



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
ART RATTAN WORKS)

Appearances:

For Appellant: Charles E. Ferreira, President and General
Manager; Ernst and Ernst, Accountants and
Auditors.
For Respondent: W. M. Walsh, Assistant Franchise Tax
Commissioner.

O P I N I O N

This appeal is made 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 Art Rattan Works to a proposed assessment of additional tax in the amount of \$416.02 for the taxable year ended December 31, 1938.

Appellant is a California corporation with its principal place of business at Oakland, California. It originally manufactured only rattan furniture at its plant in Oakland, but about July, 1925, it became engaged in the manufacture there of transportation seating equipment. Subsequently, it commenced the manufacture of the bulk of its seating equipment at plants located at Mansfield, Ohio, and Topton, Pennsylvania. The rattan furniture is manufactured exclusively at Oakland and is sold at the Oakland plant and at a retail store in San Francisco. The major part of the seating equipment is manufactured at the Mansfield and Topton plants and is sold to customers outside this State. A small amount of seating equipment is manufactured at the Oakland plant and is sold in this State.

Although the general books of account were maintained at the head office in Oakland, a separate accounting system was employed at the eastern and Oakland plants, the system reflecting the purchases of materials, sales, payrolls, and other accounts incident to the transactions of the plants. The plant at Topton is leased by Appellant. The lease agreement contains a purchase option clause with a stated price of \$20,000 for the premises. The Oakland and Mansfield plants are owned by the Appellant.

The Appellant filed its return of income for 1937 on the basis of a separate accounting of its California operations, the return disclosing a net loss of \$6,290.51 from those operations. The

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Commissioner determined, however, that the Appellant conducted a unitary business within and without the State and that its method of separate accounting did not properly reflect the income attributable to its California operations. Relying on Section 10 of the Act, he then allocated to California a portion of its total net income of \$42,308.42 through the application of the property, sales and payroll formula, which, as applied to Appellant's operations, indicated that 26.05% of its net income was attributable to sources within this State.

That the Appellant's business was of a unitary nature and one to which an apportionment formula might be applied is, in our opinion, established by Butler Brothers v. McColgan, 315 U.S. 501. In fact, such substantially appears from Appellant's statement of its position for in a "Supplementary Answer by Appellant to Brief for Respondent" filed shortly after the decision of the California District Court of Appeal in the Butler Brothers case, 102 P. (2d) 776, Appellant sets forth many points of similarity between the conduct of its business and that of Butler Brothers. The decision of that Court was, however, reversed by the California Supreme Court, 17 Cal. (2d) 664, whose decision was affirmed by the United States Supreme Court.

Appellant objects in two respects to the manner in which the Commissioner applied the apportionment formula. It contends that he was not warranted in including in the California property factor the value of a portion of its Oakland plant unnecessary for the conduct of the business and not used during the year and in failing to include in the total property factor the value of the manufacturing plant at Topton not owned but rented by Appellant for use in the courses of its operations. Here, too, however, we do not believe that the Appellant has established by "clear and cogent evidence" as required by the Butler Brothers case that the action of the Commissioner resulted in the taxation of income not properly attributable to this State.

So far as the Oakland plant is concerned, there is a conflict in the allegations of fact appearing in the memoranda of the Appellant and the Commissioner. The former asserts that a readily ascertainable portion of the plant was idle during the entire year, whereas it would appear from the Commissioner's statement that the entire plant was used and maintained as a part of the unitary business even though it was only in use a portion of the year. Following the setting of the appeal for hearing, we were advised that no appearance would be made on behalf of Appellant and while it is undoubtedly true that property not used in the conduct of the unitary business should be excluded from the allocation formula Appellant's position must be rejected in view of its failure to establish by competent evidence that a portion of the plant was in fact not devoted to the unitary business. Furthermore, it may be observed that, so far as our records show, the portion of the plant was not devoted to any other purpose and at any time, had the business required or Appellant so desired, could have been used in the course of its manufacturing operations. Even though it appears that, due to Appellant's election to manufacture the bulk of its transportation seating equipment at eastern plants, a large portion

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of the Oakland plant was not required for the remaining manufacturing operations conducted there during the year, that fact would not establish necessarily that such portion of the plant should be excluded from the California side of the property factor.

The second property factor issue raised by Appellant involves the addition to its total property of the plant rented by it at **Topton, Pennsylvania**. While Section 10 is silent as to the necessity of ownership of the property to be included, we believe that the theory involved in the use of the property factor, together with other factors, requires, at least in the absence of some extraordinary factual situation, that only property owned by the taxpayer be considered. Property is employed in the allocation computation because it is considered to be a factor in the production of income, the income of a business being attributable in part to the ownership of property. Capital is invested in property in the expectation of a return thereon, that is, in the expectation that income will have its source in or will be derived from the ownership and use of the property. In the case of rented property, however, there has been no investment of capital in property from which income may be derived. Appellant's net income from its business at the rented plant at **Topton** does not, accordingly, include income which can be said to have been realized from capital invested in that plant. The fact that the lease agreement contained an option to purchase would seem to be wholly immaterial until such time as the option might be exercised. Since, then, the property factor is included in the allocation computation to attribute to the ownership of property employed in the business its proportionate share of the net income of the business, it follows that the Commissioner was justified in excluding from Appellant's total property the value of the **Topton** plant.

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 Chas. J. McColgan, Franchise Tax Commissioner, in overruling the protest of **Prt Rattan Works** to a proposed assessment of additional tax in the amount of \$416.02 for the taxable year ended December 31, 1938, pursuant to Chapter 13, Statutes of 1929, as amended, be and the same is hereby sustained.

Done at Sacramento, California, this 24th day of August, 1944, by the State Board of Equalization.

R. E. Collins, Chairman
J. H. Quinn, Member
Geo. R. Reilly, Member
Wm. G. Bonelli, Member

ATTEST: Dixwell L. Pierce, Secretary