BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal)
)
of)
)
SACRAMENTO VALLEY TRACTOR CO.)

Appearances:

For Appellant: Downey, Brand, Seymour & Rohwer, Attorneys at Law

For Respondent: Burl D. Lack, Chief Counsel; Crawford H. Thomas, Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to Section 26077 of the Revenue and Taxation Code (formerly Section 2'7 of the Bank and Corporation Franchise Tax Act) from the action of the Franchise Tax Board in denying the claim of the Sacramento Valley Tractor Co. for a refund of tax in the amount of $5,085.78 for the taxable year ended August 31, 1947, and of interest paid thereon in the amount of $891.89.

Sutton-Morf Tractor Co. (hereafter referred to as Sutton), a California corporation, was incorporated February 21,1946, and commenced business in this State on that date, with a fiscal year ending August 31. It reported net income of $357,977.68 for its first fiscal year of operation, a period of approximately six months. In accordance with Section 13(c) of the Bank and Corporation Franchise Tax Act, as it then existed, Sutton paid the franchise tax for its first year and at the same time prepaid the tax for its second taxable year in the amount of $12,171.25 based on the first year's income, It dissolved as of March 25, 1947, having operated approximately seven months in its second taxable year. It reported $870,102.20 as its net income for that year and stated in its return that no further tax was due pursuant to Section 13(k) of the Act.

The Respondent; however, employed the second taxable year's income of $870,102.20 in the computation of the tax for that year, taking 7/12 of a tax computed thereon as the amount of tax due from Sutton. Against the tax of $17,257.03 so determined, it credited the $12,171.25 prepayment and arrived at a deficiency of $5,085.78. Appellant, as transferee of Sutton's assets, paid this asserted deficiency, together with interest thereon in the amount of $891.89, and then filed the claim for refund which is the subject of this appeal.

It is the position of Appellant that Sutton's tax for its year of dissolution should be determined under Section 13(k) relating to dissolving or withdrawing corporations, which read in part as follows:

> "(k)(1) Any bank or corporation which is dissolved and any foreign corporation which withdraws from the State during any taxable year shall pay a tax hereunder only for the months of such taxable year which precede the effective date of such dissolution or withdrawal, according to or measured by (A) the net income of the preceding income year *or* (B) a percentage of such net income determined by ascertaining the ratio which the months of the taxable year, preceding the effective date of dissolution or withdrawal, bears to the months of such income year, whichever is the lesser amount; . . ."

The Respondent, while not ignoring Sutton's status as a dissolving corporation, also regards it as a commencing corporation with a first taxable year of less than 12 months and, accordingly, looks also to Section 13(c), relating to commencing corporations, which in part provided:

> "(c) . . . In every case in which the first taxable year of a bank or corporation constitutes a period of less than 12 months, or in which a bank or corporation does business for a period of less than 12 months during its first taxable year, said bank or corporation shall pay as a prepayment of the tax for its second taxable year a tax based on the income for the first taxable year computed under the law and at the rate applicable to the second taxable year, the same to be due and payable at the same times and in the same manner as if that amount were the entire amount of its tax for that year; and upon the filing of its tax return within two months

and 15 days after the close of the second taxable year it shall pay a tax for said year, at the rate applicable to that year, based upon its net income received during that year, allowing a credit for the prepayment; but in no event shall the tax for the second taxable year be less than the amount of the prepayment for that year, and said return for its second taxable year shall also, . . . be the basis for the tax of said bank or corporation for its third taxable year."

The Respondent has used Sutton's income of its second taxable year as the measure of its tax for that year through application of subdivision (c), but has computed the tax for that year on only 7/12 of that income through application of alternative (B) of subdivision (k). Wholly apart from the question of whether any admixture of (c) and (k) is warranted by the statute, it should be observed that the Respondent has not merely applied in part the language of subdivision (c) and in part that of (k). The ratio or fraction established by alternative (B) of subdivision (k) is based specifically upon the relationship of the months of the taxable year preceding the effective date of dissolution (seven in this case) to the months of the ~~preceding~~ income year (six in this case). The Respondent has not applied these words as they appear in the statute, but has taken considerable liberty with them by way of construction in applying the tax to 7/12 of the income of the seven month's period in the second year.

