5. The disallowance of deductions from gross income for losses arising out of dealings with Dearborn Publishing Company and Stout Metal Airplane Company of $6,025,731.23

6. The exclusion from unitary business income of a net loss from rental property of $57,920.62.

7. The exclusion from the property factor of the allocation formula of property under construction of the value of $14,817,480.86, the value of the California portion thereof being $6,232.61.

Item 1. This issue presents the question whether unclaimed wages and deposits collected from employees for badges, tools and other equipment not returned by them should be included as part of income subject to allocation for the year in which such sums were transferred from a special fund to Appellant's general funds. These sums amounted to $55,961.57 in Appellant's American plants outside of California and $61,213.93 in Appellant's South American branches, The money was earned by employees or received from them in prior years and held in a special fund subject to the employees' rights to claim the wages or recover the deposit on the return of the equipment. After the lapse of several years, the unclaimed funds were transferred on Appellant's books in 1936 to general funds. Such items from the California plants apparently were reported by Appellant as California income, but it contends that the sums arising from other plants were not income of that year and, in any event, not subject to allocation under Section 10 of the Act. During the prior years Appellant included all such wages in its salary deductions and as a part of its payroll factor, and the cost of the equipment was deducted through deductions either for expenses or depreciation allowances. It seems only proper that when such sums are transferred to general funds they should be treated as income. A somewhat similar problem in regard to transfer of excessive amounts from a premium reserve account to surplus on the abandonment of a premium system was involved in The Creamette Comnang, 37 B.T.A. 216, wherein it was held that the funds so transferred were taxable income in the year of transfer. Since the wages and the cost of the equipment were previously treated as deductions in the computation of unitary business income it seems proper that these items of income should be subject to allocation. The burden of showing that any income is not subject to allocation is upon the Appellant (Butler Brothers v. McColgan, 315 U.S. 501) and it has failed to show why these items were not attributable to the unitary business. The amounts of $55,961.57 and $61,213.93, as well as the unclaimed wages and deposits of the California plants are, therefore, properly includible in the unitary business income.

Item 2. Appellant has conceded that the Commissioner has correctly included in unitary business income charges for services to the German Ford Company in the amount of $10,297.45.

Item 3. The Commissioner has conceded that the amount of $21,223.76, representing an increase in a reserve for credit losses arising out of South American transactions was properly deducted from unitary business income.

Item 4. The Commissioner has conceded that the Appellant is entitled to a deduction from gross income in the amount of $19,055.89 as a bad debt arising out of its deposit with the Grand Rapids National Bank.

Item 5. The Commissioner disallowed deductions for debts owed to Appellant by Dearborn Publishing Company and Stout Metal Airplane Company in the amounts of $4,795,354.81 and $1,230,376.42, respectively, The companies were wholly owned subsidiaries of the Ford Motor Company. The former was organized in 1918, ceased its printing and publishing activities about 1930 and was dissolved in 1936. The latter was organized in 1922 and its stock purchased by Appellant in 1925. It, too, was dissolved in 1936, Both companies were without assets for some time prior to 1936, a final balance sheet having been prepared for each as of December 31, 1932. The balance sheet for the Stout Metal Airplane Company showed assets of $1,000, which was an account receivable from Appellant representing the amount due for capital stock. That for the Dearborn Publishing Company showed no assets and a liability owing Appellant in an amount which was $1,000 less than the amount of the bad debt deduction, this $1,000 representing a charge to Appellant for capital stock. The debts represented money advanced by the Appellant to these subsidiaries and the amounts thereof were deducted on the basis that the debts were ascertained to be worthless and were charged off in 1936 under Section 8(e) of the Act,

The action of the Commissioner in disallowing a deduction for these debts must be sustained. Appellant had full knowledge of the affairs of each subsidiary and, therefore, knew at the close of the year 1932 that the debts were uncollectible except for the liquidated amounts due from Appellant which could have been and were subsequently set off against these debts. It has failed, accordingly, to make the necessary showing of a reasonable expectation of recovery to justify delaying the deductions until 1936, Curry v. Commissioner, 117 Fed. 2d 307.

