



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
CITADEL INDUSTRIES, INC.,)
SUCCESSOR IN INTEREST TO)
ALCO PRODUCTS, INCORPORATED)

Appearances:

For Appellant: Cyrus A. Johnson and
 Victor L. Diepenbrock
 Attorneys at Law

For Respondent: Wilbur F. Lavelle
 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 Citadel Industries, Inc., successor in interest to Alco Products, Incorporated, against proposed assessments of additional franchise tax in the amounts of \$79.49 and \$2,084.64 for the income years 1958 and 1959, respectively.

The issue raised by this appeal is whether all of the sales of locomotives made by appellant's predecessor, Alco Products, Incorporated, to a California customer should be attributed to California for purposes of the sales factor of the formula used to allocate income within and without the state.

Alco was a New York corporation which had been doing business in California for many years. During the years in question it was engaged in the business of manufacturing and selling diesel locomotives and parts used in the repair and maintenance of locomotives. In the period 1951-1959 it sold 272 locomotives to California customers. Thirty of these were sold in the years here in question, 1958 and 1959.

Appeal of Citadel Industries, Inc.)
successor in -interest to
Alco Products, Incorporated

Alco's **head offices** were in New York, as was its locomotive manufacturing plant. Other manufacturing plants were located in other states, although none were in California. Alco also maintained three repair parts warehouses one of which was in Los Angeles, California.

Alco had sales offices in Schenectady, New York; Chicago, Illinois; and San Francisco, California. One sales representative was assigned to the San Francisco office. His territory included Arizona, Oregon and Washington. He was paid a salary rather than sales commissions, and he also participated in annual incentive awards based upon total company business. In 1957 his salary was approximately \$98,000. This California sales representative was continually in contact with railroads in the western part of the United States, informing them of proposals for upgrading existing locomotives and introducing new models developed by Alco. These frequent 'contacts also enabled him to keep current with the railroads' needs for repair and replacement parts,

During the years in *question* the Southern Pacific Company directed three separate inquiries to Alco's San Francisco office concerning the purchase of a total of 30 new locomotives. In accordance with its usual procedure in negotiating locomotive sales in this state, Alco's San Francisco representative notified its Chicago office of these inquiries, and Chicago then notified Alco's general offices in New York. Upon advice from the New York office, propositions for the locomotives were prepared in the Chicago office and were forwarded to Alco's sales representative in California, who presented them to Southern Pacific. Further questions which Southern Pacific had concerning details of the proposed purchases were directed to the San Francisco office, and the California sales representative forwarded them to the Illinois office which, in turn, informed him of the answers to be given to Southern Pacific.

Alco's engineering department in New York prepared the specifications for the locomotives. Southern Pacific's purchase orders were issued in California and were forwarded by the San Francisco office to Alco's headquarters in New York where they were formally accepted. The locomotives were manufactured in New York and delivered to Southern Pacific in California during 1959. Alco billed Southern Pacific from New York and received payment there. Southern Pacific arranged financing *f o r* purchases in New York.

From time to time operating and purchasing officials of Southern Pacific visited Alco's manufacturing plant in New York to view the production processes. On June 4, 1959,

Appeal of Citadel Industries, Inc.,
successor in interest to
Alco Products, Incorporated

a representative of Southern Pacific was in New York regarding certain locomotive modifications. In addition, representatives of the customer and of Alco have regularly been present at annual conventions of the Locomotive Maintenance Officers and Purchasing and Stores Officers held in Chicago.

In determining its net income allocable to California for the income years 1958 and 1959, Alco used a three-factor formula of property, payroll and sales. In so doing, it attributed only 50 percent of the above described locomotive sales to California. Respondent's proposed additional assessments are based upon its determination that 100 percent of those sales of locomotives were attributable to California in the sales factor of the allocation formula.

Regulation 25101, title 18, California Administrative Code, provides:

The sales or gross receipts factor generally shall be apportioned in accordance with employee sales activity of the taxpayer within and without the State Promotional activities of an employee are given some weight in the sales factor.

