



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of }
WILBUR ELLIS COMPANY }

Appearances:

For Appellant: Walter Slack, Attorney; Brayton Wilbur,
President
For Respondent: Frank M. Keesling, Franchise Tax Counsel

O P I N I O N

This is an appeal pursuant to Section 25 of the Bank and Corporation Franchise Tax Act (Chapter 13, Statutes of 1929, as amended) from the action of the Franchise Tax Commissioner in overruling the protest of the Wilbur-Ellis Company, to his proposed assessment of an additional tax in the amount of \$1,713 for the taxable year ended June 30, 1937, based upon the income of the company for the year ended June 30, 1936.

Appellant is a domestic corporation engaged in the business of buying and selling commodities at wholesale and in acting as a broker for the sale and purchase of commodities in domestic and foreign commerce. In making its return under the Bank and Corporation Franchise Tax Act for the fiscal year ended June 30, 1936, Appellant has deducted from its gross income the sum of \$54,760.66 paid to its officers and directors as bonuses. The Commissioner has disallowed this deduction, and has assessed an additional tax against Appellant in the amount of \$1,713.57. The basis for the Commissioner's action, as expressed in his brief, is that the bonuses, considered in connection with the salaries already paid, did not constitute reasonable compensation for personal services actually rendered, within the meaning of Section 8a of the Bank and Corporation Franchise Tax Act, and that they did not, therefore, constitute proper deductions from gross income.

At the hearing had in this matter evidence was introduced on behalf of the Appellant to the effect that the total amounts paid as salaries and bonuses were reasonable in view of the nature of the business and the services rendered. Mr. Brayton Wilbur, President of the Appellant, testified that the successful operation of the business required only a small amount of capital but a great deal of effort and sagacity on the part of the Appellant's officers and employees, in view of the highly competitive conditions under which the business was carried on; that the compensation paid Appellant's officers and directors was similar both in amount and in the method of its computation to that paid by other firms engaged in a like business; that this method has been followed by Appellant for a number of years; that the total amounts paid as salaries and bonuses were reasonable and bore as direct a ratio as possible to the value to the company of the

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services performed; that the president of the corporation, who received the largest bonus for the year in question, had produced the largest amount of business during that year and that with respect to several of the other bonuses the amounts paid were computed upon a percentage basis that had been fixed in advance.

In view of the aforementioned testimony and in the absence of any evidence to the contrary having been adduced by the Commissioner, we are unable to hold that the bonuses did not constitute proper deductions from Appellant's gross income under Section 8a of the Bank and Corporation Franchise Tax Act. The Commissioner has made no attempt to show that the bonuses were in fact unreasonable except to point to the fact that the recipients in most cases were stockholders of the corporations and to assert that the amount of each bonus bore a certain relationship to the recipient's stock ownership. It appears, however from the evidence submitted that the principal stockholders were actively engaged in the business of the Appellant, so that the fact that a very large proportion of the bonuses were paid to stockholders would not justify the conclusion that they were paid as a means of distributing profits rather than as compensation for services rendered the corporation. Neither is the ratio which each bonus bore to the total bonuses paid sufficiently close to the ratio which each recipient's stock in the Appellant bore to its total outstanding stock to justify such a conclusion. Except in the case of **T. G. Franck**, who owned 22.07 per cent of the capital stock and who received 22.83 per cent of the total bonuses paid, the proportion of stock ownership in each case is at least 30 per cent larger or smaller than the proportion which the bonuses received bore to the total bonuses paid, and in one case, that of **Ned Lewis**, is less than 10 per cent of the bonus percentage,

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 that the action of Charles J. **McColgan**, Franchise Tax Commissioner, in overruling the protest of the Wilbur-Ellis Company, to his proposed assessment of additional tax in the amount of **\$1,713.57** based upon the return of income of said company for the year ended June 30, 1936, be and the same is hereby reversed. Said ruling is hereby set aside and the said Commissioner is hereby directed to proceed in conformity with this order,

Done at Sacramento, California, this 15th day of November, 1939, by the State Board of Equalization.

Fred E. Stewart, Member
George R. Reilly, Member
Harry B. Riley, Member

ATTEST: Dixwell L. Pierce, Secretary