BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
WESTERN KRAFT CORPORATION)

Appearances:

For Appellant: Lawrence V. Brookes
Attorney at Law

For Respondent: Noel J. Robinson
Counsel

OPINION

This appeal is made pursuant to section 26077 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claim of Western Kraft Corporation for refund of franchise tax in the amount of $22,174.16 for the short period income year September 1, 1967, through December 31, 1967. The parties agree that due to a mathematical error the amount of the claim was overstated; the correct amount of the, claim is $17,169.18.

The question presented is whether a 7.0 percent franchise tax rate, rather than 5.5 percent, is to be applied in computing appellant's tax liability upon the basis of its net income for the short period income year September 1, 1967, through December 31, 1967.

Appellant, an Oregon corporation manufacturing corrugateh boxes, has done business in California since 1959. Initially, it elected the fiscal year September 1 through August 31 for California franchise tax purposes. Appellant used this accounting period through and including the income year ended August 31, 1967. In 1968, with respondent's required permission, appellant changed its income year from a fiscal year to a calendar year, the first full year of which commenced on January 1, 1968. Since this change resulted in a short period income year September 1, 1967, through December 31, 1967, for which the franchise tax for the comparable taxable period September 1, 1968, through December 31, 1968, had not been prepaid, appellant paid the tax computed at 7.0 percent of net income for the short period. Thereafter, appellant filed its claim for refund, alleging that the applicable rate was 5.5 percent.

To resolve this appeal, we must determine whether. certain legislation (Stats. 1967, ch. 963, p. 2471) increased the franchise tax rate from 5.5 percent to 7.0 percent for the short period income year.

Chapter 963, an urgency measure which was to take immediate effect (Stats. 1967, ch. 963, § 155, p. 2530), was approved by the Governor and filed with the Secretary of State on July 29, 1967. It contained a comprehensive tax package aimed at increasing state revenue to balance the 1967-1968 budget, afford property tax relief, and reimburse local governments for revenue loss. Among other things, the act created a property tax relief fund whereby one-fourteenth of the revenue collected pursuant to the Bank and Corporation Tax Law after June 30, 1968, was to be used to reimburse local governments for revenue loss resulting from the repeal, or reduction, of the property tax on business inventories and household furnishings and personal effects, (Stats. 1967, ch. 963, § 152, p. 2529.)

It also contained provisions directed toward providing senior citizens property tax relief. (Stats. 1967, ch. 963, § 103.5, p. 2503.) Consequently, the rates of many state taxes were increased by this comprehensive legislation. (See Stats. 1967, ch. 963, § 1 (sales tax), § 5 (use tax), §§ 12 and 14 (inheritance tax), §§ 23 and 25 (gift tax), § 30 (personal income tax), § 104 (franchise tax), § 116 (cigarette tax), and § 146 (distilled spirits tax).)

Pursuant to section 104 of the act, section 23151 of the Revenue and Taxation Code was amended to provide that a corporation's franchise tax was to be computed "at the rate of 7 percent upon the basis of its net income for the preceding income year. " (Stats. 1967, ch. 963, p. 2510.) (Emphasis added.) The language of section 23151 was not changed except for substituting the figure-: "7" for "5. 5."

Section 154 of chapter 963 provided, however:

> With respect to the provisions specified in this section, the operative effect of such provisions of this act shall be as follows:
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> * * *
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> (d) The provisions of this act effecting changes in the Rank and Corporation Tax Law shall be applied in the computation of taxes on or measured by net income of calendar or fiscal years ending after December 31, 1966. Banks and corporations whose fiscal years began prior to January 1, 1967, and end on or before November 30, 1967, shall compute their tax by applying the rate in effect as of December 31, 1966, and the rate provided for in this act on and after such date, to their net income for the entire year in accordance with the method prescribed by Section 24251 of the Revenue and Taxation Code. (Stats. 1967, ch. 963, pp. 2529-2530.) (Emphasis added.)

Under the method prescribed by section 24251, where the rates differ between calendar years, the tax for a period beginning in the first calendar year and ending in the second is the sum of: a portion of a tax computed under the rate applicable to the first calendar year, based on the portion of the period falling in the first calendar. year; and a portion of. a tax computed under the rate applicable to the second calendar year, based on the portion of the period falling in the second calendar year.

