BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
FOX THEATRE GOLD ROOM, INC.)

Appearances:

For Appellant: Marcel E. Gerf, Robinson & Leland (by brief)

For Respondent: Chas. J. McColgan, Franchise Tax Commissioner; W. M. Walsh, Assistant Commissioner; Crawford H. Thomas, Assistant Tax Counsel.

O P I N I O N

This is an appeal taken pursuant to the provisions of 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 Fox Theatre Gold Room, Inc., to the Commissioner's proposed assessment of additional tax in the amount of $105.87 for the taxable year ended April 30, 1939.

The question involved in this appeal is whether the Appellant realized taxable income on the cancellation of certain indebtednesse owed to Michael Natov, who, the Appellant alleges is the equitable owner of all of the stock of the corporation.

Appellant filed its tax returns on the accrual basis for fiscal years ending April 30. During the fiscal year ended April 30, 1938, the corporation was forgiven salary of $2,321.01 due Micahel Natov and salary of $750.13 due Moe Natov. Both of the salaries accrued,during that fiscal year. Appellant was also forgiven a note in the sum of $500.00 drawn in favor of Samuel Sagon. All the right and title to the note, although recorded on the books of the corporation in the name of Sagon, belong to Michael Natov, who had originally loaned the money covered by the note to the corporation.

Appellant does not appeal from the Commissioner's determination that the cancellation of the indebtedness owed to Moe Natov resulted in income being realized by the taxpayer. However, Appellent does contend that the forgiveness of the salary due Michael Natov did not result in the realization of income, inasmuch as it alleges that Michael Natov was the equitable owner of all of Appellant's stock. The Appellant further contends that the cancellation of its note to Samuel Sagon does not constitute income, as it is alleged that the amount of this note was in fact loaned to the corporation by the sole stockholder,

The Respondent computed the tax by adding to income, under

Section 8(o) of the Act, as amended in 1937, both of the salary obligations which were forgiven during the income year. Inasmuch as the law applicable to the computation of the tax changed during the taxable year, because of the repeal of Section 8(o) and the enactment of Section 6(d), Respondent recomputed the tax under the Act, as amended in 1939. In this computation the Respondent, under Section 6(d), added to income the above mentioned salary items and the amount of the note in the name of Sagon. In accordance with the provisions of Section 12(d), the Respondent then computed the total tax by combining 8/12ths of the tax found to be due under the first computation, and 4/12ths of the tax found to be due under the second computation,

In its brief Appellant has made no reference to the applicable provisions of the Bank and Corporation Franchise Tax Act. Appellant relies upon regulations of the United States Treasury Department and decisions of the Federal courts, principally upon the recent decision of the United States Supreme Court in Helvering vs. American Dental Co., 87 L. Ed. Advance Opinions 574. It is true that that case settled a previous conflict among the decisions of the various federal courts on the question and that the court held that the cancellation of an indebtedness does not comprise taxable income, but is a nontaxable gift.

The decision in Helvering vs. American Dental Co., (supra) is not determinative of the question here. The court in that case was concerned with the federal statutes and regulations which contain no provisions similar to Section 8(o), prior to its repeal in 1939, or to Section 6(d), as enacted in that year. Section 8(o) plainly provides that the amount of the unpaid obligation forgiven which was previously allowed as a deduction shall constitute income in the year of forgiveness to the'extent that the deduction allowed resulted in a tax benefit. The issue involved in this appeal is identical with that involved in the appeal of Sun Lighting Fixture Company which we decided on January 20, 1943. Upon the basis of our decision in that appeal, and particularly in reliance upon the Attorney General's Opinion No. NS 4649, dated December 18, 1942, the issue insofar as Section 8(o) is concerned, must be determined contrary to the contentions of the Appellant.

It should be noted that since Appellant is on the accrual basis, the salary of Michael Natov was deducted upon the Appellant's return for the income year ended April 30, 1938, and as the taxpayer reported a net loss of 5397.11 for said income year, it follows that the deduction of salary due Michael Natov in the sum of $2,321.01, resulted in a tax benefit.

We are of the opinion also that the issue with reference to Section 6(d) must be determined against the contentions of the Appellant. That section provides:

> "If the indebtedness of a bank or corporation is cancelled or forgiven in whole or in part without payment, the amount so cancelled or forgiven shall constitute income to the extent the value of the property (including franchises) of the bank or corporation exceeds its liabilities immediately after the

> cancellation or forgiveness. The remainder of the amount of indebtedness so cancelled or forgiven, if any, shall be applied in reduction of the basis of the assets to the extent the basis thereof exceeds the alue thereof immediately after the cancellations or forgiveness, such reduction to be made in accordance with regulations prescribed by the commissioner,
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> "If an indebtedness is not paid by the time an action to enforce payment is barred by limitation, the indebtedness shall be considered cancelled or forgiven within the meaning of this subsection unless it can be established that the period of limitation has been extended by a new promise in writing.,,

Section 6(d) covers all cases of forgiveness of indebtedness, and contains no exception for the forgiveness of an indebtedness by a corporate stockholder. Consequently, like Section 8(o), Section 6(d) is not affected by decisions of the federal courts or regulations of the United States Treasury Department.

The statutory provisions make the excess of assets over liabilities the test of realization over income from forgiveness of indebtedness. The Appellant does not here contend that after the cancellation of the indebtedness in question its assets did not exceed its liabilities. The return of the Appellant shows the net worth of the corporation on April 30, 1938, to have been $3,546.77. The value of the fixed assets was increased by the Respondent's notice of proposed assessment in the amount of $637.75; consequently, the adjusted net worth of the corporation on April 30, 1938, was $4,184.52, which was more than the amount of the indebtedness forgiven. We conclude that the computation of the additional assessment by the Respondent is correct.

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 Charles J. McColgan, Franchise Tax Commissioner, in overruling the protest of Fox Theatre Gold Room, Inc., to a proposed assessment of additional tax in the amount of $105.87 for the taxable year ended April 30, 1939, pursuant to Chapter 13, Statutes of 1939, as amended, be, and the same is hereby affirmed.

Done at Sacramento, California, this 23rd day of September, 1943, by the State Board of Equalization.

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

ATTEST: Dixwell L. Pierce, Secretary