BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal

of

YEAKEL BROTHERS CORPORATION

Appearances:

For Appellant: Fay & Hoegsted, Certified Public Accountants

For Respondent: Burl D. Lack, Chief Counsel

OPINION

This appeal is made pursuant to Section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Yeakel Brothers Corporation to proposed assessments of additional franchise taxes in the amounts of $311.63 and $315.88 for the taxable years 1946 and 1947, respectively; income year 1946.

Appellant was incorporated under the laws of this State on October 9, 1945. It is wholly owned by members of the Yeakel family and serves to invest family funds in income producing properties. Its accounts are kept on the accrual basis and returns are filed on a calendar year basis. During 1946 it had gross income of $10,577.05, principally from the sale of assets and from the rental of real property. Shortly before December 31, 1946, Appellant issued and delivered checks in the amount of $8,190.00 as compensation for its directors, At the time the checks were drawn, the bank account contained a balance of approximately $362.00. The amount,of the expense was entered in Appellant's books as a credit to a liability account, "Accounts Payable Directors fees." The directors agreed that the checks would not be presented for payment. On April 30, 1947, the checks were returned uncashed to Appellant for cancellation and the accrued liability was transferred to the surplus account: The directors-all filed their tax returns on the cash basis., and each reported the amount of his check as income for the year 1946. Appellant deducted the aggregate amount of the checks from its gross income for the year 1946. The Fran-

chise Tax Board disallowed the deduction on the basis of Section 9(f) of the Bank and Corporation Franchise Tax Act (now Section 24201(f) of the Bank and Corporation Tax Law).

Section 9(f) was substantially similar to Section 24(c) of the Internal Revenue Code and provided as follows:

> "In computing net income no deduction shall be allowed under Section 8 (a), relating to expenses incurred, or under Section 8 (b), relating to interest accrued:
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> "(1) If such expenses or interest are not paid within the income year or within two and one-half months after the close thereof; and
>
> "(2) If, by reason of the method of accounting of the person or corporation to whom the payment is to be made, the amount thereof is not, unless paid, includible under the provisions of The Personal Income Tax Act, Corporation Income Tax Act or this act in the gross income of such person or corporation for the taxable year in which or with which the income year of the taxpayer ends; and
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> "(3) If, at the close of the income year of the taxpayer or at any time within two and one-half months thereafter, both the taxpayer and the person to whom the payment is to be made are persons between whom losses would be disallowed under Section 9(e), or if the corporation to which payment is to be made owns, or is owned by, the taxpayer to the extent of more than 50 per centum in value of the outstanding stock."

It is agreed by the parties that an expense may not be disallowed as a deduction under Section 9(f) unless each of the three specified conditions exist. Anthony P. Miller, Inc., 7 T. C. 729; Michael Flynn Manufacturing Co., 3 T.C. 932. The sole contention of Appellant before this Board is that the second condition of Section 9(f) did not exist, because each director reported the amount of his check as personal income for the year 1946.

As each director reported his income on the basis of cash receipts and disbursements, the fees in question were includible in their incomes for 1946 only if they were received in that year. The application of Subsection 2 of Section 9(f), accordingly, is not determined by what the directors did in respect of reporting the fees as income. Anthony P. Miller, Inc., supra.

When Appellant issued its checks to the directors at the close of the year 1946 it did not have sufficient funds on hand to permit cashing the checks and the directors had agreed not to cash the checks. Under such circumstances there was neither actual nor constructive receipt of the fees and the amounts thereof were not income to the directors. L. M. Fischer, 14 T.C. 792, 801; Pearl Whitson, T.C.M. Dec., Docket Nos. 2717-2720, entered July 24, 1944.

In its oral argument,, counsel for Appellant argued that Appellant suffered from lack of proper advice but that its intent was clear, that it intended to shift income from it to the directors, individually, and that equity should recognize this rather than sustain a technical application of the statute. We cannot agree that the Franchise Tax Board is unjustly applying the statute (P. G. Lake., Inc. v. Commissioner, 148 Fed. 2d 898), nor that we should relieve the taxpayer for its failure to properly effect its intentions. We cannot speculate on what Appellant might have done but did not do. Pearl Whitson, supra; Marian Otis Chandler, 16 B.T.A. 1248.

Appellant has failed to bring itself within the statute. The action of the Franchise Tax Board, therefore, 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, pursuant to Section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Yeakel Brothers Corporation to proposed assessments of additional franchise taxes in the amounts of $311.63 and $315.88 for the taxable years 1946 and 1947, respectively, income year 1946, be and the same are hereby sustained.

Done at Sacramento, California, this 21st day of July, 1953, by the State Board of Equalization.

Wm. G. Bonelli, Chairman

J. H. Quinn, Member

Geo. R. Reilly, Member

Paul R. Leake, Member

_____, Member

ATTEST: Dixwell L. Pierce, Secretary