BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
MARCUS-LESOINE, INC.)

Appearances:

For Appellant: L. C. Marcus, its President, Pierce Coombes Attorney; John W. Borrows, Certified Public Accountant
For Respondent: Frank M. Keesling, Franchise Tax Counsel

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, Statutes of 1929, as amended) from the action of the Franchise Tax Commissioner in overruling the protests of Marcus-Lesoine, Inc. to his proposed assessments of additional taxes in the amounts of $441.02, $1,526.69, and $1,027.33, based upon the income of the corporation for the years ended December 31, 1933, December 31, 1934 and December 31, 1935, respectively. A portion of the additional assessment was due to the fact that the Commissioner attributed to the Appellant net income supposed to have been earned by the Marles Lovalon Company and the Lesoine-Marcus Investment Co., partnerships owned and operated by the two stockholders of Appellant, each of whom owned a fifty percent interest in each of the three organizations, and the balance of the assessment resulted from the Commissioner's action in allocating to California the entire amount of Appellant's interest income. Since the hearing in this matter the Commissioner has recomputed the Appellant's net income for the years in question, arriving at the amounts of $4,735.98, $27,014.18, and $12,096.62, respectively, and he has also recomputed the portion of Appellant's income (or loss), exclusive of its interest income, allocable to California. The Commissioner has consented to the entry by the Board of an order requiring reductions in the proposed assessments in accordance with these revised computations. Except as to the treatment of interest, no objection to the revised figures has been expressed by the Appellant, so that the only question remaining for decision is the amount of interest income to be allocated to California.

The relevant provisions of the Bank and Corporation Franchise Tax Act are contained in Section 10 of the Act and are as follows:

> "..If the entire business of such bank or corporation is not done within this State, the tax shall be according to or measured by that portion thereof which is derived from business done within this State. The portion of net income derived from business done within this

> State, shall be determined by an allocation upon the basis of sales, purchased expenses of manufacturer, pay roll, value and situs of tangible property, or by reference to these or other factors, or by such other method of allocation as is fairly calculated to assign to the State the portion of net income reasonably attributable to the business done within this State and to avoid subjecting the taxpayer to double taxation."

It appears that the Appellant, a domestic corporation, is engaged in selling merchandise in California and in other states and that many of its sales are made under conditional sales contracts. During the years 1933, 1934 and 1935 the Appellant received interest in connection with these contracts in the amounts of $15,023.69, $19,529.47 and $25,931.86, respectively, and it is the Commissioner's position that these amounts, except to the extent that they were offset by the net losses otherwise attributable to California for the years 1933 and 1935 must be included in the measure of the tax. He has, accordingly in recomputing the measure of Appellant's tax deducted from Appellant's total net income for each year the amount of such interest income for that year, and the following proportions of the resulting figures have been allocated to California: For 1933, 69.4 percent, for 1934, 57.89 percent, and for 1935, 72.69 percent. To the amount thus allocated to California he has added the total amount of the interest income. The only justification offered by him for attributing the entire interest income to California is that the Appellant is a domesti corporation and that therefore the contracts have their situs for taxation in California and the interest on the contracts has its source in California. The Appellant, on the other hand, states that a portion of such interest income was derived from business done in Oregon and Washington, and in this connection explains that some of the contracts were for goods sold by its Oregon and Washington branches from stocks maintained in those states and that the payments of principal and interest on these contracts were collected by the branch offices and deposited in Oregon and Washington banks.

We believe that the action of the Commissioner cannot be sustained. Under the provisions of Section 10 of the Act, above quoted, there must be excluded from the measure of the tax all income attributable to business done outside the state (Matson Navigation Co. v. State Board of Equalization, 297 U.S. 441, 446). In our opinion the Commissioner has ignored the important fact that the negotiation of the conditional sales contracts constituted an integral part of Appellant's merchandis ing activities, a portion of which-took place outside the state. Under these circumstances the interest must be regarded as having-been derived in part from business done outside California, and the fact that the contracts may have been subject to property taxation exclusively in California is immaterial. Inasmuch as the record discloses no facts indicating the greater accuracy of any other method, we believe that the interest should be allocated to sources within and without California on

the same basis as the balance of Appellant's income.

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 protests of the Marcus-Lesoine, Inc. to proposed assessments of additional taxes in the amounts of $441.02, $1,526.69 and $1,027.33, based upon the income of said corporation for the years ended December 31, 1933, December 31, 1934, and December 31, 1935, respectively, be and the same is hereby modified. The said Commissioner is hereby directed to revise said assessments by means of a computation that recognizes as Appellant's total net income for said years the amounts of $4,735.98, $27,014.18 and $12,096.62, respectively, and that allocates to California 69.4 percent, 57.89 percent and 72.69 percent, respectively, of such amounts.

Done at Sacramento, California, this 15th day of November, 1939, by the State 'Board of Equalization.

Fred E. Stewart, Member
George Reilly, Member
Harry B. Riley, Member

ATTEST: Dixwell L. Pierce, Secretary