

In the **Matter** of the Appeal of
TRI-STATE LIVESTOCK CREDIT CORPORATION

For Appellant: Charles D. Sooy, Attorney at Law
For Respondent: John S. Warren, Associate Tax Counsel

This appeal is made pursuant to Section 25667 of the Revenue and Taxation Code from the **action** of the Franchise Tax Board on the protest of Tri-State Livestock Credit Corporation to proposed assessments of additional franchise tax in the amounts of \$169.15, \$2,334.24, \$1,243.73 and \$1,658.73 for the income years 1949, 1950, 1951 and 1952, respectively,

Appellant is a California corporation with its only office in San Francisco. During the years in question, it was engaged in the business of making loans to producers of livestock in California, Arizona, Nevada and Oregon. The loans were secured by **chattel mortgages on the** livestock of the borrowers. Occasionally Appellant took a mortgage or trust deed on real property as additional security.

Appellant had employees in the various states in which it made loans. These employees solicited the loans, appraised the security and prepared the applications which were sent to Appellant's office in San Francisco. The loan papers were prepared there and mailed to the borrowers for signing. All loan and interest payments were received by Appellant at its San Francisco office. Appellant obtained the funds which it lent by borrowing from the Federal Intermediate Credit Bank of Berkeley, pledging its loan paper and government bonds as security.

For the income years involved herein, Appellant computed the percentage of the total interest income which was paid by borrowers residing in California. It then deducted the same percentage of its total expenses to arrive **at the** California portion of net income from loans.

Respondent determined Appellant's taxable income from sources in **California** by applying an allocation formula to Appellant's total income. The formula consisted of three

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factors: (1) average value of outstanding loans; (2) payroll; and (3) interest income. The outstanding loans factor was used for Appellant's financial business in lieu of the tangible property factor used for manufacturing and mercantile businesses. Respondent included all of Appellant's loans as California loans; i.e., in the numerator of the first factor. The interest income factor was used in lieu of the sales factor used for manufacturing and mercantile businesses. For purposes of this factor, the interest income was assigned to the places where the employees solicited loans; generally, the amounts being assigned to the states in which the debtors resided.

Appellant contends that the inclusion of all outstanding loans as California loans is arbitrary and unreasonable and that either of the following two formulas should be applied: (1) a two-factor formula consisting of interest income and salaries; or (2) a three-factor formula employing the two factors used in (1) plus outstanding loans, provided that the allocation of outstanding loans be on the basis of the residence of the debtor.

Respondent states that, upon the theory that a loan has a business situs where it is serviced, the practice has been to apportion outstanding loans to the location of the taxpayer's office where this occurs. The assignment of Appellant's loans to California is consistent with this theory and practice. It recognizes the fact that the evidences of indebtedness are pledged here to obtain funds out of which such loans are made. The notes given to Appellant by its borrowers are assets used in California to enable the taxpayer to carry on its business both within and without the State.

The Franchise Tax Board has been given broad discretion to devise a formula for the allocation of income. (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.) 'By statute, the formula must be "fairly calculated" to determine the income from this State, (Section 25101 of the Revenue and Taxation Code, formerly Section 24301 of the Code and Section 10 of the Bank and Corporation Franchise Tax Act.) It has been recognized, however, that any method of allocation must be more or less arbitrary and fictitious and that rough approximation rather than precision is sufficient. (El Dorado Oil Works v. McColgan, supra.) One who attacks a formula of apportionment carries a distinct burden of showing by clear and cogent evidence that it results in extraterritorial values being taxed. (Butler Brothers v. McColgan, 315 U.S. 501.)

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The factor of "outstanding loans" reflects the capital employed in a loan business and is obviously an important income producing-element of **such** an enterprise. A loan is an intangible **thing** and as such, any assignment of it to a physical location must be more or less fictitious.

In assigning a **situs** to an intangible for tax purposes in general under the rule followed in this State, the location of the owner or the **use that he** makes of the intangible in his business is important, **not** the location of the **payor** or debtor. (Miller v. McColgan, 17 Cal. 2d 432.)

The Supreme Court of Oregon has approved the use of the factors of "outstanding loans" and "interest received" in allocating the income of a unitary loan business. (Beneficial Loan Society of Oregon v. State Tax Commission, 95 Pac. 2d 429.) In that case, there were offices in several states and the loans and the interest were assigned to the respective offices that made the loans and received the interest. No specific consideration was given to the location of the debtors.

A factor of "average monthly outstanding loan balances in the various offices in each state," in addition to a payroll factor, has been recommended by an economist for adoption by all states for use in an apportionment formula applicable to unitary personal loan companies. (John A. Wilkie, Apportionment for Unitary Finance and Insurance Businesses, 37 Taxes 940.) With respect to a commercial finance corporation, Mr. Wilkie recommends a formula composed of the factors of interest, to be assigned to the place where the interest is received, and payroll. At no point in this article does Mr. Wilkie indicate that the location of the borrower is significant in itself.

The formula used by the Franchise Tax Board does give effect to the location of the borrower indirectly through the two factors of interest received and payroll. In view of the authorities which we have considered, we cannot say that the formula is unreasonable because it does not also give effect to the location of the borrower in the factor of outstanding loans.

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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 in denying the protests of Tri-State Livestock Credit Corporation to proposed assessments of additional franchise tax in the amounts of \$169.15, **\$2,334.24**, **\$1,243.73** and **\$1,658.73** for the income years 1949, 1950, **1951** and 1952, respectively, be, and the same is hereby, sustained.

Done at Los Angeles, California, ~~this~~ 4th day of April, 1960, by the State Board of Equalization.

John W. Lynch, Chairman

George R. Reilly Member

Richard Nevins - _____, Member

_____, Member

_____, Member

ATTEST: Dixwell L. Pierce, Secretary