47-SBE-005

In the Matter of the Appeal of)
GEORGE WINDELER COMPANY, LTD.) .

Appearances:

For Appellant: John W. Burrows, Certified Public Accountant
Edward D. Keil, Attorney at Law

For Respondent: W. M. Walsh, Assistant Franchise Tax Commissioner; Edward C. Sarkisian, Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to Section 27 of the Bank and Corporation Franchise Tax Act (Chapter 13, Statutes of 1929, as amended) from the action of the Franchise Tax Commissioner in denying the claim of George Windeler Company, Ltd., for a refund of tax in the amount of $1,547.17, plus interest thereon of $242.36, for the taxable year ended December 31, 1941.

Except as respects the ownership of 100 of its 17,000 shares, Appellant was a family corporation during the period here in question, its stockholders, with the exception of the wife of the President, also being its officers. As of December 31, 1939, Appellant's books showed credits in favor of these officers for salaries totaling $61,296.79 for the period 1930 to 1939, inclusive. The amount of these salaries had been deducted as salaries paid in its returns of income and from 1935 had been reported as income in the individual income tax returns of the officers. In 1940, they agreed to turn back to the corporation's surplus such portion of the salary credits as would be represented by a capital assessment of $3.00 per share of stock held. As of November 1, 1940, an entry was made in Appellant's books crediting the surplus account with $50,700 (16,900 shares @ 33.00) and making an appropriate charge against each officer's account.

The Commissioner regarded this amount of $50,700 as income to Appellant for the year 1940, pursuant to Section 6(d) of the Bank and Corporation Franchise Tax Act, which provided as follows:

> "(d) If the indebtedness of a bank or corporation is canceled 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 exceed 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 value thereof immediately after the cancellation or forgiveness such reduction to be made in accordance with regulations prescribed by the commissioner."

The Appellant contends that the transaction did not create taxable income within the meaning of this Section. Its position is that in reality the transaction amounted to an assessment against the four stockholders in proportion to their respective holdings which was satisfied by a book adjustment. It asserts that the same object could have been accomplished by paying out to them accrued salaries to the extent required by the assessment and receiving back an equivalent sum. The amounts so credited to be paid in surplus, Appellant claims, constituted a contribution to the capital of the corporation rather than taxable income. In support of this position it cites American Dental Co. v. Commissioner, 318 U.S. 322; Carroll-McCreary Co. v. Commissioner, 124 Fed. 2d 303, and Triple Z Products, (U.S.D.C.) 27 A.F.T.R. 1164.

These cases involved Section 22(a) of the Federal Revenue Act which does not include an express requirement that canceled or forgiven indebtedness be included in gross income. Under the Federal Acts prior to 1942, the inclusion of such amounts hinged upon the question of whether the particular facts brought the transaction within the general definition of gross income in Section 22(a) as interpreted by Treasury Regulations and judicial decisions. Here, the inclusion is required in the circumstances described by Section 6(d), regardless of the nature of the effects of the transaction, and the Federal cases, accordingly, are irrelevant.

Furthermore, it may be observed that there is no evidence in the record that Appellant was authorized by its Articles, in accordance with Section 331 of the Civil Code to make an assessment upon its stocks, that a resolution imposing the assessment was adopted by its Board in accordance with Section 332 or that notice in the form required by Section 333 was published. In any event, however, the assessment, if one was in fact attempted, was invalid and void for lack of uniformity. An assessment which is imposed upon some shares and not upon others of the same class is void. Kohler v. Agassiz, 99 Cal. 9; Herbert Kraft Co. Bank v. Bank of Orland, 133 Cal. 64.

If follows, accordingly, in our opinion that the transaction must be regarded as a cancellation of indebtedness within the meaning of Section 6(d) of the Act and that the position of the Commissioner must be sustained.

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 denying the claim of George Windeler Company, Ltd., for a refund of tax in the amount of $1,547.17, plus interest thereon of $242.36, for the taxable year ended December 31, 1941, pursuant to Chapter 13, Statutes of 1929, as amended, be and the same is hereby sustained.

Done at Sacramento, California, this 24th day of July by the State Board of Equalization.

Wm. G. Bonelli, Chairman
Geo. R. Reilly, Member
J. H. Quinn, Member
Jerrold L. Seawell, Member

ATTEST: Dixwell L, Pierce, Secretary