



58-SBE-043

CEH 200-951
PH 13, 186

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of }
MARCO INDUSTRIES COMPANY }

Appearances:

For Appellant: Robert N. Gold, Attorney at Law

For Respondent: Jack Rubin, Junior Counsel

O P I N I O N

This appeal is made pursuant to Section 26077 of the Revenue and Taxation Code from the action of the Franchise Tax Board in partially denying, in the amount of \$1,207.99, the claim of Marco Industries Company for refund of franchise tax for the income year ended March 31, 1952.

Appellant is a California corporation engaged in the business of manufacturing aircraft parts. It commenced doing business in February of 1948 and showed a profit in the 1948, 1949, 1950 and 1951 income years. It did not, in any of those years, pay a dividend to either of its shareholders. Appellant is managed by V. A. Marco, its President, and J. K. Harter, its Secretary-Treasurer, each of whom own 50 per cent of the stock.

On March 31, 1950, Appellant's board of directors adopted the following resolution providing for the method of computing the salaries to be paid its President and Secretary-Treasurer:

Resolved: That from and after April 1, 1950, and thereafter until changed by action of the board of directors of this corporation, that the President and Secretary-Treasurer of this corporation shall receive, respectively, as a monthly compensation, the sum of \$2,000 and \$1,000 respectively, and as additional compensation for each fiscal year, the President and Secretary-Treasurer of this corporation shall receive, respectively, amounts equal to fifteen per cent (15%) and ten per cent (10%) of the net profits of the corporation in excess of the sum of \$100,000 for such fiscal year as computed before deduction for taxes."

Appeal of Marco Industries Company

For the income year ended March 31, 1952, Appellant's net income, before deduction of the officers' salaries, was computed to be \$256,799.56. The aggregate compensation of each officer as computed under the resolution was \$42,119.93 for the President and \$24,079.96 for the Secretary-Treasurer. These salaries were paid to the officers and deducted from net income, leaving \$190,599.67 upon which franchise tax was paid,

Two years later, the Federal Government, acting pursuant to the Federal Renegotiation Act, decreased Appellant's sales for the income year ended March 31, 1952, by \$112,580.00. Appellant filed a claim for refund of franchise taxes based upon the net income reduction which resulted from the action of the Federal Government. The Franchise Tax Board reduced Appellant's net income by \$122,580.00. Then, in view of the reduction in income, it disallowed the deduction of \$30,199.89 in officers' salaries as being excessive under the above-quoted resolution.

The statutory provision governing the deductibility of salaries for the year in question was Section 24121a of the Revenue and Taxation Code (now Section 24343), which allowed the deduction of:

"All the ordinary and necessary expenses paid or incurred during the income year in carrying on business, including a reasonable allowance for salaries or other compensation for personal services actually rendered, . . ."

Appellant contends that the issue is whether the resolution "did or did not permit of a payment of additional compensation based upon net profits of the corporation prior to renegotiation". Even if the issue is as narrow as the Appellant contends, it cannot prevail in this appeal. When a taxpayer seeks to recompute its net profit for tax purposes, it would be anomalous to use the recomputation for a tax benefit and ignore it where a tax detriment will result. Although it may be true, as Appellant argues, that net profit for one purpose need not be the same as net profit for another purpose, we have not been presented with a convincing reason for holding in this matter that net profit for reporting income is different from net profit for determining officers' salaries.

We do not believe, in any event, that the issue may be phrased so narrowly. Rather, as in the case of any deduction allowed by the Legislature, the issue is whether the taxpayer has brought itself within the terms of the applicable statutory provision. Here, therefore, the question is whether

Appeal of Marco Industries Company

the deduction claimed by Appellant represents a reasonable allowance for compensation, And where the taxing authority determines that compensation paid by a taxpayer is excessive, such determination is presumptively correct and the burden of proof rests upon the Appellant to establish the reasonableness of the salary payments. Crescent Bed Co., Inc. v. Commissioner of Internal Revenue, 133 Fed. 2d 424.

Appellant states that the Renegotiation Board and the Internal Revenue Service decided that the salaries paid were reasonable, We have found no statement in either the Report of Renegotiation or the Renegotiation Agreement that the salaries were reasonable and Appellant did not submit a copy of the report of the Internal Revenue Service. Moreover, there has been no evidence presented respecting the duties actually performed by the officers or the prevailing rate of compensation paid by other firms for comparable services. In the absence of such evidence we are unable to conclude that the Franchise Tax Board acted unreasonably in reducing the allowable deduction for salaries to \$36,000.00.

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 26077 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in partially denying in the amount of \$1,207.99, the claim for refund of Marco Industries Company for the income year ended March 31, 1952, be and the same is hereby sustained,

Done at Sacramento, California, this 7th day of November, 1958, by the State Board of Equalization.

Geo. R. Reilly Chairman

J. H. Quinn, Member

Robert C. Kirkwood, Member

_____, Member

_____, Member

ATTEST: Dixwell L. Pierce, Secretary