



BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )  
 )  
WATSONVILLE FROZEN FOOD LOCKERS, INC.)

Appearances:

For Appellant: D. O. Colegrove, President  
of Appellant; S. D. Kniffin,  
Public Accountant

For Respondent: Burl D. Lack, Chief Counsel;  
Crawford H. Thomas, Asso-  
ciate Tax Counsel; Hebard P.  
Smith, Associate 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 (now succeeded by the Franchise Tax Board) on the protests of Watsonville Frozen Food Lockers, Inc., to proposed assessments of additional tax in the amount of \$365.92 for the income year ended September 30, 1945 (taxable years ended September 30, 1945 and 1946), and in the amount of \$46.85 for the income year ended September 30, 1946 (taxable year ended September 30, 1947).

Appellant, a California corporation, commenced operations in the frozen food locker business in California on October 1, 1944, and continued to engage in that business during the years involved herein. It rented refrigerated lockers for an annual charge payable in advance. A person to whom a locker was rented was entitled to store food in the locker throughout the rental period, Appellant during that time being obliged to perform the services necessary for the maintenance of the locker. If a customer desired to discontinue the rental prior to the end of the rental period, he could do so and thereupon he became entitled to a refund of the unearned portion of the charge paid by him.

Appellant kept its books and reported its income on the accrual basis of accounting. It did not consider the charges paid to it in advance as income until they had been earned and, therefore, it did not report for the income year ended September 30, 1945, advance payments received during that year of \$5,381.28. Similarly, for the income year ended September 30, 1946, advance payments received in the amount of \$2,848.25 were not reported as income. The Commissioner, however, regarded the advance payments as income for the year in which they were received and made his proposed assessments accordingly.,

Appellant has referred to certain conditions imposed by the

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War Foods Administration for the granting of the necessary priorities for the construction of its plant, It appears that the Administration required that at least 60% of the lockers be rented, that one year's advance rental be received by Appellant and that those payments be placed in escrow before the priorities would be granted. We have not been informed as to the period of the escrow and it has not been alleged by Appellant that it did not become entitled to the use of the advance payments during the year in which they were received, subject, of course, to the right of a customer to receive a refund of a pro rata portion Of the payment if he relinquished the locker before the end Of the year.

Section 12 of the Bank and Corporation Franchise Tax Act, during the years involved herein, provided in part as follows:

"The net income shall be computed upon the basis of the taxpayer's annual accounting period, fiscal year or calendar year as the case may be, in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of said commissioner does clearly reflect the income..."

Appellant contends that its books were kept according to "good, sound and generally accepted accounting principles" and that they properly reflected its income for tax purposes. Its position, however, is not supported by the authorities.

It has frequently been held under the comparable provision of the Federal law (Section 41 of the Internal Revenue Code) that advance payments of various types are includible in income for the year in which they are received even though the recipient reports on the accrual basis. Capital Warehouse Co., Inc. v. Commissioner 171 Fed. 2d 395; South Dade Farms, Inc. v. Commissioner, 138 Fed. 2d 818; National Airlines, Inc., 9T.C. 159; Your Health Club, Inc., 4 T.C. 385; South Tacoma Motor Company, 3T.C. 411.

Appellant contends that this rule refers only to the rental of tangible assets (such as land, buildings or equipment), the possession of which is transferred for a given period of time, and that it does not apply where the prepayment consists more of a payment for services (in this case maintaining proper temperature in the coldroom, keeping the storage space clean and sanitary, etc.). Here, again, the contention is not supported by the decisions. In Capital Warehouse Co., Inc. v. Commissioner (advance payments to cover cost of removing goods from warehouse at the end of the storage period), National Airlines, Inc. (proceeds of advance sales of airplane transportation not yet furnished), South Tacoma Motor Co. (receipts from sales of automobile service coupon books) and Your Health Club, Inc. (receipts from one-year contracts for furnishing health and sport facilities), the advance payments were for personal services

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and were held income in the year received regardless of whether the service was to be performed in a subsequent year. The action of the Commissioner must, accordingly, 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 Section 25 of the Bank and Corporation Franchise Tax Act, that the action of the Franchise Tax Commissioner (now succeeded by the Franchise Tax Board) on the protests of Watsonville Frozen Food Lockers, inc., to proposed assessments of additional tax in the amount of \$365.92 for the income year ended September 30, 1945 (taxable years ended September 30, 1945 and 1946), and in the amount of \$96.85 for the income year ended September 30, 1946 (taxable year ended September 30, 1947), be and the same is hereby sustained.

Done at Los Angeles, California, this 3rd day of October, 1950, by the State Board of Equalization.

Geo. R. Reilly, Chairman  
J. I-I. Quinn, Member  
J. L. Seawell, Member  
Wm. G. Bonelli, Member

ABSENT: H. S. Wahchaftig, Acting Secretary