



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
FRESNO DRY GOODS CO., INC.)

Appearances:

For Appellant: Milo Rowell, Jr., Attorney

For Respondent: James J. Arditto, Franchise Tax Counsel;
William L. Toomey, Assistant Franchise Tax
Counsel .

O P I N I O N

This appeal is made 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 protest of Fresno Dry Goods Co., Inc., to his Proposed assessment of additional taxes in the amount of \$218.06 for the income year ending January 31, 1938.

The sole question involved on this appeal concerns the propriety of the action of the Respondent in disallowing a portion of a deduction for salaries paid Appellant's two officers and sole stockholders to the extent of reducing the total salaries paid such officers from \$7,000 to \$3,500. The Appellant is a foreign corporation, conducting a **retail** department store in the City of Fresno in this State. During the income year in question, Samuel **Sinsheimer**, the vice-president, received a similar salary. Both are residents of New York, and each owns one-half of the corporation's outstanding stock. The Commissioner has taken the position that the amounts paid as salaries to the extent that they exceed \$1,750 in the case of each officer did not represent "....a reasonable allowance for salaries or other compensation for personal services actually **rendered....**" within the **meaning** of Section 8(a) of the Act. He has, therefore, disallowed the **balance** of the deduction, and based his proposed assessment upon that determination.

In addition to the store in Fresno, the Appellant maintains an office in Brooklyn, New York, where the two officers have their headquarters. Purchases are made there and shipped to the Fresno store. A bank account is maintained in New York for the payment of purchases at the Eastern office and for other expenses and a local account is kept at Fresno for paying local purchases and expenses. The business is entirely under the supervision of the two officer;, and daily reports of sales, purchasing requirements and monthly reports of trial balances and other data, are submitted to the **Eastern** office where a coordinating system of books is maintained.

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The employees at Fresno follow out the policies as outlined by the officers of the corporation, and those officers otherwise manage the business of buying, budgeting, preparing reports, and performing such other acts as are necessary for the proper conduct of the business. It appears also that Samuel Sinsheimer devotes the major portion of his time and Zelda Seigel her entire time in the active conduct of the company's business.

Respondent has taken into account the fact that the payment of salaries to the two officers has always been equal and in direct proportion to their stock ownership in the company, and the further fact that no dividends have ever been paid by the company over a period of nine years. He concludes that the salaries paid to the two officers as stockholders have amounted to a distribution of corporate earnings in lieu of dividends. In his brief, Respondent also takes the position that the total buying expenses of the company appear excessive for an organization such as the Appellant and that the officers are but part-time employees of the company.

In the light of the facts presented in this case, we have concluded that the deductions claimed by the Appellant were proper and should have been allowed by the Respondent. The evidence discloses that the officers are not mere part-time employees of the Appellant; that one of them devotes her entire time to the business of the Appellant; and that both of the officers manage the entire operations of the company and do not confine their activities merely to making purchases in New York.

Even if it were true in this case that the two officers devoted all of their activities to buying for the company, and even if the company's buying expense appears excessive when compared with other mercantile organizations, we believe this is a matter of company policy to be determined for itself. It is well known that in the merchandising business success or failure depends to a large extent on buying activity.

It is, of course, true that a corporation will not be permitted to avoid the payment of taxes by distributing profits to its stockholders under the guise of compensating them for services rendered, and that the payment of salaries in proportion to the stock ownership of the recipients is sometimes considered as indicating that the payments are in fact distributions of earnings. General Water Heater Co. vs. Commissioner, 42 Fed. (2d) 419; Am-P-rage Battery Co. vs. Commissioner, 35 Fed. (2d) 167 Nevertheless, we believe that in this case it is not unreasonable to assume that the two officers contributed equally to the success of the business enterprise and we do not regard particularly significant the fact that their salaries and their stock ownership were proportionate. We are of the opinion that the salaries paid were not unreasonable and that the entire amount thereof constituted proper deductions from gross income.

O R D E R

Pursuant to the views expressed in the opinion of the Board on

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file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED that the action of Charles J. **McColgan**, Franchise Tax Commissioner, in overruling the protest of Fresno Dry Goods Co., Inc., to a protest assessment of an additional tax in the amount of ~~\$~~**128.06** for the income year ending January 31, **1938**, pursuant to Chapter **13**, Statutes of 1929, as amended, be and the same is hereby reversed. Said ruling is hereby set aside, and the said Commissioner is hereby directed to proceed in conformity with this order.

Done at Los Angeles, California, this 18th day of June, **1943**,
by the State Board of Equalization.

R. E. Collins, Chairman
J. H. Quinn, Member
George R. Reilly, Member
Wm. G. Bonelli, Member

ATTEST: Dixwell L. Pierce, Secretary