BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
AMERICAN SNUFF COMPANY)

Appearances:

For Appellant: Valentine Brookes, Attorney at Law

For Respondent: John S. Warren, 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 American Snuff Company to proposed assessments of corporation income tax in the amounts of $368.35, $442.41 $457.92 $463.07, $559.20, $699.98, $621.21, $730.43, $592.76, $612.61, $660.62, $1,218.67, $1,261.75, $1,252.96, $1 870.68, $1,771.64, $1,676.25, and $1,620.43 for the ye&s 1937 through 1954, respectively. Subsequent to the filing of the appeal Appellant paid the assessments for the years 1953 and 1954 and pursuant to Section 26078 of the Revenue and Taxation Code the appeals for those two years will be treated as appeals from denials of claims for refund.

Appellant is engaged in the business of manufacturing and selling snuff, The manufacturing is done in Tennessee and sales are made throughout the United States, Appellant sells its product to independent distributors in California who in turn sell to retailers. Appellant has full time employees in California whose primary function is to call on retailers to promote the sale of the merchandise produced by Appellant. The number of such employees has varied during the years in question but has never been less than two nor more than six. One of these employees is the division manager and he recruits and supervises the others as well as performing the regular duties of calling on retailers. The volume of Appellant's sales in this State increased from $118,530.26 in 1937 to $537,023.46 in 1953.

Appellant has no office or other place of business in California, Appellant supplies an automobile to each California employee at no cost to the employee, Each California employee carries in his automobile a small stock of the

merchandise produced by Appellant and makes some sales to retailers from this stock. He purchases such stock from a distributor at the same price the distributor would sell to a retailer, He sells to a retailer at cost. Appellant's records do not show the volume of sales to retailers by its California employees but it is estimated to be less than five percent of all shipments by Appellant into California.

Respondent has included in Appellant's unitary income subject to allocation amounts of interest income from sources described as follows:

Notes Receivable - Employees
Mortgages Receivable - Employees
Earned Discount - Group Insurance Premiums
Earned Discount - Retirement Income Plans

Appellant did not file California tax returns during the period in question. Upon demand of Respondent, however, Appellant filed returns in 1955 for each of the years 1937 through 1954. In 1955, subsequent to the filing of the returns, Respondent issued the notices of proposed assessment involved in this appeal,

The appeal presents four questions, namely:

(1) Whether the assessments or some of them are barred by a statute of limitations;

(2) Whether the application of the corporation income tax to Appellant is constitutional;

(3) Whether Public-Law 86-272 is applicable; and

(4) Whether the above-mentioned interest income should be included in unitary income subject to allocation.

1.

Appellant asserts that the limitation periods set forth in Part 2, Title 2 (Sections 312-363) of the Code of Civil Procedure are applicable to bar the assessments.

Section 312 of that code, however, provides:

"Civil actions, without exception, can only be commenced within the periods prescribed in this title, after the cause of action

shall have accrued, unless where, in special cases, a different limitation is prescribed by statute."

Sections 20 to 24 of the Code of Civil Procedure define a civil action as one of the classes of judicial remedies and define judicial remedies as those which "are administered by the Courts of justice, or by judicial officers empowered for that purpose by the Constitution and statutes of this State."

The Franchise Tax Board does not exercise judicial powers (Standard Oil Co. of California v. State Board of Equalization, 6 Cal. 2d 557) and therefore an assessment by the Franchise Tax Board is not a judicial remedy and is not a civil action. Accordingly, the various time limitations in Part 2, Title 2 of the Code of Civil Procedure are not applicable to an assessment by the Franchise Tax Board (Bold v. Board of Medical Examiners, 133 Cal. App. 23).

The only statutory limitation of which we are aware which could possibly apply to the assessments in question is that set forth in Section 25663 of the Revenue and Taxation Code. The limitation established by that section is that the notice of proposed assessment must be mailed within four years after the return was filed. In the present case the notices of proposed assessment were mailed only a short time after the returns were filed and well within the four year period.

2.

Appellant's argument that the application of the corporation income tax to it violates the United States Constitution is foreclosed for the reasons set forth in our opinion in Appeal of Dr. Posner Shoe Co., Inc., this day decided.

3.

A new Federal enactment, Public Law 86-272, became effective on September 14, 1959, and its applicability to this appeal is urged by Appellant. The new enactment denies power to a state to impose or assess a tax measured by net income from the sale of tangible personal property in interstate commerce under certain conditions. For purposes of this decision, we shall assume that these conditions prevail with respect to Appellant. The statute also provides in substance that a state may not collect a net income tax imposed on a person for a past period if the person's activities are such that the state could not impose the tax for future periods, except that the tax may be collected if it

was assessed on or before the effective date of the statute.

Appellant's contention is that the tax here in question will not be assessed until we determine in this appeal that an assessment should be made. In support of its position Appellantrelies on the fact that the Franchise Tax Board may not collect the tax until this Board's determination becomes final. It argues that the language in the Bank and Corporation Tax Law itself is not conclusive (Section 23043 defines "assessment" as including a proposed additional assessment), but that the word "assess" should be interpreted in such a manner as to obtain uniform application of the Federal act among all of the states.

