BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
NARDIS OF DALLAS, INC.)

For Appellant: James S. Pleasant
Attorney at Law

For Respondent: Bruce W. Walker
Chief Counsel

Richard A. Watson
Counsel

OPINION

This appeal is made pursuant to section 26077 of the Revenue and Taxation Code from the action of the Franchise Tax. Board in denying the claim of Nasdis of Dallas, Inc. for refund of franchise tax in the amounts of $2,949. 64 and $2,849. 64 for the taxable years ended May 31, 1970 and 197 1, respectively.

The issue presented is whether a federal statutory provision, Public Law No. 86-272 (73 Stat. 555 [1959], 15 U. S. C. § 381) precluded respondent from imposing a properly apportioned tax upon appellant.

Appellant, a Delaware corporation, manufactures and sells ladies apparel. 'It was incorporated in August 1969, and has its principal place of business and factories in Dallas, Texas. It qualified to transact intrastate business in California by filing the necessary written statement with the Secretary of State in 1969, and by prepaying the required $100.00 minimum tax. (Corp. Code, § 6403; Rev. & Tax Code, §§ 23153, 23221.) The telephone directory indicates that appellant has a sales office at 110 East 9th Street, Los Angeles, California, and appellant's letterhead also refers to its showroom as being there. A full line of appellant's apparel has been on display in that showroom since the date of its incorporation, or shortly thereafter.

During the years ended May 31, 1970, and 1971, appellant engaged the services of Mr. Irvin J. Neyer. Mr. Neyer is shown as lessee of the showroom in a rental agreement with the lessor. However, inasmuch as the lessor did not accept Mr. Neyer's credit, his designation as lessee was permitted during those years only after appellant independently agreed to guaranty payment of the rent and performance of all other lease covenants. Appellant paid the rent directly to the lessor and deducted it from Mr. Neyer's commissions.

Mr. Neyer's activities on behalf of appellant were limited to the solicitation of orders in California and the operation of the showroom. All orders were sent to Dallas for appellant's approval or rejection and were filled by delivery from that location directly to the customer. Mr. Neyer was paid solely by commission. He was required to pay all his expenses, including automobile expenses, without reimbursement from appellant. The relationship between appellant and Mr. Neyer was terminable at any time by either party upon written notice,.

Mr. Neyer's license as a commission broker was displayed in the showroom. His agreement with appellant permitted him to sell for others and he paid California sales tax as an independent contractor with respect to retail sales of goods other than those of appellant's. Appellant had no contractual relationship with other workers engaged by Mr. Neyer. The telephone directory also indicates that Mr. Neyer's sales office is at 110 East 9th Street, and his telephone number is the same as appellant's.

Appellant reported and paid payroll taxes under the California Unemployment Insurance Code on the commissions of $70,361.00 paid to Mr. Neyer for the fiscal year ended May 31, 1970. It also withheld federal income taxes that year from his commissions, with Mr. Neyer's consent. As far as is known, these practices continued during the next fiscal year.

Appellant filed a California franchise tax return in August of 1970 for the short income year ended May 31, 1970, and paid tax of $5,799.28 it considered then due for the taxable years ended May 31, 1970 and 1971. On its return appellant reported the commissions to Mr. Neyer as compensation to an employee for California payroll factor purposes, and considered the rental paid as its own expense in computing the California property factor, when allocating unitary net income to sources in this state.

Subsequently, appellant concluded that it was immune from tax because of the language of Public Law No. 86-272, and filed a refund claim for the franchise taxes paid. Respondent disagreed with appellant's view, and denied all but $100.00 of the claim. 1/ This appeal followed.

1/ According to respondent's records, in January 1970 appellant prematurely paid an estimated tax of $100.00 for the taxable year ended May 31, 1972, which respondent treated as an overpayment of the tax due in August of 1970 for the taxable year ended May 31, 197 1. Its records indicate appellant received credit for this overpayment when liability for that estimated tax became due in November 1970.

Public Law No. 86-272 provides, in part:

(a) No State. .. shall have'power to impose, ... a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are. ..

(1) the solicitation of orders by such person, or his representative, in such State for sales of tangible. personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State:

* * *

(c) For purposes of subsection (a) of this section, a person shall not be considered to have engaged in business activities within a State during any taxable year merely by reason of sales in such State, or the solicitation of orders for sales in such State, of tangible personal property on behalf of such person by one or more independent contractors, or by reason of the maintenance, of an office in such' State by one or more independent contractors whose activities on behalf of such person in such State consist solely of making sales, or soliciting orders for sales, of tangible personal property.

