BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of)
)
JAMES S. AND MARIAN FORKNER;)
ROBERT L. AND PAMELA D. FORKNER;)
and ALBERT AND MARY F. REYNOLDS)

Appearances:

For Appellants: William T. Huston, Attorney at Law

For Respondent: Crawford H. Thomas, Associate Tax Counsel

O P I N I O N

These appeals are made pursuant to Section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on protests against the following proposed assessments of personal income tax:

Appellants	Amount	Year
James S. and Marian Forkner	$6,805.59	1956
Robert L. and Pamela D. Forkner	4,825.48	1956
Albert and Mary F. Reynolds	7,128.55	1956

The three appeals are consolidated herein because the additional taxes proposed to be assessed against the individual Appellants relate to the same transactions and involve identical issues.

The two Appellants in each of the appeals are husband and wife who filed joint returns for 1956. In February of 1956 each couple owned one-third of the outstanding stock of J. C. Forkner, Inc., which, on February 9, 1956, adopted a plan of liquidation which was completely executed during February of 1956 through distribution of all of the corporate assets and redemption of all of the stock.

Appellants filed elections to have their gains limited under Section 17402 of the Revenue and Taxation Code, a part of the Personal Income Tax Law, and Section 24503 of the Revenue and Taxation Code, a part of the Bank and Corporation Tax Law. They conformed with the sections in that they were all "qualified electing shareholders" and constituted 80 percent of those

entitled to vote on the plan of liquidation.

Respondent rejected the elections on the grounds that (1) application of Section 17402 to the year of 1956 is unconstitutional and (2) Section 24503 relates exclusively to taxes on banks and corporations.

Respondent's bases for contending that Section 17402 may not be applied to the year 1956 are that prior to 1959 the section by its own terms did not apply to the year of 1956, with which conclusion Appellants do not disagree, and that an amendment effective June 8, 1959, which applied the section to all years subsequent to 1950, is unconstitutional as respects taxes such as those for 1956 which, in accordance with Allen v. Franchise Tax Board, 39 Cal. 2d 109 [245 P. 2d 297], became due and payable on April 15, 1957. Respondent cites a number of cases, including Estate of Stanford, 126 Cal. 112 [54 P. 259], wherein it has been held that an act of the Legislature cannot be given retroactive effect to reduce or remit a tax that has become due and payable.

We believe that Respondent's contentions raise a substantial constitutional question of the sort we have consistently refused to consider, except in an appeal from a denial of a claim for refund. (Appeal of Richfield Oil Corp., Cal. St. Bd. of Equal., March 2, 1958, 1 CCH Cal. Tax Cas. Par, 200-083, 2 P-H State & Local tax serv. Cal. Par. 13103,) In Appeal of F. T. and Fumiko Mitsuuchi, Cal. St, Bd. of Equal., Jan. 5, 1949, 3 P-H State & Local Tax Serv. Cal. Par. 58038, we said:

> In most instances the contention of unconstitutionality has been raised by an Appellant and it has been our practice to reject the contention in order that a judicial determination might be had thereon. On the other hand, in the few instances in which the issue has been presented by the Commissioner, we have similarly left the matter open for judicial determination by upholding the position of the Commissioner. See, e.g., Appeal of Ralph G. Lindstrom, July 15, 1943. Inasmuch as a taxpayer is in a position to present the constitutional question to the courts after an adverse decision of this Board and the Commissioner is unable to do so, it is only by sustaining the action of the Commissioner in both situations that a judicial decision may be had on the issue of constitutionality.

Turning to the next question, Section 24503 of the Revenue and Taxation Code is very similar to Section 17402 and concededly may be applied to the year 1956 but is a part of the Bank and Corporation Tax Law. Appellants point put, however, that both the code section and Respondent's regulation thereunder (Cal. Admin. Code, Tit. 18, Reg. 24503(b)) refer to noncorporate

shareholders. Respondent argues that no part of the Bank and Corporation Tax Law may be applied to the tax liability of a natural person and, more particularly, that while Section 24503 mentions stockholders other than corporations, the operative part refers only to corporate shareholders.

The pertinent terms of Section 24503 are as follows:

> (a) . . . in the case of each qualified electing shareholder (as defined in subsection (c)) gain on the shares owned by him at the time of the adoption of the plan of liquidation shall be recognized only to the extent provided in subsection (f).
>
> * * *
>
> (c) For purposes of this section, the term "qualified electing shareholder'; means a shareholder ... of any class of stock (whether or not entitled to vote on the adoption of the plan of liquidation) who is a shareholder at the time of the adoption of such plan, . . . but --
>
> (1) In the case of a shareholder other than a corporation, only if written elections have been so filed by shareholders (other than corporations) who at the time of the adoption of the plan of liquidation are owners of stock possessing at least 80 percent of the total combined voting power (exclusive of voting power possessed by stock owned by corporations) of all classes of stock entitled to vote on the adoption of such plan of liquidation; or
>
> (2) In the case of a shareholder which is a corporation, only if written elections have been so filed by corporate shareholders . . . which at the time of the adoption of such plan of liquidation are owners of stock possessing at least 80 percent of the total combined voting power (exclusive of voting power possessed by stock owned by . . . shareholders who are not corporations) of all classes of stock entitled to vote on the adoption of such plan of liquidation.
>
> * * *
>
> (f) In the case of a qualified electing shareholder which is a corporation, the gain shall be recognized only to the extent of the greater of the two following -- . . .

Until subsection (f) is reached the section gives the impression that both corporate and natural stockholders are covered by its provisions. However, subsection (f), which specifies the manner in which the gain may be elected to be treated, refers only to "... a qualified electing shareholder which is a corporation, . .." (underscoring ours). Both Section 17402 and Section 24503 are based on Section 333 of the Internal Revenue Code, which applies to Federal income taxes of both corporations and individuals. Clearly indicating the intent of our Legislature, Section 17402 omits that portion of the Federal statute which specifically limits gain in the case of corporate shareholders and Section 24503 omits the equivalent portion which is applicable only to noncorporate shareholders.

Respondent's Regulation 24503(b) is very long and will not be reproduced here. It may be conceded that it could mislead a taxpayer into believing that Section 24503 allows an election limiting the gains of both corporate and noncorporate shareholders. However, it is well settled that an administrative agency may not vary or enlarge by regulation the terms of a statute. (Dillman v. McColgan, 63 Cal. App. 2d 405[146 P.2d 978].) From a practical standpoint, Appellants could not have been misled by the regulation because it was not adopted until January 11, 1958, after they had filed their elections.

We conclude that the limitation of gain feature of Section 24503 does not extend to noncorporate shareholders.

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 18595 of the Revenue and Taxation Code, that the action

Appeals of James S. and Marian Forkner, et al.

of the Franchise Tax Board on protests against the following proposed assessments of personal income tax:

Appellants	Amount	Year
James S. and Marian Forkner	$6,805.59	1956
Robert L. and Pamela D. Forkner	4,825.48	1956
Albert and Mary F. Reynolds	7,128.55	1956

be and the same is hereby sustained.

Done at Sacramento, California, this 7th day of August, 1963, by the State Board of Equalization.

John W. Lynch, Chairman

Paul R. Leake, Member

Geo. R. Reilly, Member

Richard Nevins, Member

_____, Member

ATTEST: H. F. Freeman, Secretary