

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
SEALITE, INC.)

For Appellant: Reed C. Ferguson
President

For Respondent: James C. Stewart
Counsel

O P I N I O N

This appeal is made pursuant to section 26075, subd. (a) of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claims of Sealite, Inc. , for refund of franchise tax in the amounts of \$743.87, \$777.60 and \$1,196.33 for the income years ended September 30, 1965, September 30, 1966, and September 30, 1967, respectively.

Appeal of Sealite, Inc.

The issue to be decided is whether respondent's adjustments in the payroll and sales factors of appellant's apportionment formula were proper.

Appellant is a closely held California corporation with its headquarters and a manufacturing plant in San Leandro, California. During at least part of the appeal years, it apparently also maintained two other manufacturing plants, in Texas and Florida. Appellant had employees working out-of-state whose principal activities were demonstrating and providing samples of appellant's products. Orders were generally placed through independent brokers, although some were placed through appellant's employees. All orders from west of the Continental Divide were supplied from the California plant. Other orders were usually supplied from the nearest district warehouse, although some of these were filled from the California plant as well. Bills of lading were sent to the San Leandro office and billings were issued there. Final accounting also took place in California, and some of the order forms and other stationery and promotional literature used out-of-state were provided by the California office.

Appellant used the standard three-factor apportionment formula to determine the amount of its unitary business income subject to tax in California. In its returns for each of the years concerned, it treated the commissions of out-of-state independent brokers as out-of-state payroll and included them in the denominator of the payroll factor. The bulk of out-of-state independent brokers' sales were treated as non-California sales, only about six percent being included in the numerator of the sales factor as attributable to California.

After auditing appellant's returns, respondent determined that the independent brokers' commissions should not be included as part of the payroll factor at all and eliminated them from the denominator of that factor. It also concluded that a greater portion of the independent brokers' sales should be treated as attributable to California. Appellant, however, failed to provide adequate information regarding either the total amount of out-of-state brokers' sales or the sales activities of its own employees within and without this state in connection with such sales. Respondent, therefore, calculated the total amount of sales based on the brokers' commissions paid and the average commission rate, and it then treated 50 percent of that amount as attributable to out-of-state employee promotional activity. This resulted in a

Appeal of Sealite, Inc.

determination that 50 percent of the out-of-state brokers' sales were attributable to California and includible in the numerator of the sales factor.

Proposed assessments were issued for the income year, involved. Appellant paid these amounts under protest. The payments under protest were treated as claims for refund, which were denied by respondent. Appellant then filed this appeal.

All income years at issue here antedate the Uniform Division of Income for Tax Purposes Act (Rev. & Tax. Code, §§ 25120-25139), which is effective for income years beginning after December 31, 1966. Therefore, this appeal must be decided under former section 25101 as it read before its amendment in 1966. Under that section respondent has wide discretion to determine the proper apportionment of income within and without the state (El Dorado Oil Works v. McColgan, 34 Cal. 2d 731, 737 [215 P. 2d 4], app. dismissed, 340 U.S. 801 [95 L. Ed. 589] (1950)), and the apportionment will not be set aside unless the taxpayer can clearly establish that it is manifestly unreasonable or results in the taxation of extraterritorial values. (Butler Brothers v. McColgan, 17 Cal. 2d 664, 667 [111 P. 2d 334] (1941), affd., 315 U.S. 501 [86 L. Ed. 991] (1942); Pacific Fruit Express Co. v. McColgan, 67 Cal. App. 2d 93, 96 [153 P. 2d 607] (1944).)

Respondent's action in excluding out-of-state independent brokers' commissions from the payroll factor is clearly correct. Only compensation paid to employees is includible in the payroll factor. (Cal. Admin. Code, tit. 18, reg. 25101, subd. (a).) Amounts paid to independent brokers or contractors cannot properly be included in this factor because the activities of such persons are not regarded as activities of the taxpayer. (Irvine Co. v. McColgan, 26 Cal. 2d 160, 165 [157 P. 2d 847] (1945); Appeal of Sudden and Christenson, Inc., Cal. St. Bd. of Equal., Jan. 5, 1961; Appeal of The Times-Mirror Company, Cal. St. Bd. of Equal., Oct. 27, 1953.)

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 are given some weight in the sales factor. (Cal. Admin. Code, tit. 18, reg. 25101, subd. (a).)

Appeal of Sealite, Inc.

In Irvine Co. v. McColgan, supra, it was 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, as well as that of 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.) In determining the attribution of sales for purposes of the sales factor, the focal point is the place where the activities of appellant occurred which resulted in the sales. (Appeal of The Times-Mirror Co., supra.)

It is apparent from the record that some of appellant's selling activities in connection with the out-of-state brokers' sales were performed in California. Appellant has not provided any evidence to show the exact, or even approximate, percentage of those sales which were due to selling activities of its employees either within or without the state. In the absence of sufficient evidence to the contrary, we cannot say that respondent has abused its discretion in attributing **50** percent of out-of-state brokers' sales to California.

In its brief, respondent modified its computations of the total out-of-state brokers' sales based on additional information received from appellant after this appeal was filed. This resulted in a more favorable sales factor for appellant for the income year ended September 30, **1965**, and respondent is prepared to concede a partial refund or credit for that year based on the adjusted sales factor. Subject to this concession, we find that appellant has failed to show any error in respondent's determinations.

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 Scalite, Inc.

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 Scalite, Inc. , for refund of franchise tax in the amounts of \$743.87, \$777.60 and \$1,196.33 for the income years ended September 30, **1965**, September 30, 1966, and September 30, 1967, respectively, be and the same is hereby modified in accordance with respondent's concessions regarding the sales factor for the income year ended September 30, 1965. In all other respects the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this 30th day of March 1981, by the State Board of Equalization, with Members Dronenburg, Bennett and Nevins present.

Ernest J. Dronenburg, Jr., Chairman
William M. Bennett, Member
Richard Nevins, Member
 _____, Member
 _____, Member