In contending that the 5.5 percent rate applied to the short period income year, appellant relies upon the wording in section 154(d) of the act that the provisions effecting changes in the Rank and Corporation Tax Law "shall be applied in the computation of taxes on or measured by net income of calendar or fiscal years ending after December 31, 1966. " Calendar and fiscal years are defined by law as 12 month periods. (Rev. & Tax. Code, § 24631, subds. (d) and (e).)1/ Consequently, it is argued that chapter 963 simply failed to effectuate the 7.0 percent rate for short period income years.

In addition to a calendar or fiscal year, however, an income year means the period for which the return is made, if a return is made for a period of less than 12 months, (Rev. & Tax. Code, § 24631, subd. (b)(3); see also § 23042, subd. (a).) In view of the language of section 104 of the act, it is clear that the Legislature intended the new rate to apply to all income years - fractional, as well as calendar or fiscal income years as defined

1/ Section 23032 does include within its definition of "fiscal year", accounting periods of less than 12 months, but only if ending on the last day of any month other than December. However, section 24631, unlike section 23032, is found with the sections relating to short periods and to tax computations for short periods caused by changing accounting periods. (§§ 24634-24636.) Therefore, appellant maintains that only section 24631 is relevant, and argues that section 154(d) did. not even effectuate the 7.0 percent rate for short periods ending other than on the last day of December.

in section 24631. This interpretation is consistent with the legislative purpose of increasing state tax revenue which we have discussed above, Appellant does not disagree with this interpretation, claiming that what happened was most likely an instance of legislative oversight, but insists that the legislative intent was not executed. It urges that section 154(d) is free from ambiguity, and maintains that we cannot depart from its literal language.

We do not agree that section 154(d) is free from ambiguity. For reasons to be explained immediately below, when that section is viewed with chapter 963 in its entirety, and with, existing law, we find it ambiguous insofar as the scope of the amendment to section 23151 is concerned.

Section 23058 of the Revenue and Taxation Code provides:

> Unless otherwise specifically provided the provisions of any law effecting changes in the computation of taxes shall be applied only in the computation of taxes for income years beginning after December 31st of the year preceding enactment and the remaining provisions of any such law shall become effective on the date it becomes law.

Section 23058 supplies an operative date for a tax computation statute in the absence of an express one. (Appeal of Manufacturers Bank, Cal. St. Bd. of Equal., June 4, 1970.) We believe section 23058 can also properly supply an operative date for that part of the language of a tax computation statute not governed by an express operative date. In other words, we believe that the express "application" date contained in section 154(d) for calendar and fiscal years did not preclude the possibility that the Legislature, by its silence, intended section 23058 to supply an operative date for fractional income years.

Certain rules of construction support an interpretation that section 23058 supplied the operative date. First, while statutes under which taxes are levied are to be strictly construed against the taxing power, when the language will reasonably permit they will be construed so that they are effective rather than given a construction that will defeat their purpose. (See RCA Photophone Inc. v. Huffman, 5 Cal. App. 2d 401 [42 P. 2d 1059]; see also Thompson v. Board of Supervisors, 13 Cal. App. 2d 134 [56 P. 2d 571].)

Second, the rule has repeatedly been applied that a literal interpretation of a statute which leads to an absurd result should not be given if it can be avoided. (Clements v. T. R. Bechtel Co., 43 Cal. 2d 227 [273 P. 2d 5]; Dempsey v. Market Street Ry Co., 23 Cal. 2d 110 [142 P. 2d 929]; Dept. of Motor Vehicles v. Indus. Acc. Com., 14 Cal. 2d 189 [93 P. 1311; Leo v. Board of Medical Examiners, 36 Cal. App. 2d 490 [97 P. 2d 1046]; Jordt v. State Board of Education, 35 Cal. App. 2d 591 [96 P. 2d 809]; Gallagher v. Campodonico, 121 Cal. App. Supp. 765 [5 P. 2d 48].)

