in overruling the protest of Marchant Calculating Machine Co. against a proposed additional assessment in the amount of $559.29 based upon its return for the year ended December 31, 1929..

The sole point before the Board for determination is the basis upon which the income of the taxpayer is to be allocated pursuant to the provisions of Section 10 of the kct. The Appellant is engaged in the manufacture and sale of calculating machines maintaining its factory in Oakland, California, but selling its product through world wide distribution. There can be no doubt that the corporation is entitled to an allocation of a substantial portion of its income to business outside of this State and the controversy has arisen only with reference to the extent of that portion.

Schedule "C" of form number 104 prescribed by the Franchise Tax Commissioner for the reporting of the net income of corporations derived from their business during the year ended Decembe 31, 1929, contains three items "for the purpose of determination the proportion of net income arising from business within and without the state". These are:

1. Average monthly value (actual) of real and tangible personal property;

2. Wages, salaries and commissions and other compensation of employees; and

3. Gross sales.

As to each, the reporting company is required to show (a) "total within and without the state", (b) "total within the state" 'and (c) "per centum within the state", i.e. (b) divided by (a). The three percentages thus obtained are averaged-and the average percentage is then applied to what would otherwise be the net

income for state purposes, the California proportion being considered as that per centum of the total net income. This is the method followed in the vast majority of cases in which an allocation is required.'

However, the taxpayer has sought to substitute a method for allocation whereby the three factors above mentioned are to be considered but instead of taking an average percentage, the total of all three items within and without the state and their total within the state are related the one to the other. By the use of this method a somewhat lower percentage of income is allocated to California than obtains under the method prescribed in the form for report.

In our opinion in the matter of the Appeal of Pacific-Burt Company, Ltd. (filed August 4, 1930), we held that the provisions of Section 10 of the Act do not require any specific method to be employed for the allocation of net income. The only positive requirement concerning methods is that the one adopted be "fairly calculated to assign to the state the portion of net income reasonably attributable to the business done within the state and to avoid subjecting the taxpayer to double taxation." In our opinion in the matter of the Appeal of R. J. Reynolds Tobacco Company (filed January 19, 1931), we observed that at best, any allocation is but rough justice, because it is impossible to estimate exactly the weight of the factors that enter into that common commercial pursuit - the acquisition of net income. In that same matter we pointed out that if consideration of the three primary factors of ownership of property employment of persons and sale of some product or service appeal best calculated to accomplish the design of the statutory in most cases it should be preferred in all cases in the absence of compelling reasons to the contrary.

The only departure which the Appellant has urged from the usual formula is the averaging of the totals in terms of dollars of each of these three factors rather than the averaging of the California percentage of each of them. We think that the method employed by the taxpayer is erroneous because it attempts to consider in terms of dollars, factors which cannot be weighed relatively in this way, We do not believe that there is mathematical justification for such a process. If the factors of situs of property, payroll and sales are each to be considered, then the California percentage of each must first be obtained and used along with the other percentages. It may be that equal weight should not be given to each of these percentages but, in any event, we think it would be illogical to add in terms of dollars tangible property, payroll and sales and then to determine the allocation of income on the basis that the totals in terms of dollars for all business and California business bear to one another. We do not believe that-these factors can be used in connection with a common denominator in such a way. We are of the opinion that the taxpayer has not shown a sufficient reason for departure from the formula established by the Commissioner and that the formula suggested by it cannot be supported mathematically or logically.

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, that the action of the Franchise Tax Commissioner in overruling the protest of Marchant Calculating Machine Co., a corporation, against a proposed additional assessment based upon a return of said corporation for the year ended December 31, 1929, pursuant to Chapter 13, Statutes of 1929, be and the same is hereby sustained.

Done at Sacramento, California, this 15th day of May, 1931, by the State Board of Equalization.

Jno. C. Corbett, Chairman
H. G. Cattell, Member
R. E. Collins, Member
Fred E. Stewart, Member

ATTEST: Dixwell L. Pierce, Secretary