Item 6. Appellant received income and incurred expenses in 1936 in connection with several properties which it rented to others during that year. The properties located outside of California were rented at a net gain of $55,188.39 and those in the State at a net loss of $113,109.01. The manner in which the Appellant handled the transactions respecting the rental properties in its return and the nature of the adjustments made by the Commissioner are not entirely clear. It will suffice to say, however, that the Appellant, in general, proceeded on the theory

that the rental of the properties was hot a part of its unitary business, whereas the Commissioner concluded to the contrary. He subsequently conceded, however, that one of the California properties, that located at Cakland, was not used in the unitary business.

The properties in question, with the exception of the Oakland property which was acquired in settlement of a debt, had been used in Appellant's unitary business, but that use had been abandoned prior to 1936 on the ground that they were of a type no longer suitable for use in the course of that business. During that year they were held for sale and were rented pending their disposition. Under these circumstances, they did not contribute to the unitary operations and are not to be regarded as used in or constituting a part of the unitary business. It follows, accordingly, that the income and expenses incident thereto should not be reflected in Appellant's unitary business income, that the properties should not enter into the property factor in the allocation process, and that Appellant is entitled to deduct the net loss of $113,109.01 from the California properties from the California portion of its unitary business income in computing the measure of its tax liability under Section 10 of the Act.

Item 7. During 1936 the Appellant had in the course of construction certain machinery, equipment and tools for use, when completed, in its unitary operations. Some of the property was being constructed in California and some outside the State. In its return of income the Appellant regarded the property as being used in its unitary business and included it in the property factor of the allocation formula. The Commissioner determined, however, that the inclusion of this property in the property factor did not correctly reflect business done in this State and, accordingly, excluded it from the factor. In support of its position, Appellant points to the reference in Section 10 to tangible property and apparently argues that inasmuch as the Property under construction is tangible property it should be included in the property factor as a matter of law regardless of whether it contributed to Appellant's earnings.

The Appellant's contention, in our opinion, is untenable. Section 10 by no means requires the inclusion of all tangible property in the property factor of the formula applied in a given case. As stated in the Butler Brothers case, it merely calls for a method of allocation which is fairly calculated to assign to California that portion of the net income reasonably attributable to business done here. The Commissioner having determined that the California portion of Appellant's income was more accurately reflected by the exclusion of the property under construction from the property factor, it was incumbent upon Appellant, under that decision, to establish by clear and cogent evidence that the Commissioner's action resulted in the taxation of extraterritoriai values. Inasmuch as the Appellant has not met this burden, the action of the Commissioner in this regard must be sustained,

Appeal of Ford Motor Company

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 Chapter 13, Statutes of 1929, as amended, that the action of Chas. J. McColgan, Franchise Tax Commissioner, on the protest of Ford Motor Company to a proposed assessment of additional tax in the amount of $20,119.54 for the taxable year ended December 31, 1937, the additional tax having been redetermined by the Commissioner in the amount of $16,675.53, be and the same is hereby modified. The Commissioner is hereby directed to compute the additional tax for said year in accordance with the views expressed in the opinion of the Board on file in this proceeding and to notify the Ford Motor Company of such computation. If the Commissioner and the Company are in agreement as to the amount of the additional tax, they shall file promptly with the Board a statement of the computation of said amount. If they are not in agreement as to said amount, each shall file with the Board a statement of the computation of said amount as believed by him or by it to be in accordance with the views expressed in said opinion. Further action in this matter will be deferred for a period of sixty days for the computation of the amount of the additional tax and the filing of the statement or statements required herein, Upon the filing of said statement or statements such further order of the Board as may appear appropriate will be entered herein.

Done at Sacramento, California, this 22d day of April, 1948, by the State Board of Equalization.

Wm. G. Bonelli, Chairman
Geo. R. Reilly, Member
J. H. Quinn, Member
Jerrold L. Seawell, Member
Thomas H. Kuchel, Member

ATTEST: Dixwell L. Pierce, Secretary