



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of }
INTERSTATE FINANCE CO. }

Appearances:

For Appellant: Bruce Casey, Attorney at Law

For Respondent: Burl D. Lack, Chief Counsel
Crawford H. Thomas, Associate Tax Counsel

O P - L N I O - N

This appeal is made pursuant to Sections 25667 and 26077 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Interstate Finance Co. to a proposed assessment of additional franchise tax in the amount of \$6,055.86 for the income year ended November 30, 1954, and in denying claims for refund of franchise tax in the amounts of \$8,609.30 and \$9,010.29 for the income years ended November 30, 1955 and 1956, respectively. Appellant having paid the assessment for 1954 in the amount of \$7,421.66, which includes interest, the appeal for that year will be treated as from the denial of a claim for refund in accordance with Section 26078 of the Revenue and Taxation Code.

Appellant was organized in 1949 under Utah law for the purpose of purchasing installment sales contracts from three affiliated corporations which were engaged in selling juke boxes and other coin-operated machines. In 1951, after entering into an agreement with the Bank of America whereby the bank agreed to buy from Appellant those installment contracts meeting certain credit standards, Appellant qualified to do business in California. This was done to be near the bank and implement the bank's right of inspection under the agreement.

During the years relevant to this appeal, Appellant's commercial domicile was in San Francisco, where it maintained its only office. There Appellant kept the records which were required by the bank to be made available for its inspection. Since most of the paper work involved in handling the installment contracts was done by the selling corporation, Appellant employed only three persons, an office manager and two bookkeepers, all of whom worked in San Francisco.

Appellant's method of operation was to buy the conditional sales contracts acquired by the affiliated corporations upon sales of machines to customers in the western states and Alaska.

Appeal of Interstate Finance Co.

Appellant then rediscounted, with recourse, the major portion of the contracts to the Bank of America. The bank generally accepted from 60% to 70% of the contracts.

Appellant's president, R. F. Jones, was a principal stockholder and officer of each of the three affiliated corporations. Appellant's vice president and treasurer, K. R. Moynihan, actively directed the financial operations of the entire group. Every 30 to 45 days, either Mr. Jones or Mr. Moynihan made trips on behalf of Appellant and the other corporations in the group through the territory served. Mr. Moynihan's salary was allocated among the four affiliates and Appellant paid \$3,600 per year as its share. Mr. Moynihan lived in California.

On its franchise tax returns for the years in dispute, Appellant attributed to California that proportion of its net income which the average monthly balance of installment contracts purchased from California sources bore to the total average monthly balance of installment contracts. The Franchise Tax Board allocated additional income to California through the use of a three-factor formula of (1) accounts receivable, (2) payroll, and (3) income from receivables. Taking the income year ended in 1954 as illustrative, Appellant by its method allocated approximately 42% of its net income to California while the Franchise Tax Board allocated approximately 80% to California.

Appellant does not deny that it conducts a unitary business, but contends that Respondent's allocation formula is improper. It further argues that the formula it used is appropriate and in the alternative urges the use of a two-factor formula made up of (1) income from receivables and (2) purchases.

Section 25101 of the Revenue and Taxation Code gives the Franchise Tax Board wide discretion in prescribing a formula for the allocation of income (El Dorado Oil Works v. McColgan, 34 Cal. 2d 731, appeal dismissed, 340 U. S. 801; Pacific Fruit Express Co. v. McColgan, 67 Cal. App. 2d 93). That section requires only that the method of allocation be "fairly calculated" to determine the income attributable to sources within California. A formula substantially identical to the one here used, employing the factors of loans outstanding, payroll and interest on loans has been upheld by this Board on several occasions as applied to finance companies. (Appeal of Public Finance Co., Cal. St. Bd. of Equal., December 29, 1958 (2 CCH Cal. Tax Gas. Par. 201-205), (2 P-H State & Local Tax Serv., Cal., Par. 13,194-j; Appeal of Tri-State Livestock Credit Corp., Cal. St. Bd. of Equal., April 4, 1960 (3 CCH State Tax. Rep., Cal., Par. 201-533), (2 P-H State & Local Tax Serv., Cal., Par. 13,219); Appeal of Beneficial Finance Co. of Alameda and Affiliates, Cal. St. Bd. of Equal., June 6, 1961 (3 CCH State Tax Rep., Cal., Par. 201-753), (2 P-H State & Local Tax Serv., Cal., Par. ____). The exercise by the Franchise

Appeal of Interstate Finance Co.

Tax Board of its discretion in selecting the allocation formula used by it here may be set aside only if Appellant establishes by clear and cogent evidence that the formula results in the taxation of extraterritorial values. (Butler Bros. v. McColgan, 315 U. S. 501.)

Appellant attacks the use of a payroll factor on the ground that its staff was negligible. Obviously, however, some staff was required for Appellant to operate and the staff necessarily contributed to the profit of the operation. The payroll factor is the easiest of all factors to justify as long as human services are necessary to the conduct of business. (Altman & Keesling, Allocation of Income in State Taxation, 122 (2d ed. 1950).)

Appellant also urges that the accounts receivable factor cannot properly be used to reflect income from California. This factor was composed of the installment obligations Appellant was unable to discount with the Bank of America; We have long held that the intangible nature of property will not prevent its use in allocating income. (Appeal of R. L. Polk & Co., Cal. St. Bd. of Equal., October 26, 1944, 2 P-H State & Local Tax Serv., Cal., Par. 13,055.) This property was clearly an income producing factor. It is entirely appropriate to assign the intangibles to their situs. (Altman & Keesling, supra, pp. 121-122,) Since Appellant's commercial domicile is California and the intangibles have not acquired a business situs elsewhere, their situs is in this State. (Southern Pacific Co. v. McColgan, 68 Cal. App. 2d 48.)

Appellant attempts to establish the impropriety of Respondent's formula by arguing that it could easily move its operation to another state without affecting its income. It points out that a transfer of its clerks and records to Utah would greatly alter the results obtained by Respondent's formula. The fact is, however, that for reasons sufficient to Appellant it established its operation in California.

Save for a few trips a year taken by its officers, Appellant's business was conducted entirely within the confines of this State. We are of the opinion that Respondent's formula is more than fair in apportioning only 80% of Appellant's net income to California.

Appellant also asserts that the use of Respondent's formula denies to it due process and equal protection of the law. Appellant cites a federal statute permitting state taxation of national banks which provides that "the taxing State may ... include the entire net income received from all sources, but the rate shall not be higher than the rate assessed upon other financial corporations." (12 U.S.C. 548§1(c).)

We can see no merit to Appellant's argument. Appellant does not come within the protection of the above language since

