

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
CONTRACTORS INVESTMENT CO., INC.)

Appearances:

For Appellant: Robert M. Himrod, Attorney at Law

For Respondent: Crawford H. Thomas, Associate Tax Counsel

O P I N I O N

This appeal was made pursuant to Section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Contractors Investment Co., Inc., to a proposed assessment of additional franchise tax in the amount of \$3,383.41 for the income year ended June 30, 1955. At the time the appeal was filed, Appellant paid the sum of \$3,551.63, representing the tax and accrued interest. Therefore, in accordance with Section 26078 of the Revenue and Taxation Code, the appeal will be treated as from the denial of a claim for refund.

Appellant's principal business activity was the construction and sale of residences. It elected to report the gain from the sale of the houses by use of the installment method. All the houses, with the exception of one repossession, were sold before July 1, 1954, the beginning of the income year involved in this appeal. On June 30, 1955, at the close of the year, Appellant held installment contracts with a face value of \$238,421.00, which, if fully paid, would have resulted in income of \$31,971.75. In the next year, Appellant distributed the installment contracts to its stockholders together with the rest of its assets and dissolved.

Under the installment method of reporting income, the method used by Appellant-here, a taxpayer reports as income in any income year that proportion of the installment payments actually received in that year which the gross profit realized or to be realized when payment is completed, bears to the total contract price. (Sections 25291 and 25292, now 24667 and 24668 of the Revenue and Taxation Code.) Since Appellant dissolved in the year ended June 30, 1956, its tax for that year is to be based on income of the prior year, ended June 30, 1955. (Section 23332 of the Revenue and Taxation Code.) This is consistent with the normal franchise tax procedure by which the tax for a given year is measured by income of the preceding year.

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In reliance upon Section 25295 (now 24672) of the Revenue and Taxation Code, the Franchise Tax Board has included in Appellant's income for the year ended June 30, 1955, the sum of \$31,971.75 as "unreported income" from installment contracts. The position of the Franchise Tax Board is that "unreported income" means the entire income from installment obligations that would be reported if they were ultimately paid in full and if the corporate taxpayer remained in existence long enough to collect the payments.

Appellant contends that Section 25295 must be read in conjunction with Section 25294 (now 24670) of the Revenue and Taxation Code, with the result that only the difference between the basis and the fair market value of the obligations should be included in income. It states that the fair market value of the obligations here involved was not more than 80 percent of their face value. The Franchise Tax Board does not question the fair market value assigned to the obligations by Appellant.

So far as material here, Section 25294 of the Revenue and Taxation Code provided that:

"If an installment obligation is ... distributed ... gain or loss shall result to the extent of the difference between the basis of the obligation and ~~..the fair market value of the obligation at the~~ time of such distribution-;... The basis of the obligation shall be the excess of ~~the face value~~ of the obligation over, an amount equal to the income which would be returnable were the obligation satisfied in full.99

Section 25295 provided that:

"(a) Where a taxpayer elects to report income from the sale or other disposition of property . . . [on the installment basis-], and the entire income therefrom has not been reported prior to the year that the taxpayer ceases to be subject to the tax . . . the unreported income shall be included in the measure of the tax for the last year in which the taxpayer is subject to the tax ..."

Our decision in Appeal of American Home Supply, Inc., Cal. St. Bd. of Equal., May 19, 1954 (CCH, 1 Cal. Tax Cases, Par. 200-272), (P-H, St. & Loc. Tax Serv., Cal., Par. 13,141) has been cited by the Franchise Tax Board. We there considered the effect of Section 19(e)(5) of the Bank and Corporation Franchise Tax Act, the predecessor of Section 25295, as applied to a corporation which did business throughout its last taxable year. We did not

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consider or discuss in that opinion the effect of Section 25294 or its predecessor and therefore the decision is not controlling in this matter.

Section 25294 was based upon and is substantially identical with Section 44(d) of the United States Internal Revenue Code of 1939. Section 44(d) was intended to terminate the deferral of income by an installment basis taxpayer when it distributed or otherwise disposed of its installment obligations and to tax at that time the "deferred profits" or "unreported profits."

(Report of House Committee on Ways and Means, CB 1939-1, Part 2, pp.384,394; IT 3586, CB 1942-2, p. 65.)

Section 25295 has no counterpart in the Federal income tax law. This section comes into operation when a corporation on the installment basis ceases to be subject to the franchise tax and is designed to eliminate the advantage which the corporation might otherwise obtain under the prepayment provisions of the California law by which the tax for the last year is measured by income of the preceding year.

It is fundamental that parts of the same act should be construed together, not in isolation. We see nothing in either of the two statutes here involved that expressly or impliedly precludes the operation of Section-25294. On the contrary, each of the sections may be given effect so as to harmonize with and complement the other. Applying them here, the only item of "unreported income" within the meaning of Section 25295 that appears would consist of any gain derived from the distribution of the installment obligations as computed under Section 25294. Upon the undisputed facts that have been presented to us, there was no gain on the distribution. Thus, Appellant's position must be sustained.

An additional issue involves a gain of \$70,638.06 realized by Appellant on the sale of certain land during the income year ended June 30, 1955. Appellant contends that no gain should be recognized because of the application of Sections 24511-24514 of the Revenue and Taxation Code. These sections provide that no gain or loss shall be recognized on the sale of certain types of property during a period of a particular type of liquidation.

The aforementioned sections were added to the Code by Statutes of 1955, Chapter 938, Section 20. Section 36 of said Chapter 938 reads:

"The amendments made by this act are applicable only in the computation of taxes for income years beginning on or after January 1, 1955."

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Appellant's income year began on July 1, 1954. Therefore, Sections ~~24511-24514~~ cannot be considered in computing its income for such year. Appellant has offered no other authority for excluding the gain on the sale and we are not aware of any.

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 on the claim of Contractors Investment Co., Inc., for refund of franchise tax in the amount of \$3,551.63 for the income year ended June 30, 1955, be and the same is hereby modified as follows: The sum of \$31,971.75 added to Appellant's income by the Franchise Tax Board is to be excluded. In all other respects the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this 5th day of January, 1961, by the State Board of Equalization.

John W. Lynch, Chairman

Geo. R. Reilly, Member

Alan Cranston, Member

Paul R. Leake, Member

Richard Nevins, Member

ATTEST: Ronald B. Welch, Acting Secretary.