59-SBE-040

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
THE UNITED STATES SHOE CORPORATION)

Appearances:

For Appellant: Richard E, Guggenheim, Attorney at Law

For Respondent: Burl D. Lack, Chief Counsel; Crawford H. Thomas, Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to Section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of The United States Shoe Corporation to proposed assessments of additional corporation income tax in the amounts of $112.18, $161.70, $257.52, $260.32, $413.27, $914.53 and $1,387.51 for the years ended November 30, 1945, 1946, 1947, 1948, 1949, 1954 and 1955, respectively.

Appellant, an Ohio corporation with its'principal place of business and manufacturing plants in Cincinnati, Ohio, is engaged in the business of manufacturing and selling women's shoes under the brand name of "Red Cross Shoes." The shoes are sold to merchants whom Appellant has designated as franchise holders authorized to sell the shoes at retail. Appellant has approximately 75 such customers in Caiifornfa. These customers purchase "make up" shoes, which Appellant manufactures according to specifications by the customers, and "stock" shoes, which are maintained in inventory in Cincinnati. The sales of "make up" shoes constitute approximately 80 percent of Appellant's total sales. During the years involved, Appellant had two salesmen in California.

Three California customers, The May Company, The Emporium and Streicher's, are treated in the manner described in the following statement by the Appellant:

> "These accounts are not handled by our salesmen, but are exclusively and personally handled by Mr, A. B. Cohen, the President of this corporation, who of course resides in Cincinnati, The actual sales of make up shoes

to these customers are almost entirely made at meetings with the buyers from those stores outside of the state of California, either in New York City or occasionally in Cincinnati. At those meetings the purchasing program for those stores are laid out, and generally the orders are written up, Orders for stock shoes from these customers are made by them individually by mail direct to Cincinnati. They are solicited by no one except Mr. Cohen, Mr. Cohen does make two trips each year to California during which he calls upon executives of these customers. These trips are devoted to a discussion of advertising and promotion, planning, business problems and the promotion of good will, and are made for the purpose of maintaining a close personal relationship. With reference to the Emporium in San Francisco, it should be stated that this store receives visits at the end of each season from one of our salesmen who lives in San Francisco to display new shoes that have been put in the line, These visits are made at the instruction of Mr. Cohan and the San Francisco salesman does not himself sell any shoes, Subsequently, Mr. Cohen recommends to the Emporium what shoes he believes they should buy, and they later write up the orders based upon his recommendations, and forward them to Cincinnati, The Emporium also writes some of its schedules following Mr. Cohen's visits and forwards these to Cincinnati where the orders are actually written.

"There are no commissions whatsoever paid on the sale of shoes, whether stock or make up, to these particular customers. "

In filing its returns, Appellant computed the sales factor of the allocation formula by regarding sales to The May Company, The Emporium and Streicher's as out-of-California sales. Respondent's proposed assessments are on the basis that 50 percent of such sales are California sales.

Appellant contends that the activities of Mr. Cohen in California are not selling activities for the purpose of the sales factor but -that the sales factor should be based solely on its -activities relating directly and immediately to purchase orders. It argues with respect to the three accounts in question that only its activities in Cincinnati

an New York through which it displays shoes to buyers and assists them in making decisions constitute sales activities for purposes of the sales factor,

The following remarks from our opinion in the Appeal of Avco Manufacturing Corporation, this day decided, are applicable here:

> "It is well established that the Franchise Tax Board has the authority, within reasonable limits, to originate and prescribe the formula to be used for the allocation for tax purposes of income of a corporation deriving income from sources within and without the State (El Dorado Oil Works v. McColgan, 34 Cal. 2d 731, app. dism. 340 U.S. 801, 885; Pacific Fruit Express Co. v. McColgan, 67 Cal. App. 2d 93). Such authority necessarily carries with it the authority to define the factors used in the formula. The Franchise Tax Board has defined the sales factor in Regulation 24301, Title 18 of the California Administrative Code, in part as follows:
>
> > 'The sales or gross receipts factor generally shall be apportioned in accordance with employee 'sales -activity 0f the taxpayer within and without the State ... Promotional activities of an employee are given some weight in the sales factor.'
>
> "The purpose of the sales factor in the allocation formula has been described by eminent authorities as being to serve as a balance against the other factors of property and payroll and to give recognition to the efforts of the taxpayer in obtaining customers and markets (Final Report of the Committee on Tax Situs and Allocation, 1951 Proceedings of the National Tax Association, p. 463; Altman & Keesling, Allocation of Income in State Taxation, Second Edition, 1950, p. 126). As Altman & Keesling put it:
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> > 'With this exception [that sales should not be apportioned to states or countries where the taxpayer is engaged in neither inter nor intrastate activities] sales should, so far as possible,

> be apportioned to the state where the markets are found, from which the business is received, or where the customers are located.' (Op. cit. p. 128.)"

Although the Appellant points out that Regulation 24301 (supra) was adopted in 1952, after most of the years here in question, we see no basis for concluding that the approach of the Franchise Tax Board must be different with respect to those years. If the approach is reasonable after 1952, it is no less reasonable for prior years when there was no specific regulation with respect to the sales factor.

Sales of Appellant's shoes to the three customers in question have been made the exclusive responsibility of Mr. Cohen. The ultimate objective of his trips to California is the sale of merchandise to these customers. Although Mr. Cohen does not receive purchase orders while here, it seems readily apparent that a substantial portion of the sales to these customers is the result of his regular bi-annual activities in this State. We cannot say that the Franchise Tax Board has abused its discretion in taking those activities into consideration for purposes of the sales factor of the allocation formula.

Appellant asserts that even if Mr. Cohen's activities may properly be reflected in the sales factor, a 50 percent figure is excessive. For the reasons stated above, we have concluded that a substantial portion of Appellant's sales to these three customers is the result of Mr. Cohen's activities in California. In the absence of detailed facts with respect to the time spent within and without the State by Mr. Cohen and other employees in the solicitation and promotion of such sales, we are unable to determine that the percentage selected by the Franchise Tax Board produces a disproportionate result.

Appellant also contends that Respondent erred in including in allocable unitary income the income from contracts with foreign manufacturers. Appellant owns the trade mark "Gold Cross Shoes" which is registered in foreign countries. Appellant entered into contracts with foreign manufacturers allowing them to manufacture "Gold Cross Shoes" and, provided them with technical and styling advice, advertising advice, specifications and sample patterns and lasts. In return, the licensees paid Appellant approximately 25 cents per pair of shoes manufactured.

A significant factor in determining whether a particular item of income is part of the unitary income in a case such

as this is whether the taxpayer's ability to furnish information, service, ad-vice and "know-how" to a licensee arose out of its unitary business. (See Appeal of International Business Machines Corp., decided October 7, 1954.) It is clear that the types of problems arising in the course of a licensee's business for which Appellant's advice is sought are the same types with which Appellant is familiar through its own shoe business. It follows, therefore, that the Income from the licensing agreements is merely income from the sale of experience accumulated in the course of the unitary business and that Respondent properly considered the income as arising out of the unitary business.

O R D E R

Pursuant to the views expressed in the Opinion of the Board on fiie 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 the protests of The United States Shoe Corporation to proposed assessments of additional corporation income tax in the amounts of $112.18, $161.70, $257.52, $260.32, $413.27, $914.53 and $1,387.51 for the years ended November 30, 1945, 1946, 1947, 1948, 1949, 1954 and 1955, respectively, be and the sarne is hereby sustained.

Done at Sacramento, California, this 16th day of December, 1959, by the State Board of Equalization.

Paul R. Leake, Chairman

Richard Nevins, Member

John W. Lynch, Member

George R. Reilly Member

_____ Member

ATTEST: Dixwell L. Pierce, Secretary