BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of

CORPORATION OF AMERICA,)
BANKAMERICA COMPANY AND)
ASSOCIATED AMERICAN)
DISTRIBUTORS)

Appearances:

For Appellants: Louis Ferrari, Attorney at Law; William Johnson, Accountant
For Respondent: Chas. J. McColgan, Franchise Tax Commissioner

O P I N I O N

These are appeals pursuant to Section 25 of the Bank and Corporation Franchise Tax Act (Chapter 13, Statutes 1929, as amended) from the action of the Franchise Tax Commissioner in overruling the protests of Corporation of America, Bankamerica Company and Associated American Distributors, against his proposed assessments of additional taxes. The amount of the additional taxes and the years for which proposed are as follows:

Corporation of America.....$83,446.17 for the year 1931.
Bankamerica Company.,.....$ 661.39 for the year 1930.
Associated American Distributors,.$ 270.90 for the year 1931.

Inasmuch as the problems presented for the determination of this Board in the appeals of Bankamerica Company and Associated American Distributors are also raised in the appeal of Corporati of America, together with another problem not presented in either of the appeals of the first two mentioned corporations, and inasmuch as all of the above Appellants were represented by the same counsel, we have considered the proceedings as a consolidat appeal.

During the year 1930, Corporation of America received dividends from Transamerica corporation, a foreign corporation not doing business here, but which received a part of its income in the form of dividends from a California corporation doing business in California, The Commissioner disallowed as a deduction the entire amount of dividends received by Corporation of America from Transamerica Corporation in computing Appellant's net income for the year 1930. The Appellant contends that the dividends it received are deductible under Section 8(h) of the= Act insofar as they were paid out of income of Transamsrica Corporation which the latter corporation received in the form of dividends from a California corporation doing business in California.

Section 8(h) of the Act provides that from gross income

there may be deducted:

> "Dividends received during the taxable year from income arising out of business done in this state."

The controlling factor in determining whether dividends received are or are not deductible would seem to depend on whether they were paid out of or came from "income arising out of business done in this state". If the income out of which the dividends were paid arose out of business done in this state, the dividends are deductible. If, however, the income out of which the dividends were paid did not arise from business done in this State, the dividends are not deductible. The problem presented for our decision then is whether the income of Transamerica Corporation, i.e., the income out of which the dividends received by Corporation of America were paid, should be considered as income "arising out of business done in this state."

It is to be borne in mind that Transamerica Corporation, although owning stock in a California corporation doing business in this State, and although receiving a part of its income in the form of dividends from this stock, did not itself engage in business in California. Consequently, it would seem that its income could not be considered as income "arising out of business done in this state" for the simple reason that it did no business here. But Appellant maintains that we should not be satisfied to look solely at the immediate source of Transamerica Corporation's income, but that we should look beyond that immediate source to a more remote source, to the source from which the corporation paying dividends to Transamerica Corporation received its income, and so looking, find that the source of Transamerica's income was business done in California.

In effect, Appellant's contention amounts to this: that when the corporation paying dividends to Transamerica received income from business done in California, that income became tagged with the label "Income arising out of business done in California;" that this income, although changed in its ownership retained its label when it paid to Transamerica Corporation; and consequently that the dividends received by Corporation of America from Transamerica Corporation must be considered as being paid out of income arising out of business done in this State.

We are not impressed by Appellant's contention. We are fully cognizant of the fact that income may be spoken of as having a source, as for example income from tax exempt bonds, or income from business done in this State. But we are of the opinion that when the individual or corporation receiving or earning the income passes it on to other individuals or corporations in payment of debts or for the purchase of goods, or as dividends on stock, the income loses the source it first had, and acquires a new source. So when an individual or corporatio

receives interest on tax exempt bonds, for example, and passes the interest on to other individuals or corporations, the interest loses its designation as income from tax exempt bonds, and must be considered as having acquired a *new* designation, Thus when the corporation which earned income from business done in California paid some of that income to Transamerica Corporation in the form of dividends, we think the income must be considered as having lost its character as income from business done in California. Consequently, we must hold that when Transamerica Corporation paid dividends to Corporation of America, the dividends were not paid out of income arising out of business done in California, and consequently, the dividends are not deductible under Section 8(h) of the Act.