Respondent contends that its position is a logical one and in accord with the pattern established by Section 13 for the taxation of commencing and dissolving corporations. We fail to understand the reason, however, why the tax for the period of seven months comprising the second year should be measured by 7/12 of the income of that seven month's period and we are unable to find support for this construction anywhere in the language of Section 13.

'Although we are not in accord with the position of Respondent it does not necessarily follow that reliance upon subdivision (k), as contended for by Appellant, is proper in this situation. For example, as pointed out by Respondent, a corporation might engage in business only one month in its first taxable year but eleven months in its second taxable year. Nevertheless, subdivision (k) would in terms permit it to measure its tax for the second taxable year by the one month's net income of the first taxable year. As applied to Sutton, subdivision (k) would permit it to measure its tax

for the second taxable year by $357,977.68, the net income received in the 6 months of its first taxable year, rather than by $870,102.20, the net income received in its second taxable year of 7 months. That this construction does violence to the legislative pattern for the taxation of commencing corporations would seem to be sufficiently demonstrated by the fact that it completely excludes from the measure of the tax more than $500,000 of the net income received by Sutton during its 13 months of operation.

For the period involved herein, the Franchise Tax Act imposed an annual tax upon every corporation doing business within the State for the privilege of exercising its corporate franchise within the State. The tax was according to or measured by the net income of the corporation for its next preceding fiscal or calendar year, except in the case of a commencingcorporation. Under subdivision (c) of Section 13 of the Act, a commencing corporation with a first taxable year of less than 12 months paid a tax for the second taxable year measured by the income of the second taxable year, rather than on the basis of the net income for the preceding year, Thus, for purposes of computing the tax, such a corporation retained its status as a commencing corporation during the second taxable year.

That subdivision (k) was limited in its application to dissolving corporations other than commencing corporations seems clear. By its terms, the subdivision provided for a tax upon the basis of net income for the preceding income year, whereas a commencing corporation was taxed on the basis of its net income for the current taxable year. To compute the tax of a commencing corporation for its second taxable year under (k), accordingly, would be wholly inconsistent with the statutory scheme for taxing commencing corporations even though that corporation might be dissolved during that year. As we have demonstrated above, the application of (k) to Sutton's situation would permit the escape from taxation of more than 1/2 million dollars. In contrast to this illogical result, reliance upon subdivision (c) would have resulted in a tax measured exactly by the net income received by Sutton during the 13 months of its operation. The tax so determined would have fitted precisely into the legislative pattern for the taxation of corporations which had not reached the prepaid basis of taxation contemplated generally by the Act. It is our opinion, accordingly, that the tax for Sutton's second taxable year should have been computed under subdivision (c).

The Appellant states that the 1949 amendment to Section 13, which added to subdivision (c) the phrase "except as provided in subdivision (k) of this section" to the clause providing that in no event shall the tax for the

second taxable year be less than the amount of the prepayment for that year, was declaratory of the existing law and indicates the legislative intent that Section 13(k) should govern in the case of a corporation which dissolves in its second year. The Respondent, however, argues that the only intent of the 1949 amendment was to permit the prorating of the prepayment for the second taxable year where the prepayment was greater than the tax imposed upon the basis of the second year's income. While this interpretation appears compatible with the general scheme of subdivision (c) we are not calledupon to decide its correctness. We do agree, however, that the amendment was not declaratory of a previous legislative intent to preclude the taxation under subdivision (c) of a commencing corporation which dissolved before reaching a prepaid basis of taxation.

Although we do not agree with the interpretation upon which the Respondent based its assessment of additional tax it appears, for the reasons stated herein, that the Appellant did not make an overpayment of Sutton's tax for the year in question. We conclude, accordingly, that the action of the Franchise Tax Board in denying Appellant's claim for refund should 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 pursuant to Section 26077 of the Revenue and Taxation Code that the action of the Franchise Tax Board in denying the claim of Sacramento Valley Tractor Co. for a refund of tax in the amount of $5,085.78 for the taxable year ended August 31, 1947, and of interest paid thereon in the amount of $891.89, be and the same is hereby sustained.

Done at Los Angeles, California, this 5th day of May, 1953, by the State Board of Equalization.

Wm. G. Bonelli, Chairman

J. H. Quinn, Member

Paul R. Leake, Member

_____, Member

_____, Member

ATTEST: Dixwell L. Pierce, Secretary