BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal)
)
of)
)
FARMERS UNDERWRITERS ASSOCIATION)

Appearances:

For Appellant: Dempsey, Thayer, Diebert & Kumler, Attorneys at Law

For Respondent: Hebard P. Smith, Associate Tax Counsel

O P I N I O N

This appeal is 'made pursuant to Section 25666 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of Farmers Underwriters Association to proposed assessments of additional tax in the amounts of $4,401.31, $2,853.58, $6,437.06 and $1,399.35 for the income years 1945, 1946, 1947 and 1948, respectively.

Appellant, a Nevada corporation, is engaged in selling insurance as attorney-in-fact for the Farmers Insurance Exchange. It owns a substantial amount of property within and without the State, consisting principally of land and buildings, furniture, office equipment and supplies and motor vehicles used in its business of selling insurance. Its principal office and a division office are located in California. The California division has charge of activities.in

California, Nevada, Arizona, Utah and New Mexico. In each of these states Appellant is represented by state and district agents who function in a supervisory capacity. The actual selling is done by Appellant's salaried employees and certain local agents who are compensated on a commission basis. The local agents are appointed by Appellant, Truck Underwriters Association and Fire Underwriters Association acting in their own behalf and as attorneys-in-fact for the Farmers Insurance Exchange, Truck Insurance Exchange and Fire Insurance Exchange, respectively. The appointment agreement stipulates that the associations shall pay commissions and bonuses on business produced and claims settled by the agent, and provide "Ad-aid" assistance, the nature of which is not elaborated upon, and group life insurance for the agent. The agent agrees to produce satisfactory business, to represent no other'insurer without the Association's consent, to -conform to the rules of the Associations, Exchanges and the District Agent, to service policies diligently, maintain adequate records available to representatives of the Associations, and to surrender materials relating to the business of the Exchanges or Associations on demand. The agreement further provides for cancellation on 30 days notice by either party, and for nomination of a successor by the agent or his heirs or representatives in the event of termination of the agency, such nominee to be given first consideration by the Associations. The agent or his heirs or representatives may negotiate with the

nominee for reasonable compensation for the value of the nomination and good will of the agency. Finally, the agreement states that:

> "Nothing contained herein is intended or shall be construed to create the relationship of employer and employee. The time to be expended by the Local Agent is solely within his discretion and the persons to be solicited and the area within the District involved wherein solicitation shall be conducted is at the election of the Local Agent. No control is intended to be exercised by the Associations over the time when, the place where, or the manner in which the Local Agent shall operate in carrying out the objectives of this agreement provided only that they conform to normal good business practice.:?

It does not appear that the offices of the local agents are maintained by Appellant. Insurance solicited by the local agents is subject to Appellant's approval in California, and the policies are issued by Appellant from California.

For the years involved in this appeal Appellant filed its franchise tax return reporting income earned in California by means of an allocation formula using the two factors payroll and sales. Included in the payroll factor were commissions paid to local agents appointed under the agreement described above, and included as out of State sales in the sales factor were Appellant's commissions on insurance solicited from out of State residents on out of State property by such agents located out of State.

Respondent re-allocated the income, using a three factor formula of property, payroll and sales. It excluded from the payroll factor commissions paid to local agents

and treated Appellant's income from sales of insurance by local agents as California sales in the sales factor. This action resulted in the deficiency assessments which are the subject of this appeal.

In Irvine Co. v. McColgan, 26 Cal. 2d 160, and El Dorado Oil Works v. McColgan, 34 Cal. 2d 731, it was held that sales outside California through independent brokers or factors of goods produced in California did not constitute doing business outside this State by the producing corporation within the meaning of Section 10 of the Bank and Corporation Franchise Tax Act as amended in 1935. Although Section 10 was amended in 1939 (Stats. 1939, p. 294.4) to provide that if income is derived from or attributable to sources both within and without the State the tax shall be measured by net income derived from or attributable to sources within this State, whereas before the amendment the tax had been measured by that portion of net income derived from business done in this State, we believe the reasoning in those decisions to be applicable to the present controversy. From the standpoint of the source of income, as well as that of doing business, the activity of Appellant outside California is to be distinguished from activity outside California on its behalf by independent agents. (See the Opinion of this Board in Appeal of Great Western Cordage, Inc., decided April 22, 1948.)

In support of its position that the Irvine and El Dorado Oil Works decisions are not determinative of the

present controversy Appellant attempts to distinguish between insurance agents and independent brokers engaged in making sales of tangible property, both as to 'the nature of their respective sales activities and their status as agents. While it is true that sales of insurance differ somewhat from sales of tangible goods, the agreement by which Appellant appoints its local agents establishes, in our opinion, their status as independent agents engaged in the conduct of their own businesses. Furthermore, it may be pertinent to note that Appellant is not an insurance company and does .not sustain the liability of an insurer on the policies sold. In any event, the activities of independent local agents in soliciting sales of insurance are not identifiable as activities of the Appellant. We conclude, accordingly, that these decisions require us to sustain the Franchise Tax Board on this issue.

In the Appeal of Great Western Cordage, Inc., supra, we held that commissions paid to an independent broker, even though the broker was acting as agent, were not to be regarded as payroll expenditures. Arguments to the contrary presented by this Appellant do not convince us that our previous determination of this issue was erroneous. The Appellant's contention regarding the payroll status of sales commissions paid to local agents who are not employees must, accordingly, be rejected.

Appellant's contention that the property factor should not be utilized in determining net income allocable

to this State is based on the grounds that it is a service corporation, that Respondent does not customarily use this factor in allocating the income of such corporations, and that to do so in this case distorts the income allocable to this State. Respondent points out, however, that the omission of the factor in other cases is based on the fact that only a small amount of property is ordinarily used in a service type of business. The factor was applied in this case in view of the fact that a large amount of property was used by Appellant in the production of income. We do not believe it may be said under these circumstances that the inclusion of the factor violated the provisions of Section 10 or that it resulted in the taxation of extra-territorial values. Consequently, we must sustain the Respondent.

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 25667 of the Revenue and Taxation Code, that the

action of the Franchise Tax Board on protests of Farmers Underwriters Association to proposed assessments of additional tax in the amounts of $4,401.31, $2,853.58, $6,437.06 and $1,399.35 for the income years 1945, 1946, 1947 and 1948, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 18th day of February, 1953, by the State Board of Equalization.

Wm. G. Bonelli, Chairman

J. H. Quinn, Member

Paul R. Leake, Member

Geo. R. Reilly, Member

, Member

ATTEST: Dixwell L. Pierce, Secretary