44-SBE-003

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
C. L. DUNCAN)

Appearances:

For Appellant: A. Don Duncan, Attorney at Law.

For Respondent: James J. Arditto, Franchise Tax Counsel.

O P I N I O N

This appeal is made pursuant to Section 19 of the Personal Income Tax Act (Chapter 329, Statutes of 1939, as amended) from the action of the Franchise Tax Commissioner in overruling the protest of C. L. Duncan to a proposed assessment of additional tax in the amount of $1,859.06 for the taxable year ended December 31, 1936.

Appellant acquired the entire stock in C. L. Duncan Company, a corporation, by exchange or purchase. Thereafter, in 1926, the corporation was liquidated and dissolved and Appellant received all its assets in liquidation. Appellant filed a personal income tax return for the calendar year 1936 on or about April 6, 1937, but did not include therein any gain from said liquidation as gross income. On June 17, 1940, the Respondent issued his notice of proposed assessment of additional tax for 1936. This assessment was based, inter alia, on the theory that Appellant realized a gain in 1936 on the liquidation of the Duncan Company measured by the excess of the fair market value of the assets he received in liquidation over the cost of his stock.

The first question raised by the Appellant is whether the 1939 amendment to Section 19 of the Personal Income Tax Act extending from three to four years the period within which a deficiency tax might be assessed is applicable to a deficiency tax for the year 1936, the return for that year having been filed on or about April 6, 1937.. As amended, Section 19 provides, in part:

> "Except in the case of a fraudulent return, every notice of a proposed deficiency tax shall be mailed to the taxpayer within four years after the return was filed and no deficiency shall be assessed or collected with respect to the year for which such return was filed unless such notice is mailed within such period." (Stats. 1939, p. 2558)

Section 23 of the amendatory act (Stats. 1939, p. 2566) provide: as follows:

> "This act, inasmuch as it provides for a tax levy for the usual current expenses of the State, shall, under the provisions of section 1 of Article IV of the Constitution, take effect immediately, and shall be applied in the computation of taxes accruing subsequent to December 31, 1938."

This act became effective on July 25, 1939, and at that time the three-year period provided by Section 19 as enacted in 1935 had not yet expired as respects a return for 1936. The notice of the proposed deficiency tax was mailed to Appellant within the four-year period specified by the amendment, but not within the three-year period originally prescribed.

The Appellant concedes that it is within the power of the Legislature to extend the limitation period from three to four years as respects assessments not barred at the time of the amendatory act. He contends, however, that the Act should not be construed as so extending the period unless it clearly appears that such was the legislative intent.

Section 23 of the amendatory act offers, in our opinion, little or no assistance in this connection. It is difficult to see wherein a limitation period relates to the computation of taxes. It appears that the purpose of the second clause of the Section, which states that the act shall be applied in the computation of taxes accruing subsequent to December 31, 1938, is to overcome the presumption against retroactivity and to provide for a limited retroactivity of the provisions of the act relating to the computation of taxes. These provisions relate to such matters as inclusions in or deductions from gross income. It should be observed that the Legislature did not provide, as it might easily have done had it so desired, that the act shall be applied to the assessment and collection, as well as the computation, of taxes accruing subsequent to December 31, 193

The Respondent contends that the application of the amendatory act to the assessment in question involves not a retroactive but rather a prospective application of that act. This position is, we believe, adequately supported by Davis & McMillan v. Industrial Accident Commission, 198 Cal. 631; Doehla v. Phillips, 151 Cal. 488; Weldon v. Rogers, 51 Cal. 432; and Swamp Land District No. 307 v. Glide, 112 Cal. 85. Under these authorities the four-year period provided by the 1939 Act is applicable to an assessment not-barred on the effective date of that act even though there be no mention therein of existing liabilities.

Furthermore, it may be noted that prior to 1939, Section 19 of the Personal Income Tax Act, relating to the levy of assessments, and Section 20 of the Act, relating to the filing of claims for refund, provided three-year periods of limitation from the time of the filing of the return. The 1939 Act amended both sections, substituting a four-year for the three-year period in each. In the Appeal of Phyllis Marshall (December 31, 1941), we determined that the Legislature intended that the 1939 amendment to Section 20 apply to a claim for refund for the year 1935, the claim having been filed within the four-year period provided by the 1939 Act, though it was

barred when filed. It is unnecessary for us to determine herein whether the 1939 amendment to Section 19 operated to revive a barred assessment. It does seem proper to conclude, however, in view of the prescribing of similar periods for levying assessment and claiming refunds both before and after the 1939 Act, that the Legislature intended that the four-year period provided by Section 19 as amended be applicable to assessments not barred on the effective date of that act.