The Federal act does not define "assess." Nothing in the committee reports or legislative history regarding the act indicates any special definition of the word. The ordinary and essential meaning of "assess," in so far as it is relevant to this matter, is to determine the amount of tax that is due from a particular person. Such a determination may be an assessment whether or not the determination is final. Thus, the dictionary defines the term as meaning "To fix or determine the rate or amount of." (Webster's New International Dictionary, Second Edition.) As stated by the United States Supreme Court:

> "Some machinery must be provided for applying the rule to the facts in each taxpayer's case, in order to ascertain the amount due. The chosen instrumentality for the purpose is an administrative agency whose action is called an assessment.
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> "In recognition of the fact that erroneous determinations and assessments will inevitably occur, the statutes, in a spirit of fairness, invariably afford the taxpayer an opportunity at some stage to have mistakes rectified. Often an administrative hearing is afforded before the assessment becomes final ..." (Bull v. U. S., 295 U.S. 247, 259, 260.)

In Commissioner v. Patrick Cudahy Family Co., 102 Fed. 2d 930, the court also recognizes that an assessment may exist prior to the time that the obligation to pay it becomes final.

There is a variety of terminology and procedure in the income tax laws of the various states. Common to all of these laws, however, is a provision for some official act by the taxing agency by which the amount of tax imposed by the law is determined. The time when this act becomes final and when the tax must be paid varies in the different states. Some method of review of the act at the instance of the taxpayer is ordinarily provided. The review may be by the taxing agency itself, by another administrative agency, by the courts or by all of these bodies. In some states the act may not become final so that the tax must be paid until after review by the supreme court of the state. In other states the tax must be paid prior to court review.

Under the foregoing circumstances, uniformity in the application of the Federal legislation will be best achieved by adherence to the commonly accepted view that the initial determination of a tax by the appropriate administrative agency constitutes an assessment. Moreover, we are of the opinion that if Congress had intended to permit only the collection of taxes the assessment of which had become final on or before the effective date of the Federal act it would have expressly so provided. Under the California statute the word "assessment" is defined to expressly include a proposed assessment of tax by the Franchise Tax Board. The protests of Appellant to the proposed assessments against it were denied by that Board long prior to the enactment of the Federal legislation. In our opinion, the taxes in question were "assessed" within the meaning of Public Law 86-272 prior to the crucial date of September 14, 1959.

4.

Appellant contends that interest income from loans to employees should not be considered as income from the unitary business and therefore subject to allocation within and without the State, but should be assigned entirely to Appellant's domicile outside of California. Respondent has included the interest in unitary income on the basis that the loans were made for the purpose of retaining employees, keeping them satisfied,--improving the quantity or quality of work, or obtaining new employees.

Respondent relies upon our previous decisions in Appeal of Marcus-Lesoine, Inc., Cal. St. Bd. of Equal., July 7, 1942 (P-H, St. & Loc. Tax Serv., Cal., ¶13,006); Appeal of Houghton Mifflin Co., Cal. St. Bd. of Equal., March 28, 1946 (P-H St. & Loc. Tax Serv., Cal., ¶13,060); Appeal of International Business Machines Corp., Cal. St. Bd. of Equal., Oct. 7, 1954 (CCH, 1 Cal. Tax Cases,

¶200-286), (P-H, St, & Loc. Tax Serv., Cal. ¶13,143). In those decisions we stated that income from intangibles is a part of the unitary income subject to allocation where the acquisition, management and disposition of the intangibles constitute integral parts of the owner's regular business operations. In each of those cases, the income was directly related to the activities of the unitary business. Here the loans which gave rise to the interest were made for the purpose of increasing the efficiency of the employees and they, accordingly, contributed to the operations of the unitary business. We are, therefore, of the opinion that the interest is includible in unitary income.

Appellant also contends that interest income which appears to have been received in the form of discounts on insurance and annuity premiums is not part of the unitary income. The premiums were deducted by Appellant from the unitary income. We believe that the discount should be included as a part of the unitary income since it would have been equally correct from an accounting viewpoint to regard the discount as a reduction of the premium expense rather than as a separate item of income. (Accountants' Handbook, 4th ed., Sec. 5.28,)

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 Sections 25667 and 26077 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protests of American Snuff Company to proposed assessments of corporation income tax in the amounts of $368.35, $442.41, $457.92, $463.07, $559.20, $699.98, $621.21, $730.43, $592.76, $612.61, $660.62, $1,218.67, $1,261.75, $1,252.96, $1,870.68, and $1,771.64 for the years 1937 through 1952, respectively, and the action of the Franchise Tax Board in denying claims of American Snuff Company for refund of corporation income tax in the amounts of $1,676.25 and $1,620.43 for the years

1953 and 1954, respectively, be and the same are hereby sustained.

Done at Sacramento, California, this 20th 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