Third, where two interpretations are possible, it is also settled that a mere literal interpretation will not prevail over that which accords with the obvious purpose of the legislation. (In re Keman, 242 Cal. App. 2d 488 [51 Cal. Rptr. 515]; Hidden Valley Municipal Water Dist. v. Calleguas Municipal Water Dist., 197 Cal. App. 2d 411 [17 Cal. Rptr. 416]; H. S. Mann Corp. v. Moody, 144 Cal. App. 2d 310 [301 P. 2d 28]; see also Edson v. Southern Pacific.R. R. Co., 144 Cal. 182 [77 P. 894]; City of Los Angeles v. Barrett, 153 Cal. App. 2d 776 [315 P. 2d 503].) Nor will the obvious legislative purpose be sacrificed to a literal construction of any part of the statute. (Select Base Materials v. Board of Equalization, 51 Cal. 2d 640 [335 P. 2d 672].)

The obvious legislative purpose was to establish a 7.0 percent rate for all income years. It *is* possible to interpret the Legislature's silence regarding an application date for short period income years as indicating an intent that section 23058 should govern. Applying the above rules of construction it is clear that the 7.0 percent tax rate should be applied. In doing so, the legislative purpose is carried out, and a literal interpretation resulting in an unintended and absurd result is avoided; namely, that of lowering the tax rate for an income year -merely because. a taxpayer changes accounting periods. 2/

2/ Furthermore, in the absence of section 23058, -we believe that the operative date for the 7.0 percent rate would have been supplied by the effective date of the statute. (See Appeal of Manufacturers Rank, supra.) Since the statute was to go into immediate effect (§ 155) this operative date would have been July 29, 1967.

Petitioner, as part of its brief, has furnished this Board with a copy of an unpublished opinion of a Court of Appeal in support of the proposition that legislative oversight barred application of an amended statute because another statute which was interrelated was not amended. We reject this citation as authority[3/] although we have in this opinion discussed applicable rules of statutory construction.

Additionally appellant urges, by a construction of the language of section 24636 of the Revenue and Taxation Code, that where a short period is created as the consequence of a permitted change in accounting period, the short period becomes both an income and taxable year. As we understand the argument, appellant claims that it, has paid tax twice for the privilege of exercising its corporate franchise during the taxable period September 1, 1967, through December 31, 1967, once as part of the tax computation

3/ We believe it is appropriate for us to follow a policy with respect to unpublished opinions similar to that followed by the courts under Rule 977 of the California Rules of Court. The rule provides:

> "An opinion of a Court of Appeal, or of an appellate department of a superior court that is not published in the Official Reports shall not be cited by a court or by a party in any other action or proceeding except when the opinion is relevant under the doctrines of the law of the case,. res judicata or collateral estoppel, or in a criminal action or proceeding involving the same defendant or a disciplinary action or proceeding involving the same respondent."

The fact that this Board was a party to the cited proceeding in our capacity of administering the California Sales and Use Tax Law is not within the exception allowed by the rule for a proceeding involving the same respondent.

based on income of the income year ended August '31, 1967, and again in its computation based on the income of the short period. Because of this assumption, appellant maintains that it is clearly equitable, just, and fair that the lower rate should be used and, therefore, section 154(d) of chapter 963 should be applied literally.

Appellant is in error in concluding that the period September 1, 1967, through December 31, 1967, is both an income and taxable year. The short period became an income year and the tax computed on income of that period was payment for the privilege of exercising its franchise for the taxable period September 1; -2968, through December 31, 1968, and not a second payment for exercising the privilege from September 1, 1967, through December 31, 1967, Section 24636 provides an annualizing method of computing the tax for the short period. We find nothing in the language of section 24636 warranting a construction that the short period is both an income and taxable year.

For the foregoing reasons, we conclude that the 7.0 percent rate was properly applied to the short period income year.

ORDER

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

Appeal of Western Kraft Corporation

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 Western Kraft Corporation for refund of franchise tax in the amount of **$22, 174. 16** for the short period income year September 1, 1967, through December 3 1, 1967, be and the same is hereby sustained.

Done at Sacramento, California, this 3rd day of June, 1975, by. the State Board of Equalization.

John W. Lynch, Chairman

William M. Bennett, Member

George R. Reilly, Member

Richard Nevins, Member

_____, Member

ATTEST: W. W. Dunlop, Executive Secretary