BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
HAMMOND ORGAN COMPANY)

For Appellant: Devlin, Diepenbrock & Wulff, Attorneys at Law

For Respondent: Burl D. Lack, Chief Counsel; Israel Rogers, Junior 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 Hammond Organ Company to proposed assessments of additional corporation income tax in the amounts and for the fiscal years indicated:

Year ended	Amount
March 31, 1949	$ 449.70
" 1950	892.21
" 1951	1,908.33
" 1952	1,058.78
" 1953	2,198.09
" 1954	2,167.99
" 1955	2,956.69
" 1956	4,373.34

After this appeal was filed, Appellant paid the above amounts. Thus, in accordance with Section 26078 of the Revenue and Taxation Code, the appeal will be treated as from the denial of claims for refund.

Appellant is a Delaware corporation with its headquarters in Illinois. Its principal business is the manufacture and sale of electrical musical instruments.

Appellant had a western district representative who operated in California part of each year. He was paid a straight salary and his job was to promote and stimulate sales of Appellant's products. The representative lived in California. His territory consisted not only of California but also Oregon, Washington, Nevada, Arizona and the then territories of Alaska and Hawaii. He attempted to contact each franchised retail dealer, either by phone or in person, at least every ninety days and at least every thirty days in the case of the larger dealers. There

were 35 dealers in his territory, 17 of whom were located in California. For the most part the dealers were well established and experienced music stores or *were* large stores with specialized music departments. The representative spent approximately 20 percent to 30 percent of his working time in California.

Appellant had a sales promotional program on a national level which was planned in Chicago and transmitted directly to the dealers. Appellant did not underwrite or participate in the cost of local advertising campaigns. Appellant's representative did, however, contact the dealers and encourage the use of the sales methods and materials furnished by Appellant. The representative also conveyed any dealer criticism of the sales program to the Chicago office.

Appellant maintained no inventories in this State. All dealers ordered their merchandise directly from Appellant's main office in Chicago.

At Respondent's request returns for the years ending March 31,1949, to March 31,1953, were filed in August, 1955. The return for the year ending March 31,1954, was filed timely. The returns for the years ending March 31, 1955, and March 31, 1956, were filed in June, 1956.

In its returns for the years in question Appellant included none of its sales in the numerator of the sales factor of the allocation formula. Respondent included 25 percent of the sales to Appellant's distributors in California in the numerator of the sales factor, as sales attributable to this State. Other adjustments were also made. Notices of proposed assessment, based on these changes were issued in October, 1956. Appellant protested only the adjustment to the sales factor.

Appellant's contentions are as follows: There was no activity by Appellant within California except the promotional work of its western district representative. To attribute 25 percent of the sales made to the distributors in California to the activity of the representative is unrealistic. At most, his activity was responsible for 5 percent of the sales in California. Any greater amount of allocation would be a violation of Appellant's rights under the due process and equal protection clauses of the Fourteenth Amendment to the Constitution of the United States.

Respondent contends as follows: The presence of Appellant's representative in California had a substantial effect on sales in California. The purpose of the sales factor in the allocation formula is to give recognition to a taxpayer's efforts in obtaining customers and markets. The allocation of only 25 percent of sales to the efforts of Appellant's representative was

fair and reasonable. Appellant has the burden of proving by clear and cogent evidence that the formula as applied taxes extra-territorial values. Appellant has not met this burden.

The sole issue to be determined is the propriety of Respondent's action in attributing 25 percent of Appellant's sales to distributors in California to the activities of its representative in this State.

It is well established that the Franchise Tax Board has 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, appeal dismissed 340 U.S. 801, 885; Pacific Fruit Express Co. v. McColgan, 67 Cal. App. 2d 93.)

The Franchise Tax Board has provided that the promotional activities of a representative are to be given some weight in the sales factor of its three-factor formula, which consists of sales, property and payroll. (Cal. Admin. Code, Tit. 18, § 24301.)

There is no dispute that Appellant's representative was in this State to promote sales through his activities. His frequent contact with distributors and his efforts to have them adopt and implement Appellant's sales techniques were intended to and must have had a substantial effect on sales of Appellant's products in this State. The exact extent of the effect we cannot determine. Respondent in its discretion has attributed 25 percent of the California sales to the activities of Appellant's representative. Appellant asserts the percentage is too high and states 5 percent would be more proper. It offers no basis for arriving at the latter figure other than a list of the representative's activities which, if anything, support Respondent's position rather than Appellant's, since it shows extensive effort by the representative to increase sales. In our opinion Appellant has failed to show facts sufficient to establish that less than 25 percent of the sales to Lalifornia distributors should be attributed to the sales activity of its representative in this State.

We hold, therefore, that Respondent's action in attributing to the activities of Appellant's representative 25 percent of sales to the distributors in California for purposes of the sales factor of the three-factor formula was proper.

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 denying the claims of Hammond Organ Company for refund of' corporation income tax in the amounts and for the fiscal years indicated below, be and the same is hereby sustained.

Year ended	Amount
March 31, 1949	$ 449.70
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Done at Sacramento, California this 17th day of May, 1962, by the State Board of Equalization.

Geo. R. Reilly, Chairman

John W. Lynch, Member

Paul R. Leake, Member

Richard Nevins, Member

_____, Member

ATTEST: Dixwell L. Pierce, Secretary