



BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )  
B. F. COULTER ASSOCIATION )

Appearances:

For Appellant: Ralph W. Smith, Attorney, and Sherman Jones

For Respondent: Chas. J. McColgan, Franchise Tax Commissioner

O P I N I O N

This is an appeal pursuant to Section 25 of the Bank and Corporation Franchise Tax Act (Statutes of 1929, Chapter 13, as amended) from the action of the Franchise Tax Commissioner in **overruling** the protest of B. F. Coulter Association, a **corporation, to a proposed assessment** of an additional tax in the sum of **\$259.86** based upon its return for the fiscal year ended July 31, 1932.

During the year 1927, Appellant executed a fifteen year lease on a building owned by it. Under the terms of the lease, the lessees paid in advance the sum of **\$19,250.00**, **\$2,750.00** of which was applied on the first month's rental, and the balance of **\$16,500.00** was credited on the rental for the last six months of the term. In consideration of the payment of the last six months rental in advance, the lessees were to obtain a reduction in the annual rental in an amount equal to five percent of said payment of **\$16,500.00**.

In 1932, the lessees defaulted in the payment of the stipulated rental, and in May of said year the lease was forfeited. A compromise agreement was entered into pursuant to which the lessees paid Appellant the sum of **\$2,750.00**. Neither the advance payment of **\$16,500.00** nor the sum of **\$2,750.00** paid in May 1932 was reported as income in Appellant's franchise tax return for the fiscal year ended July 31, 1932. The Commissioner however, considered, both items as income for said year and, accordingly, proposed the additional assessment in question.

The Appellant concedes that the item of **\$2,750.00** should have been reported as income for the fiscal year ended July 31, 1932, but contends that the item of **\$16,500.00** should be **considered** income for the year 1927 rather than income for 1932, inasmuch as Appellant's books are kept on a cash receipts and disbursement basis and inasmuch as the item was actually received during the year 1927. The Appellant cites a number of Board of Tax Appeals' cases which, although not directly in point, nevertheless tend to support Appellant's position to the effect that an advance payment of rental is to be regarded as income for the

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year in which paid in cases where the taxpayer reports on a cash receipts and disbursement basis (See *O'Day Investment Company*, 13 B.T.A. 1230; *James Butler*, 19 B.T.A. 718; *Roby Realty*, 19 B.T.A. 696; *Douglas Properties*, 21 B.T.X. 347; and *Boston Providence*, 23 B.T.A. 1126).

The Commissioner's position is that the item in question, although paid in the year 1927, cannot be regarded as "constructively received" during that year and hence must be considered as income for the year 1932, when, as a result of the surrendering of the lease, Appellant's right to retain the advance payment of rental was finally and definitely established.

Although a doctrine of constructive receipt of income has arisen in connection with the Federal income tax, we know of no instances in which it has been held as a result of the doctrine that items actually received during a particular year constituted income for a subsequent year rather than for the year in which received. On the contrary, it appears that the effect of the doctrine is to expand the term "received" and to treat as income for a particular year not only items actually received during that year but in addition such receivable items as were not received solely through the fault of the taxpayer. "The failure to receive must be entirely due to the taxpayer's unwillingness to receive or to his neglect to do so." (Klein, *Federal Income Taxation*, Par. 6:23). Apparently, the purpose of the doctrine is to prevent a taxpayer, simply by refusing or neglecting to receive items which he could have received, from exercising an option as to the year in which the items should be regarded as income.

In view of the above, it would seem that the doctrine of "constructive receipt" is entirely inapplicable in the instant case, and hence we need not consider whether the advance payment of rental was, or was not, "constructively received" during the year 1927.

That the sum of \$16,500.00 in question was actually paid by the lessees to Appellant during the year 1927 is not question. Although the item is to be regarded as in the nature of a deposit or as security for the performance by the lessees of the lease agreement, and although under certain circumstances, such as violations by the Appellant of the lease agreement, the Appellant might have been required to reimburse the lessees for the advance payment of rental, it appears that the Appellant obtained full and complete control over the advance payment in 1927 and could have lawfully expended it for any purpose it desired. Under these circumstances, we believe Appellant must be regarded as having actually received the advance payment" in 1927. Consequently inasmuch as Appellant keeps its books on a cash receipts and disbursement basis, we must conclude that the item constituted income for the year 1927 rather than for the year 1932.

O R D E R

Pursuant to the views expressed in the opinion of the Board

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on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, that the action of the Franchise Tax Commissioner in overruling the protest of B. F. Coulter Association against a proposed assessment of an additional tax in the amount of \$259.86 based upon the net income of said corporation for the fiscal year ended July 31, 1932, be and the same is hereby modified. Said action is reversed insofar as the Commissioner included in the income of the B. F. Coulter Association for said year an item of \$16,500 representing advance payment of rental received during the year 1927. In all other respects said action is sustained. The correct amount of the tax to be assessed to the B. F. Coulter Association is hereby determined as the amount produced by means of a computation which will exclude the above sum of \$16,500.00 from the income of said corporation for said year in the calculation thereof. The Commissioner is hereby directed to proceed in conformity with this order and to send B. F. Coulter Association a notice of the assessment revised in accordance therewith.

Done at Sacramento, California, this 16th day of February, 1934, 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