

Appeal of Redding Moulding & Lumber Co., Ltd.

time she spent was substantial. The officers worked extraordinarily long days and worked seven days a week. The president and the vice president have been in this type of business for many years.

From October 15, 1955, to August 18, 1956, the minutes of the corporation authorized each officer to receive \$1,000 every two weeks. Prior to and subsequent to that period an average of \$750 every two weeks was authorized.

Appellant's sales, gross income, net income,, capital investment, and compensation paid (divided equally between the two officers) for the income years ended September 30, 1954, to September 30, 1957, were as follows:

<u>Year</u>	<u>Sales</u>	<u>Gross Income</u>	<u>Net Income</u>	<u>Capital Investment</u>	<u>Compensation Of Officers</u>
1954	\$314,314	\$ 58,862	\$14,941	\$14,993	\$18,956
1955		103,807			
1956	413,3618	119,713	17,4854	49,3101	28,080 50,100
1957	366,472 ,	87,238	12,779 ,	58,255 ,	30,600

Respondent, Franchise Tax Board, has allowed as a reasonable business expense the compensation paid to each officer in the amount of \$15,000, but has disallowed as a deduction the compensation paid in excess thereof as being unreasonable and constituting a distribution of earnings.

There is no fixed rule by which a reasonable allowance for compensation can be determined. What is reasonable is dependent upon the facts and circumstances of each particular case. (Mayson Mfg. Co. v. Commissioner, 178 Fed, 2d 115.) The burden is upon Appellant to prove that it is entitled to the deduction. (Botany Worsted Mills v. United States, 278 U. S. 282.)

The fact that the two officers received equal compensation while owning disproportionate stockholdings in Appellant supports the conclusion that Appellant was trying to fix reasonable compensation rather than distribute profits. (Mayson Mfg. Co., supra; Akeley Camera & Instrument Corp., 18 T. C. 1045; M. W. Parsons, Imports and Plymouth Organic Laboratories, Inc., T. C. Memo., Dkt. No. 3068, January 3, 1945; Schaberg-Dietrich Hardware Co., T. C. Memo., Dkt. No. 7813, March 5, 1947; Drilling and Service, Inc., T. C. Memo., Dkt. No. 51673, December 11, 1956.) In addition, the fact that there was a net income of \$17,485 remaining after the deduction for salaries for the year in question means that there was a 35 percent return realized on the invested capital of \$49,310. This constitutes a fair return on the invested capital, and also supports the conclusion that the

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compensation paid to Appellant's two officers was reasonable. (Klug & Smith Co., 18 B.T.A. 966; Olympia Veneer Co., 22 B.T.A. 892.) The evidence indicates that Mr. Berry and Mr. DeGiovanna were largely responsible for the success of Appellant, and that they worked early and late. The action of the board of directors in authorizing salaries for the period in question is entitled to the presumption that such salaries are reasonable and proper. (Mayson Mfg. Co. v. Commissioner, supra.)

Respondent alleges that \$15,000 for each officer is reasonable in view of salaries paid by similar firms, but has introduced no evidence to refute Appellant's contention that the testimony of its president that Appellant is unique and consequently that there are no similar concerns to look to in determining the reasonableness of the officers' compensation. But even if Appellant were not unique, due consideration must be given to the skill and experience of Appellant's two officers as well as the fact that they worked extraordinarily long hours.

Respondent argues that the compensation paid to Appellant's two officers in excess of \$30,000 was unreasonable in view of the failure to pay dividends, the annual fluctuation of salaries paid to the officers, and the increase of compensation without a corresponding increase of duties. The failure to pay dividends loses its significance in view of the fact that Appellant retained a fair profit on invested capital. The annual fluctuations of salaries without distinct increase in duties constitutes a basis for careful scrutiny but it alone is not conclusive since the issue remains whether the salaries paid were reasonable for the year in question.

Viewing the evidence in its entirety, we conclude that Appellant has shown that the entire salaries paid to its two officers during the income year ended September 30, 1956, were reasonable within the meaning of Section 24343.

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 the protest of Redding Moulding &

