



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter **of the** Appeal of)
WESTERN URBAN REDEVELOPMENT)
INVESTMENT CORPORATION)

Appearances:

For Appellant: R. J. Sullivan
Certified **Public Accountant**

For Respondent: Gary M. **Jerrit**
Counsel

O P I N I O N

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 Western Urban Redevelopment Investment Corporation against proposed assessments of additional franchise tax in the amounts of **\$1,561.77** and \$672.15 for the income years ended March 31, 1967, and 1968, respectively.

The sole issue for determination is whether certain dividends received by appellant from its subsidiary were included in the subsidiary's measure of

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tax and, therefore-, deductible by appellant pursuant to the terms of section 24402 of the Revenue and Taxation Code.

Appellant owned 52 percent of the stock of Golden Gate Community Hospital (Golden) until June 30, 1967, when the stock was sold and the subsidiary liquidated. At all times pertinent to this appeal Golden was a California corporation and derived all of its income from sources within this state. During its income years ended March 31, 1967, **and 1968**, appellant received dividends from Golden in the amounts of \$26,000 and \$31,200 respectively. The \$26,000 dividend was paid entirely from Golden's earnings for its income year ended April 30, 1967. The sources of the \$31,200 dividend were varied. Part of the dividend was paid from Golden's capital **and** part from earnings accumulated prior to May 1, 1966. The status of these dividends are not in question. The former is a nondeductible capital distribution while the latter is deductible in its entirety. The remainder of the \$31,200 dividend was attributable to income earned by the subsidiary during its income year ended April 30, 1967, and to income earned during the short period, May 1 through June 30, 1967, prior to its liquidation.

During the years in question appellant deducted all the dividends received from its subsidiary. However, respondent determined that none of the dividends attributable to the subsidiary's income from the short period, May 1 through June 30, 1967, and only one-sixth of the dividends attributable to the subsidiary's income for its income year ended April 30, 1967, were deductible. Based upon that determination respondent issued proposed assessments of additional franchise tax which were protested by appellant. The protest was denied, and this appeal followed.

1/ See page 3 for footnote 1.

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1/ The following table indicates the source and disposition of the dividends in question:

<u>AMOUNT OF DIVIDEND PAID TO APPELLANT</u>	<u>SOURCE OF DIVIDEND PAID BY GOLDEN</u>	<u>PERCENTAGE OF DIVIDEND ALLOWED AS DEDUCTION</u>	<u>AMOUNT OF DEDUCTION ALLOWED</u>	<u>AMOUNT OF DEDUCTION DISALLOWED</u>
<u>\$26,000.00</u>	Earnings For Income Year Ended 4-30-67	16.667 (1/6)	\$4,333.42	\$21,666.58
\$ 9,250.25	Earnings Accumulated Prior to 5-1-66	100.00	\$9,250.25	- 0 -
\$ 7,349.73	Earnings For Income Year Ended 4-30-67	16.667 (1/6)	\$1,224.98	\$ 6,124.75
\$12,694.15	Earnings For Short Period 5-1 Through 6-30-67	-0-	-0-	\$12,694.15
<u>\$ 1,905.87</u>	Capital	-0-	-0-	\$ 1,905.87
<u>\$31,200.00</u>				

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In support of its proposed assessments, respondent contends that no part of the income earned by Golden during the short period and only one-sixth of the subsidiary's income for the previous income year ended April 30, 1967, were included in Golden's measure of tax. Since a deduction has **been** allowed for all of the dividends attributable to the income included in the subsidiary's measure of tax, respondent concludes that appellant is not entitled to any further deduction.

On the other hand, appellant maintains that all of Golden's income earned after April 30, 1966, was included in the subsidiary's measure of tax. Therefore, since the dividends in question are all attributable to those earnings they should be deductible.

Section 24402 of the Revenue and Taxation Code describes as a permitted deduction:

Dividends received during the income year declared from income which has been included in the measure of the taxes imposed under [The Bank and Corporation Franchise Tax or the Corporation Income Tax] upon the taxpayer declaring the dividends./

The purpose of the statute is to avoid double taxation, at the corporate level, of income which has already been subjected to California taxation in the hands of the dividend-declaring corporation. (Safeway Stores, Inc. v. Franchise Tax-Board, 3 Cal. 3d 745, 749-750 [91 Cal. Rptr. 616, 478 P.2d 48]; Burton E. Green Investment Co. v. McColgan, 60 Cal. App. 2d 224, 232-233 [140 P.2d 451]; see also Rosemary Properties, Inc. v. McColgan,

2/ See Rev. & Tax. Code § 24401 which states: "In addition to the deductions provided in Article 1, there shall be allowed as deductions in computing taxable income the items specified in this article." Section 24402 is included within the specified article.