It is to be noted that the above conclusion is the only conclusion we could reach which would be consistent with our decision in the Appeal of Keck Investment Company (decided by this Board on December 14, 1931). The following situation was presented in that appeal: Keck investment Company, a California corporation doing business in this State, received dividends from Union Oil Associates, a California corporation regarded by this Board as doing business in this State; all of the income of Union Oil Associates was received from Union Oil Company, a California corporation doing part of its business outside the state. The problem for determination was whether the dividends, received by Keck Investment Company were deductible under Section 8(h) of the Act, i.e., were they received from income arising out of business done in this State. If, in determining whether the income of Union Oil Associates was or was not derived from business done in this State, we had looked to the source from which Union Oil Company derived its income, we should have had to hold that only a part of the income of Union Oil Associates was derived from business done in this State, and consequently, that only a part of the dividends received by Keck Investment Company were deductible under Section 8(h). However, we looked only to the source from which Union Oil Associates derived its business, and so looking we held that all its income was derived from business done in California, i.e., holding stock, and consequently we held that all of the dividends received by Keck Investment Company were deductible, Applying this same reasoning to the instant appeal, we would have to conclude that the dividends received by Appellant were derived from business done outside the state, and hence are not deductible since Transamerica Corporation did no business in this State.

The next problem involved in these appeals relates to the deduction of federal income taxes alleged by Corporation of America and Bankamerica to have accrued during the year 1930. Apparently, both of the above corporations were members of an affiliated group which filed a consolidated return with the Federal government for the year 1930. If separate returns had been filed by each of these corporations, substantial federal income taxes for the year 1930 would have had to been paid. But due to the fact that other members of the affiliated group sus-

tained losses, no taxes for the year 1930 were required to be paid on account of the net income earned by either of the above two corporations. Notwithstanding this fact, Corporation of America and Bankamerica contend that the amount of federal income taxes which they would have been required to pay had they not joined with other corporations in filing a consolidated return should be considered as having accrued during the year 1930 and hence should be allowed as a deduction in computing the net income of these corporations for the year 1930 in accordance with Section 8(c) which permits the deduction from gross income of federal income taxes accrued during the year, with certain exceptions not relevant here. We see no merit in this contention. We recognize that taxes can accrue prior to the time they are paid, and also prior to the time they become due and payable if all the events have occurred which give rise to the taxes, and liability therefor is certain (See United States v. Anderson, 269 U. S. 422; Appeal of May Department Stores, decided by this Board on May 11, 1932). But we know of no authority holding that taxes can accrue when there are no taxes to become due and payable and when there is no liability to pay the taxes as is the case in the instant appeal. In the absence of any such authority, we must hold that an accrual for taxes cannot be made unless events have occurred on the basis of which taxes will at some time become due and payable.

The next and final problem in these appeals involves a question as to the proper method of computing taxes for the year 1931 of corporations commencing to do business for the first time in 1930. Associated American Distributors, and two subsidiaries of Corporation of America commenced to do business in this State for the first time after the effective date of the Act, during the year 1930. Their taxes for the year 1930 were computed on the basis of their net income for the year 1930 in accordance with the second paragraph of Section 13. In computing their taxes for the second taxable year, i.e., the year 1931, the Commissioner followed the provisions of an amendment to the second paragraph of Section 13 which became effective on February 27, 1931 (See Stats. 1931, p. 65) and which provides that the return for the first taxable year shall be used as the basis for the tax for the second taxable year

> "except that in every case in which the first taxable year of a bank or corporation constitutes a period of less than twelve months, the net income to be used as the measure of the tax for the second taxable year shall be in the same proportion to the net income for the first taxable year as the number of months in the second taxable year bears to the number of months covered by the return for the first taxable year."

