BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )
)
R.N.B. CO., TAXPAYER AND EARL D. )
BRODIE, ASSUMER AND/OR TRANSFEREE )

Appearances:

For Appellants: A. S, James,
Certified Public Accountant
Earl D. Brodie, in pro. per.

For Respondent: Tom Muraki,
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 protest of the R.N.B. Co. and Earl D. Brodie, as assumer and transferee, against proposed assessments of additional franchise tax in the mounts of $1,893.44, $4,185.68, $2,976.53 and $2,808.72 for the income years ended June 30, 1960, June 30, 1961, June 30, 1962, and June 30, 1963, respectively.

The issue raised by this appeal is whether respondent, in applying an income allocation formula to a unitary bus ineess, properly regarded 25 percent of the sales credited by appellant to its out of state district offices as California sales.

Appellant, a California corporation with its principal office and manufacturing plant in San Leandro, California, manufactured and sold meters, valves, and related products used in measuring liquid petroleum products.

Sales operations were divided into seven geographical districts and district headquarters as follows: Northern California, with headquarters at San Leandro, California; Southern California, with headquarters at Los Angeles; Northwest, with headquarters at Seattle, Washington; Southwest, with headquarters at Dallas, Texas; Midwest, with headquarters at Forest Park, Illinois; Eastern, with headquarters at New York City; and Southeast, with headquarters at Atlanta, Georgia. A small assembly plant was located in Albany, New York. An inventory of goods was maintained in warehouses in the above cities.

The number of employees headquartered in each district office varied from one to ten. One employee at each district office was the district manager who sold appellant's products and, to the extent that such personnel were headquartered in his division, supervised sales servicemen, field engineers, office personnel, and salesmen. Each manager also contracted for the services of independent sales brokers who solicited saies, received orders from customers, and reported to the district manager. Approximately 100 brokers were connected with out of state districts. The managers were given considerable autonomy and consequently the contracts with the brokers varied.

Under many contracts, before the broker was entitled to an entire sales commission, three conditions had to be satisfied: (1) the condition that he had been responsible for having the customer specify appellant's product; (2) the condition that he had received the order, and (3) the condition that the product had been shipped into his territory. If only two of the foregoing conditions occurred the broker received a portion of the commission, and if only one occurred, a still-lesser portion. Under the typical contract with appellant the brokers could, and did, engage in the brokerage business for others but the contract prohibited them from selling competitors' products.

Some sales resulted from direct solicitation by brokers, others from solicitation by appellant's employees' and still others from indirect sales efforts, such as recommendations to customers by servicemen and field engineers, "follow-ups" by district managers or their assistants, and other "missionary work". A majority of the orders were placed with the brokers, including a substantial number resulting from sales efforts by appellant's employees. Orders obtained by a broker or an employee were sent to the district office with which the broker or employee was associated. Under appellant's recording system, the sale was credited to that office.

The out of state district managers approved credit on small orders but final credit approval on large orders was the responsibility of the San Leandro office, Where possible, orders were filled from the *inventories* maintained in the territory where the orders were received but the major portion of the orders were filled'by delivery from California stock. Over 80 percent of appellant's inventory was maintained in California. Billings for all sales were made from the San Leandro office.. Accounting records relating to sales were maintained there. Much advertising literature was prepared and sent to the brokers from that office.

Under appellant's recording system, whether or not the order was solicited in California, sales for export were credited to California. Orders. received in a few states that for one reason or another did not conveniently fit into any geographical district were reported to the home office and were regarded as California sales.

Appellant allocated all sales credited on its records to out of state district offices as non-California sales for purposes of the sales factor of *the* allocation formula . Respondent determined that 25 percent of such sales should be attributed to California for purposes of the sales factor.'

It is provided in respondent's regulations that "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 arc given some weight in the sales factor." (Cal. Admin., Code, tit. 18, reg. 25101, subd. (a) .)

While many sales arising from orders placed with out of state brokers were solicited by appellant's out of state employees or resulted in part or entirely from "missionary work" of employees, a substantial number of such sales were directly solicited by the brokers. In Irvine Co, v. *McColgan*, 26 Cal. 2d 160 [157 P.2d *847*], and El Dorado Oil Works v. McColgan, 34 Cal. 2d 731 [ 215 P.2d 4], appeal dismissed, 340 U.S. 801[95 L.Ed.589], itwas held that sales outside California through independent brokers were not out of state activities of the California taxpayer and did not constitute business by the taxpayer outside this state . From the standpoint of the source of income,aswell as that 0;' doing business, the activity of appellant outside California is to be distinguished from activity outside California on its behalf by independent brokers. (Appeal of Great Western Cordage, Inc., Cal. St.

Bd. of Equal., April 22, 1948; Appeal of Farmers Underwriters Ass'n, Cal. St. Bd. of Equal., Feb. 18, 1953; Appeal of The Times-Mirror Co., Cal. St. Bd. of Equal., Oct. 27, 1953; Appeal of Caltex Sportsmen Co, of Calif., Inc., Cal. St. Bd. of Equal., Jan. 20, 1954.)

With respect to those sales where the out of state solicitation was performed by, and the order placed with, a broker, any activities conducted by appellant which could be regarded as sales-activities were usually conducted in California. To illustrate, the major portion of orders were filled from-California inventory. Final credit approval on large orders was made at the San Leandro, California, office. Billings were made from that office. Accordingly, the facts are unlike the situation in Appeal of The Sweets Company of America, Inc., Cal. St. Bd. of Equal., June 23, 1964, which is cited by appellant. In that case all, or substantially all; of the activity by the taxpayer in connection with the orders from brokers was performed at the district office and substantially all of the orders were filled from goods manufactured or stored in the area where the district office was located.

The evidence is insufficient to establish the exact, or even approximate, percentage of sales attributable to the activities of appellant's employees outside or" California. However, in comparison with the number of brokers, appellant had relatively few out of state employees engaged in selling, even when the number engaged in "missionary work" is considered. It is entirely possible that the activities of employees outside the state accounted for not more than 75 percent of the out of state sales.

Respondent has discretion within reasonable limits. to- determine a proper apportionment of income within and without the state. (El Dorado Oil Works v. McColgan, supra, 34 Cal. 2d 731 [215 P.2d 4], appeal dismissed, 340 U.S. 801 [95L. Ed. 589].) Upon the record before us., we cannot say that respondent has abused its discretion,

Respondent has conceded that certain income from the rental properties located outside California and gain from the sale of land located outside California were not properly includible in income subject to allocation by formula. With these concessions, assessments proposed by respondent for the income years ended June 30, 1960, June. 30, 1961, and June 30, 1962, are reduced to $1,858.44, $2,388.97, and $2,947.67, respectively.

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## 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 R.N.B. Co, and Earl D. Brodie, as assumer and transferee, against proposed assessments of additional franchise tax in the amounts of $1, 893.44, $4,185.68, $2, 976.53, and $2,808 .72 for the income years ended June 30, 1960, June 30, 1961, June 30, 1962, and June 30, 1963, respectively, be modified to the extent of the concessions made by the Franchise Tax Board as indicated in the opinion of the board. In all other respects the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this 23rd day of November, 1966, by the State Board of Equalization.

Chairman

Member

Member

Member

Member

Attest: , Secretary