



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
BREITSTEIN MANUFACTURING COMPANY)

Appearances:

-Treasurer
For Appellant: J. Breitstein, Secretary/of corporation;
H. Kahan, Certified Public Accountant
For Respondent: Chas. J. McColgan, Franchise Tax Commissione

O P I N I O N

This is an appeal pursuant to Section 25 of the Bank and Corporation Franchise Tax Act (Chapter 13, Stats, 1929, as amended) from the action of the Franchise Tax Commissioner in overruling the protest of Breitstein Manufacturing Company to a proposed assessment of an additional tax in the amount of \$51.60 for the calendar year 1932, based upon its return for the year ended December 31, 1931.

The sole problem involved in this appeal is whether the Commissioner acted properly in disallowing as a deduction in computing Appellant's net income for the year 1931 the amount of salaries actually paid by the Appellant to its president, vice-president and secretary-treasurer. Each of the above three officers was paid the sum of \$7,800 for the year 1931.

Section 8(a) of the Act provides that there may be deducted in arriving at net income

"a reasonable allowance for salaries or other compensation for personal services actually rendered."

The Commissioner contends that the sum of \$7,800 paid to each of the above three officers does not constitute a reasonable allowance for salaries; that \$6,000 would be such a reasonable allowance; and that the difference between \$6,000 and \$7,800 represents a distribution of net income under the guise of salaries. In support of his contentions, the Commissioner points out that the three officers whose salaries are in question in this appeal own all of the stock of the Appellant, and that for a number of years Appellant has varied the amount of salaries paid to the three officers so as to absorb all the net income of Appellant.

On the other hand, the Appellant vigorously contends that the officers perform services of a value to the Appellant equal to or greater than the salaries paid them; that it would no doubt be necessary to pay as great or even greater salaries to

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obtain the services of others capable of performing duties which the officers perform; and that Appellant has not at any time sustained a loss in any year, whereas many other **corporations** in the same line of business have suffered serious losses and in many instances have been forced to discontinue operations.

The Appellant, it is to be noted, is engaged **in the** business of manufacturing clothing. During the year 1931, it did a considerable volume of business, the gross sales for the year amounting to **\$427,624.18**. Although we consider relevant the amount of stock owned by the officers and the policy of the Appellant in prior years with respect to salaries in determining whether or not the particular amount paid in salaries is **reasonable or** whether it is in fact a distribution of income, nevertheless, we think the controlling consideration is the nature and extent of the business done by the Appellant and the type of service rendered by the individuals receiving compensation.

The following remarks made by this Board in the Appeal of Miss Saylor's Chocolates, Inc. (decided by this Board on the **fourth day** of August, 1930) in connection with a problem **similar** to the 'one herein involved,' indicate our **position** with respect to allowances for salaries:

"**Nothing** has been suggested to us in this case indicating any reason why we should consider the salaries excessive merely because of the ratio which they bear to the profits of the business. It seems to us that the true test of the reasonableness of salaries should turn principally upon a consideration of the nature and extent of the business done and the type of service afforded by the individual receiving compensation.

"Corporate enterprises frequently must be conducted on a narrow margin of profit even under **the most** efficient management, and, in times of such stress, it would be a peculiar rule which would deny a taxpayer a deduction for salaries paid merely because they were large in comparison with the net income. If a company had not had the type of management worthy of such salaries, it would be conceivable that its loss would be many times greater than the amount expended to assure efficient supervision of the corporate affairs."

In the instant appeal, in view of the volume of business and type of business done by Appellant, and in view of the fact that it has operated during a period of unfavorable business conditions without loss, we are unable to say that the amounts paid by the Appellant to its officers were actually unreasonable. In other words, we are unable to say that the officers did not in fact perform services of a value to the corporation equal in amount to the compensation which they received. Consequently, we must hold that the Commissioner acted erroneously in disallowing as a deduction the amounts actually paid by Appellant to its officers in arriving at Appellant's net income for the year **1931**.

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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 Chas. J. McColgan, Franchise Tax Commissioner, in **overruling** the protest of Breitstein Manufacturing Company, a corporation, against a proposed additional assessment based upon the return of said corporation for the year ended December 31, 1931, under Chapter 13, Statutes of 1929, be and the same is hereby reversed. Said ruling is hereby set **aside** and said Commissioner is hereby directed to proceed in conformity with this order.

Done at Sacramento, California, this 10th day of October, 1932, by the State Board of Equalization.

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

ATTEST: Dixwell L. Pierce, Secretary