Prior to the effective day of this amendment, the Act provided simply that the tax for the second taxable year of a bank or corporation should be computed on the basis of its net income for the first taxable year. But under this amendment, if there are, for example, six months in the first taxable

year, the net income earned during the first taxable year will be doubled for the purpose of computing a tax for the second taxable year.

The Appellants contend that this amendment should not be followed in computing the taxes for the year 1931 of corporation: which commenced to do business for the first time in 1930 for two reasons: (1) The second paragraph of Section 13 of which the amendment is a part, purports to relate only to corporations which commence "to do business in this state, after the effective date of this act"; that by the term "act" was meant the act by which the amendment was adopted; and consequently, the amendment is applicable only to corporations which commence to do business in this State after the effective date of the amendment, i.e., after February 27, 1931; (2) that to follow the amendment in the computation of taxes based on 1930 income would be to give to the amendment a retroactive effect inasmuch as it did not become effective until after the close of the year 1930.

The first contention, we think, can be dismissed with but little serious consideration. The first part of the second paragraph of Section 13 which contains the phrase "a corporation which commences to do business in this State, after the effective date of this act" was a part of the Bank and Corporation Franchise Tax Act when originally enacted in 1929. Consequently, we think that the phrase "effective date of this act" had reference to the effective date of the Bank and Corporation Franchise Tax Act and not the act amending the second paragraph.

A problem similar to the problem raised by the second contention has been passed on by this Board in a previous appeal. In the appeal of United States Oil and Royalties Company, (decided by this Board on May 10, 1932) we held that an amendment, effective February 27, 1931, to Section 8(g) of the Act providing that depletion in the case of oil and gas wells could not be computed on the basis of January 1, 1928 values, as was previously provided, should be followed in computing taxes for the year 1931 notwithstanding the fact that said taxes were to be measured by income for the year 1930. In so holding, we were careful to point out that we were applying the amendment prospectively and not retroactively. In this connection, we expressed ourselves as follows:

> "The application of the amendment to the computation of income for the year ended December 31, 1931, does not in any way affect taxes for a year prior to the effective date of the amendment. The income of Appellant for the year ended December 31, 1930, is used solely as a basis for computing Appellant's tax liability under the act for the year 1931. This tax, although it accrued, under Section 4 of the act, prior to the time the amendment in question became effective, is nevertheless a tax on Appellant for the privilege of exercising its corporate franchise throughout the year 1931, the current year as of the time the amendment became effective, We are

unable to perceive why a change in the method of computing a tax should be considered retroactive because the change is applied to the computation of the tax for the year in which the change became effective."

In line with the above views we might quote the following statement of R. J. Traynor, Associate Professor of Law, University of California, appearing at page 739 of the 1932 edition of Ballantine's California Corporation Laws:

"The tax imposed in 1931 is not a retroactive tax but a tax for the current taxable year. It is difficult to see on what basis a taxpayer can claim that, regardless of legislative action, current taxes must be figured on the same basis on which past taxes have been assessed, or in fact om what grounds he can complain if the rates of current taxes were increased or if, indeed, additional taxes were imposed during the same year on the same subject."

The problem involved in the instant appeal with respect to the 1931 amendment to the second paragraph of Section 13 is substantially the same as the problem involved in the Appeal of United States Oil and Royalties Company. The same reasons which caused us to reach the result we reached in that appeal, compel us to hold that the amendment to the second paragraph of Section 13 should be followed in computing the taxes for 1931 of corporations commencing to do business in this State for the first time during the year 1930.

For the reasons above given, we must hold that the Commissioner did not err in overruling the protests of Appellants to the proposed assessments of additional taxes involved in these appeals.

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 protests of Corporation of America, Bankamerica Company, and Associated American Distributors against proposed assessment, of additional taxes under Chapter 13, Statutes of 1929, be and the same is hereby sustained.

Done at Sacramento, California, this 12th day of May, 1932, by the State Board of Equalization.

R. E. Collins, Chairman
Fred E. Stewart, Member
Jno. C. Corbett, Member
H. G. Cattell, Member

ATTEST: Dixwell L. Pierce, Secretary