The out of state activities relied upon by appellant in support of its position are the following: formal acceptance of the Contracts,, drawing of the specifications, manufacture of the locomotives, billing and receipt of proceeds of sales, visits by Southern Pacific personnel to Alco's manufacturing plant, and attendance of representatives of both Alco and Southern Pacific at conventions. Appellant also points to the complexity of its product, i.e., the locomotive, the work and detail involved in selling it, and the fact that during production it is subject to numerous modifications.

In the Appeal of Pratt & Whitney Co., Cal. St. Bd. of Equal., May 24, 1961, we discussed the meaning of the term "employee sales activity" as it is used in regulation 25101, supra. That case involved the soliciting of special orders for products which were designed and manufactured outside of this state. The California customers were initially contacted by salesmen in California. We there stated:

In order to give effect to the purpose of the sales factor and to make feasible its use as a distinct factor the selling activities which are taken into consideration must be a relatively restricted group of activities and cannot include

Appeal of Citadel Industries, Inc.,
successor in interest to
Alco Products, Incorporated

everything which might conceivable influence the making of a sale The activities of the design department ... are reflected in the payroll factor and, together with the manufacturing plants which are reflected in the property factor, give weight to the place where the products are manufactured.

We sustained respondent's action in treating as California sales all sales to California customers.

In Appeal of Atlantis Sales Corporation, Cal. St. Bd of Equal., Jan. 7, 1964, we sustained respondent in attributing sales to California notwithstanding the fact that substantial services in connection with the sales were performed in New York. In reaching this decision we emphasized that all the direct negotiations resulting in the sales were made through the appellant's sales office in California.

The principles of the above decisions apply here. The direct negotiations of the sales in question were conducted by a sales representative from an office maintained in California for the sole purpose of making sales. Those negotiations constituted "sales activity" in the essential meaning of the term. The value of the representative's service in effecting sales was recognized by Alco itself, as demonstrated by the very substantial salary that the representative received. The out of state activities stressed by appellant were largely of a technical nature and had only a secondary, indirect influence on the particular sales that concern us.

Appellant has pointed out that in 1952 respondent and Alco settled an appeal to us on facts similar to those here presented by stipulating that 50 percent of the locomotive sales should be treated as California sales. The stipulation, however, is not binding for subsequent years. (Rev. & Tax. Code, § 26424; Municipal Bond Corp., 41 T.C. 20, rev'd on other grounds, 341 F.2d 683; Smith Paper Co., 31 B.T.A. 28, aff'd sub nom. Export Leaf Tobacco Co. v. Commissioner, 78 F.2d 163, cert. denied, 295 U.S. 627 [80 L. Ed. 446].) Moreover, in view of the principles applied to the taxpayers in the Pratt & White and Atlantis Sales appeals, it is evident that continued adherence to the stipulation with Alco would constitute unduly favorable and discriminatory treatment.

Respondent has been given wide discretion in allocating income within and without the state. (El Dorado Oil Works v. McColegan, 34 Cal. 2d 731 [215 P.2d 4], appeal dismissed, 340 U.S. 801 [95 L. Ed. 589]; Pacific Fruit Express Co. v. McColegan, 67 Cal. App. 2d 93 [153 P.2d 607].)

Appeal of Citadel Industries, Inc.
successor in interest to
Alco Products, Incorporated

We cannot find that respondent has abused its discretion
in this case.

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 protests of Citadel
Industries, Inc. , successor in interest to Alco Products,
Incorporated.) against proposed assessments of additional
franchise tax in the amounts of \$79.49 and \$2,084.64 for the
income years 1958 and 1959, respectively, be and the same is
hereby sustained,

Done at Pasadena , California, this 28th day
of June , 1966, by the State Board of Equalization.

_____, Chairman
_____, Member
_____, Member
_____, Member
_____, Member

ATTEST: *J. H. Aloney*, Acting
Secretary