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29 Cal. 2d 677, 603 [177 P.2d 7571.] Thus, if the dividends in question have been declared from income which has been included in the subsidiary's measure of tax they are deductible by appellant, the receiving corporation. Conversely, if the dividends have not been included in the subsidiary's measure of tax they are not deductible.

In construing the crucial phrase, "the measure of tax," it is essential to keep in mind the fact that the California scheme of corporate franchise tax involves the prepayment of the tax for the succeeding taxable year. In general, a corporation doing business in this state must pay annually, for the privilege of exercising its franchise, a tax measured by its net income computed at a specified rate upon the basis of its net income for the next preceding income year. (Rev. & Tax. Code § 23151.)

However, the computation of the franchise tax, for a corporation in its year of dissolution is controlled by section 23332 of the Revenue and Taxation Code which, during the periods in question, provided:

[A]ny taxpayer which **is** dissolved...during any taxable year shall pay a tax only for the months of the taxable year which precede the effective date of such dissolution... according to or measured by (a) the net income of the preceding year or **(b)** a percentage of net income determined by ascertaining the ratio which the months of the taxable year, preceding the effective date of dissolution . . .bears to the months **of the** income year, whichever is the lesser amount. . .

In the instant situation Golden's measure of franchise tax for its short period, May 1 through June 30, 1967, was controlled by subsection (b). The result was that Golden's franchise tax for the final two months of its existence was measured by two-twelfths, or one-sixth, of its income for the previous income year, May 1, 1966, through April **30**, 1967. It is true that the subsidiary

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was taxed for the privilege of exercising its franchise during the last taxable period of its operation. However, none of the income earned by the subsidiary during that last taxable period was included in the measure of tax. (Appeals of Park-Citron Agency, Taxpayer, etc., Cal. St. Bd. of Equal., Feb. 26, 1969.) **It follows, therefore, that none of Golden's income for the period May 1 through June 30, 1967, was included in the measure of tax and none of the dividends declared therefrom are deductible.**

If Golden had remained in existence for the entire taxable year ended April 30, 1968, all of its income for the previous income year would have been included in **its** measure of tax and all dividends declared out of that income would have been deductible. However, since its existence was terminated after only two months of the taxable year only one-sixth of the income from the previous income year, May 1, 1966, through April 30, 1967, was included in the measure of tax. (Rev. & Tax. Code § 23332.) Although tax on the entire amount was initially prepaid, five-sixths of the prepaid tax was refunded to Golden. The final result was that only one-sixth of the income for Golden's income year ended **April 30, 1967, was ever included in its measure of tax.** Accordingly, one-sixth of the amount of dividends declared out of that year's income, the portion attributable to the income included in the measure of tax, was deductible. Respondent allowed the deduction of that amount.

Contrary to appellant's assertion, concluding, as we do, that the dividends in question were not declared out of income which had been included in the subsidiary's measure of tax does not do violence to the holding of Burton E. Green Investment Co. v. McColgan, supra. (See also Rosemary Properties, Inc. v. McColgan, supra.) In Burton E. Green the court pointed out that the purpose **of the dividend** deduction is to avoid double taxation, at the corporate level, of income which **has** already been **included in** the measure of tax and subjected to taxation by this state while in the hands of the dividend-declaring

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corporation. (Burton E. Green Investment Co., supra, at 231-232. See also Rosemary Properties, Inc. v. McColgan, supra.) Here, the income from which the dividends in question were declared was never taxed while it was in the hands of the subsidiary nor was it ever included in the subsidiary's measure of tax.

For these reasons respondent's action in this matter 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 Western Urban Redevelopment Investment Corporation against proposed assessments of additional franchise tax in the amounts of **\$1,561.77** and **\$672.15** for the income years ended March 31, 1967, and 1968, respectively; be and the same is hereby sustained.

Done at Sacramento, California, **this 13th** day of November, 1973, by the State Board of Equalization.

William P. ..., Chairman
Scott Keefley, Member
John W. Lynch, Member
Paul ..., Member
..., Member

ATTEST: W. W. ..., Secretary