Appellant has urged vigorously that the decision of the United States Supreme Court in Russell v. United States, 278 U.S. 181, is determinative of the present matter and that under that decision the change from three to four years does not effect the assessment in question. Wholly apart from the fact that decisions of the United States Supreme Court are not controlling on the question of the mere construction of a state law, it should be observed that the Court determined in that case only that Congress had expressly directed that the amendatory act should not apply to assessments made prior to a specified date.

Appellant further objects to the proposed assessment upon the ground that no gain was realized by him when he received the entire assets of the Duncan Company upon its liquidation. Section 7(g)(3) of the Personal Income Tax Act as adopted in 1935 (Stats. 1935, p. 1096) provided, in part:

> "Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under subsection (d) of this section, but shall be recognized only to the extent provided in subsection (d) of this section. Despite the provisions of subsection (e) of this section, 100 per centum of the gain so recognized shall be taken into account in computing net income.

It is Appellant's position that as he was the sole stockholder of the corporation and as he carried on the business after the distribution by the corporation, there was no liquidation. It will be noted? however, that the language above quoted relates to the "liquidation of a corporation" rather than to the liquidation of the business carried on by the corporation. Appellant relies principal13 on Hinkel v. Motter, 39 Fed. (2d) 199, and Law v. McLaughlin, 2 F. Supp. 601. Hinkel v. Motter, like the present appeal, involved the taxability of a transfer a corporation of all its assets to its sole stockholder, and it was held that the stockholder did not realize any taxable income from the transaction even though the value of the assets exceeded the purchase price of the stock. Law v. McLaughlin involved the sale of property by a sole stockholder after all the property of the corporation had been transferred to that stockholder, it being held that the corporate entity should be dis-

regarded and the property considered as purchased as of the time the stock in the corporation had been acquired.

These cases relied upon by Appellant are in direct conflict with the following cases:

Coxe v. Handy, 103 F. (2d) 873

France Co. v. Commissioner, 88 F. (2d) 917 (Certoirari denied 302 U. S. 699)

Cook v. United States, 3 F. Supp. 47

Appeal of Greenwood, 1 B. T. A. 291

Appeal of E. C. Huffman, 1 B. T. A. 52

C. L. Duncan Company, a corporation, was liquidated even though the business formerly carried on by the corporation was thereafter carried on by the Appellant. It is our opinion that the liquidation of the corporation constituted a "liquidation" within the meaning of Section 7(g)(3). In France Co. v. Commissioner, supra, the business was apparently carried on by the sole stockholder, but nevertheless the transfer to the stockholder was held to constitute a taxable transaction. In the Appeal of E. C. Huffman, supra, the business was carried on by partners who had been stockholders of the corporation.

It is interesting to note that the United States District Court in its opinion in Coxe v. Handy (24 F. Supp. 178; aff'd 103 F. (2d) 873) commenteds follows on Hinkle v. Motter and Law v. McLaughlin:

> "An offer of settlement was accepted while the Hinkel case was pending on appeal. The McLaughlin case was decided upon demurrer in the district court. Afterwards the question of valuation was compromised and the case was settled. The reason for decision stated in the McLaughlin case is unsound. The cases are without weight."

Another point was originally argued by Appellant but apparently has been abandoned. It was that only thirty per cent or forty per cent of the gain should be taxable as provided in the 1937 and 1939 amendments to the Personal Income Tax Act rather than one hundred per cent as provided in the original Act of 1935.

So far as the "computation of taxes" for the year 1936 is concerned, the amendments of 1937 and 1939 have no effect. (Stats. 1937, p. 1861, Sec. 21; Stats. 1939, p. 2566, Sec. 23, hereinabove quoted.) Furthermore, a reduction or cancellation of a tax which had already accrued would be in conflict with Section 31 of Article IV of the California Constitution prohibiting gifts. Estate of Stanford, 126 Cal. 112.

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 protest of C. L. Duncan to a proposed assessment of an additional tax in the amount of $1,859.06 under the Personal Income Tax Act for the taxable year ended December 31, 1936, be, and the same is hereby, affirmed.

Done at Sacramento, California, this 9th day of March, 1944, by the State Board of Equalization.

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

ATTEST: Dixwell L. Pierce, Secretary