48-SBE-014

BEFORE THE STATE BOARD OF E QUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
GREAT WESTERN CORDAGE, INC.)

Appearances:

For Appellant : Pillsbury, Madison and Sutro, Attorneys at Law

For Respondent: W. M. Walsh Assistant Franchise Tax Commissioner; James J. krditto, Franchise Tax Counsel, Hebard P. Smith, Associate Tax Counsel

O P I N I O N

This appeal originally was 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 on the protest of Great Western Cordage, Inc., to a proposed assessment of additional tax in the amount of $63.74 for the taxable year ended December 31, 1939. The Appellant subsequently having paid the amount of the additional tax, the appeal is to be considered, pursuant to Section 27 of the Act, as one from the denial of a claim for refund.

Appellant, a Nevada corporation, was engaged during the year 1938 in the manufacture and sale of rope and cordage, its manufacturing establishment and principal office being located in California and its products being sold in California and other states. Sales of its products to purchasers outside of California were made exclusively through Schermerhorn Bros. co., an independent firm. Deliveries to customers on such sales were made from stocks of merchandise owned by and maintained at the risk of Appellant in warehouses of Schermerhorn Bros. Co. or in independent warehouses outside this state. Title to the goods comprising such stocks at all times prior to sale remained in Appellant, and sales made by Schermerhorn Bros. Co. were made in Appellant's name and billed upon Appellant 's invoices. Checks in payment for goods so sold were made payable to Appellant and delivered to Schermerhorn Bros. Co,, which was authorized to deposit these checks in a special account for Appellant. Remittances from this account were mailed to Appellant monthly by Schermerhorn Bros. Co. in the total amount received from sales less the commissions payable to it for its services to Appellant. Schermerhorn Bros. Co. did not deal exclusively in Appellant's products, but sold goods of other firms as well.

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In its return of income for 1938 Appellant prodeeded on the basis that it was carrying on business within ahd without California and allocated a portion of its net income to this State, under Section 10 of the Act, through the use of the three-factor formula of property, payroll and sales. The Commissioner determined that its income was attributable solely to sources within this State and, accordingly, levied a proposed assessment measured by its entire net income. He subsequently conceded, however, that Appellant is entitled to allocate a portion of its income to sources outside California through the use of the property factor of the allocation formula, but continued to assert that its payroll and sales are attributable wholly to this State.

In support of its position that its activities were conducted in such a manner as to entitle it to determine its income from California sources through the use of the payroll and sales as well as the property factor, Appellant contends that Schernerhorn Bros. Co. was acting as its agent as respects the out-of-state sales in that the firm in its dealings with purchasers of Appellant's products acted for and on behalf of Appellant. By virtue of this agency, Appellant argues, it engaged in business outside California.

The decision in Irvine Company v. McColgan, 26 Cal. 2d 160, compels, in our opinion, the rejection of the Appellant's position. That case stands for the proposition that the sale outside California through independent brokers or factors of goods produced in California, deliveries being made from stocks maintained by the producing corporation in warehouses in other states, does not constitute doing business outside this State by that corporation within the meaning of Section 10 of the Bank and Corporation Franchise Tax Act as amended in 1935 (Stats. 1935, p. 965). While this appeal involves the application of that Section as amended in 1939 (Stats. 1939, p. 2944), the grounds of the decision are determinative of the present controversy.

The Court pointed out in the course of its opinion that "Transactions engaged in for a foreign corporation in a state are not necessarily engaged in by the corporation in that state" and that ".. . although factors or commission merchants are agents, it has been held that their activities in a state do not constitute the doing of business therein by the foreign principals they represent within the purview of statutes imposing franchise or license taxes." 26 Cal. 2d 165. The Court concluded that ". . . a corporation transacting business in this state is not doing business outside of the state within the meaning of Section 10 of the Bank and Corporation Franchise Tax Act, by virtue of the fact that its products are sold from warehouses in other states by independent brokers." 26 Cal. 2d 168.

Although prior to the 1939 amendment income could be allocated to other states only if the corporation was doing business outside California, whereas after the amendment an alloca-

tion could be made if income was derived from or attributable to sources without the State, the Irvine case, we believe, establishes that sales made outside California of Appellant's products by independent brokers, under the circumstances above described, are not sales made by Appellant outside this State even though the brokers are acting as agents of Appellant. So far as activity outside California by Appellant is concerned, the sales made for it in other states by the independent brokers were not made by it in those states. From the standpoint of the source of income, as well as that of doing business, activity by it outside California is to be distinguished from activity for its account outside California by independent brokers,

So far as the payroll factor of the formula is concerned, there is similarly no basis for the allocation to other states of any portion of the salaries or commissions paid by Appellant. In any event, Schermerhorn Bros. Co. being an independent broker rather than an employee of Appellant, the commissions paid to it for its services are not to be regarded as payroll expenditures. The activities for which the commissions were paid were not activities performed by Appellant and the commissions were not paid because of activities of Appellant outside California. The action of the Commissioner in refusing to regard any portion of Appellant% sales or payroll as attributable to other states must, therefore, be sustained.

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 Chapter 13, Statutes of 1929, as amended, that the action of Chas. J. McColgan, Franchise Tax Commissioner, on the protest of Great Western Cordage, Inc,, to a proposed assessment of additional tax in the amount of $63.74 for the taxable year ended December 31, 1939, that action to be regarded as the denial of a claim for refund in said amount for said year in view of the payment of the tax subsequent to the filing hereof, be and the same is hereby modified. The Commissioner is hereby directed to measure the tax liability of said Great Western Cordage, Inc., for said year by its net income derived from or attributable to sources within this State, determined by an allocation wherein there is assigned to California the value of the tangible property of said Great Western Cordage, Inc., having a situs in this State and all its sales and payroll, and to refund the balance of said tax to it.

Done at Sacramento, California, this 22d day of April, 1948, by the State Board of Equalization,

Wm. G. Bonelli, Chairman
George R. Reilly, Member
3. H. Quinn, Member
Jerroid L. Seawell, Member
Thomas H, Kuchel, Member

Attest: Dixwell L. Pierce
Secretary