BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFCRNIA

In the Matter of Appeal of)

H. C. SMITH OIL TOOL CO.)

Appearances:

For Appellant: Andrew Castellano, Attorney at Law

For Respondent: Burl D. Lack, Chief Counsel

OPINION

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 H. C, Smith Oil Tool Co, against proposed assessments of additional franchise tax in the amounts of $716.53, $1,696.46, $844.10 and $1,852.49 for the income years 1950, 1951, 1953 and 1954, respectively.

Appellant is a California corporation with its manufacturing plant and headquarters in Compton, California. It is engaged in the manufacture of oil well drilling bits and related items. These products are sold through sales representatives located in several states.

The sales representatives operate pursuant to written contracts which are assignable with Appellant's consent and may be cancelled only on 60 days' notice or "for cause."

Warehouses and office space are rented by many of the salesmen and in other cases Appellant shares or pays all of the rental. A stock of merchandise is sent on consignment to each representative and is stored in his warehouse for sale. Deliveries to customers are made by the salesmen from these stocks, If a representative extends credit to his customers he must bear the entire risk unless Appellant has approved the extension of credit.

The representatives are permitted to hire assistants, they maintain their own automobiles and must carry their own public liability insurance. Appellant retains the right to designate the insurer and the type of coverage. The salesmen are compensated solely ty commissions on sales and each receives commissions on all sales of the company's products in his territory,

The contracts provide that the representatives, and not the Appellant, are responsible for damages and claims arising from their acts and the acts of employees hired by them. The contracts also provide that

the representatives have the sole responsibility for compliance with all state and federal laws governing their operations.

The representatives are not permitted to carry lines of goods that are competitive with those of Appellant. Appellant sets the prices for its products and bills all credit accounts. The salesmen are required to submit sales reports periodically and are visited by Appellant's sales manager, who recommends procedures for increasing sales. Catalogues and other data regarding its products are furnished by Appellant without charge. The representatives are covered under Appellant's group insurance plan.

In its returns for the years involved, Appellant, using a formula composed of the factors of property, payroll and sales allocated a portion of its income to California. Although the payroll factor as computed by Appellant did not include as out-of-State payroll the commissions paid to the representatives, sales made by them in other states were treated as out-of-State sales in the sales factor. The percentages of income allocated to California were 81.813, 82.97, 82.69 and 76.165 for the income years 1950, 1951, 1953 and 1954, respectively.

Respondent, acting under section 25101 (formerly 24301) of the Revenue and Taxation Code, adjusted the allocation on the ground that the representatives are not employees of Appellant and thus sales solicited by them outside of California cannot be treated as out-of-State sales for purposes of the sales factor. Respondent increased the percentages of income allocable to California to 91.193, 94.452, 94.283 and 93.608 for the years in question. After this appeal was filed, Respondent conceded that the assessments for the income years 1950 and 1951 should be revised by adjusting the payroll factor to reflect the performance of services outside of this State by Appellant's executives. This adjustment reduces the assessments for those years to $454.49 and $1,667.29, respectively.

The rule that sales activity by, and commissions paid to, independent contractors are not to affect the allocation formula is well settled and is not in dispute. (Irvine Co. v. McColgan, 26 Cal, 2d 160; El Dorado Oil Works v. McColgan, 34 Cal. 2d 7313 Cal. Admin. Code, tit. 18, Regs. 24301 and 25101; Appeal of Farmers Underwriters Ass'n, Cal, St. Bd. of Equal,, Feb. 18, 1953, 1 CCH Cal. Tax Cas. Par. 200-205, 2P-H State & Local Tax Serv. Cal, Par, 13129.) The issue to be determined, therefore, is whether the representatives are employees or instead are independent contractors.

In many business relationships there are elements of both the status of independent contractor and the status of employee, No one factor is conclusive; it is the total situation that controls the determination. (Bartels v. Birmingham, 332 U.S. 126,)

An appropriate consideration is whether or not the parties themselves believe they are creating the relationship of employer-employee.

(Empire Star Mines Co, v. Cal. Emp. Comm'n., 28 Cal. 2d 33.) It is apparent from the contracts before us that Appellant intended to establish the representatives as independent contractors. This is demonstrated by the provisions placing upon the salemen the sole responsibility for claims arising from their acts and for compliance with all state and federal laws governing their operations. That Appellant did not regard the representatives as employees is reflected in its failure to deduct social security contributions and withholding taxes from the commissions paid to them.

The facts that the representatives are compensated only by commissions, bear most of the expenses connected with their activities and are permitted to hire employees of their own indicate that they are engaged in independent businesses. Their profits depend upon efficient management by them, and it is the opportunity for profit from sound management that is one of the marks of an independent contractor. (United States v. Silk, 331 U.S. 704.)

The provisions that the contracts are assignable and may be terminated only on 60 days' notice or "for cause" are also more consistent with an independent relationship than that of employer-employee. It is certainly not typical of an employee that he may assign his right to work.

Appellant contends that because of its requirement of sales reports, the trips made by its sales manager to visit the representatives, and other sales measures that have beendescribed, it is exercising control indicative of an employer-employee arrangement. However, as the court stated in Mountain Meadow Creameries v. Industrial Acc. Comm'n., 25 Cal. App. 2d 123:

> One who contracts with another is permitted to retain certain, measures of control which would look to the results to be obtained without assuming the responsibilities that follow the relation of employer and employee.

We think that the enumerated controls exercised by Appellant are of the type designed to secure satisfactory results and do not preclude independent action by the representatives.

After weighing all of the factors that bear upon the issue, we are of the opinion that the sales representatives are independent contractors rather than employees,

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,

Appeal of H. C. Smith Oil Tool Co.

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 H. C, Smith Oil Tool Co. against proposed assessments of additional franchise tax in the amounts of $716.53, $1,696.46, $844.10 and $1,852.49 for the income years 1950, 1951, 1953 and 1954, respectively, be and the same is hereby modified by reducing the proposed assessments for the income years 1950 and 1951 to $454.49 and $1,667.29, respectively, In all other respects the action of the Franchise Tax Board is sustained,

Done in Sacramento, California, this 20th day of September, 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