(d) For purposes of this section--

(1) the term "independent contractor" means a commission agent, broker, or other independent contractor who is engaged in selling, or soliciting orders for the sale of,. tangible personal property for more than one principal and who holds himself out as such in the regular course of his business activities; and

(2) the term "representative" does not include an independent contractor.

It further provides that the statutory immunity is inapplicable to domestic corporations. It defines a "net income tax" as any tax imposed on, or measured by, net income.

Appellant asserts that its activities in California were confined solely to solicitation of orders and, accordingly, it was immune from taxation by this state.

Respondent first contends that Mr. Neyer was appellant's employee and, consequently, maintenance of the showroom by him on appellant's behalf was a business activity by appellant which went beyond the statutory minimum protected by the federal statute. Appellant, on the other hand, relies upon that part of Public Law No. 86-272 which states that the term "independent contractor" means a commission agent, broker, or other independent contractor engaged in selling or soliciting orders for more than one principal who holds himself out as such. Appellant claims that when representing it, Mr. Neyer was acting as a commission agent or broker, and therefore was an "independent contractor" under the special statutory definition, and not an employee. Thus, appellant urges that Mr. Neyer maintained the showroom exclusively in his capacity as an independent contractor.

We believe, however, that the word "other" in the statute merely ties the terms "commission agent" and "broker" to the general category of "independent contractor" in order not to exclude such persons automatically from being considered in that general category. The real test is whether, when representing a particular taxpayer, such persons are acting as "independent contractors" within the ordinary meaning of that term. Moreover, accepting the special definition argument would mean that many foreign corporations, not otherwise immune under the federal statute, might obtain such immunity by hiring brokers as employees, or paying employees only by commission. For this reason, the special definition argument has been disapproved. (Herff Jones Co. v. State Tax Commission, 247 Ore. 404 [430 P. 2d 998].)

Consequently, to determine whether Mr. Neyer was an "independent contractor" (as contrasted with an "employee") in his relationship with appellant, we look to the ordinary meaning of the

term as developed at common law. Appellant suggests that Mr. Neyer acted for appellant as an "independent contractor" under the tests at common law. These tests are reviewed in Empire Star Mines Co. v. California Employment Commission, 28 Cal. 2d 33 [168 P. 2d 686]. (See also Restatement (Second) of Agency, § 220.) As explained in that case, the most important factor is the right to control the manner and means of accomplishing the results desired. If there is authority to exercise complete control, whether or not exercised, an employer-employee relationship exists. Strong evidence of that relationship is the right to discharge at will, without cause. The record in this appeal shows that the right to discharge upon notice did exist.

Moreover, in close cases such as this, the view of their own relationship which is acted upon by the parties, particularly with reference to the payment of employment taxes, is very significant. (Illinois Tri-Seal Products, Inc. v. United States, 353 F. 2d 216, 218.) There is evidence here that the parties believed they created an employment relationship, and acted in accordance with that belief, because taxes were paid by appellant for unemployment insurance purposes, and federal income taxes were withheld by agreement.

Respondent further contends that even if Mr. Neyer acted for appellant in his capacity as an independent contractor, it was not Mr. Neyer who maintained the showroom. We also share this view. Appellant relies upon the fact that Mr. Neyer was the named lessee. It also emphasizes that rental payments were deducted from his commissions. Nevertheless, because the lessor refused to accept Mr. Neyer's credit, the showroom's continued existence was principally the result of appellant's guaranty and the rental payments it made directly to the lessor. Furthermore, it was also shown as appellant's address **in** the telephone directory and on appellant's stationery.

It is important to note that in enacting Public Law No. 86-272, Congress carved out a specific area of immunity from state taxation and the courts have limited the exempted area strictly to solicitation or activities incidental thereto. (See Herff Jones Co. v. State Tax Commission, supra; Cal-Roof Wholesale, Inc. v. State Tax Commission, 242 Ore. 435 [410 P. 2d 233].) We conclude, therefore, that the activity in California went beyond the statutory minimum established by Public Law No. 86-272.

Accordingly, we are unable to conclude that there has been any overpayment of tax liability.

ORDER

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 claim of Nardis of Dallas, Inc. for refund of tax in the amounts of $2,949. 64 and $2, 849. 64 for the taxable years ended May 31, 1970 and 1971, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 22nd day of April, 1975, by the State Board of Equalization.

_____, Chairman

_____, Member

_____, Member

_____, Member

_____, Member

ATTEST: _____, Executive Secretary