



In the Matter of the Appeal of )  
 )  
C-M RANCH COMPANY, TAXPAYER, AND )  
M. H. SHERMAN FOUNDATION, INC., )  
ASSUMER AND TRANSFEREE )

For Appellants: J. Patrick Whaley  
Attorney at Law

For Respondent: Timothy W. Boyer  
Counsel

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 C-M Ranch Company, Taxpayer, and M. H. Sherman Foundation, Inc., Assumer and Transferee, against a proposed assessment of additional franchise tax in the amount of \$75,746.42 for the income year 1971. During the course of these proceedings respondent has conceded that the correct amount of tax in controversy is \$30,013.67.

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Appellant C-M Ranch Company, a taxable corporation, was incorporated in California in 1955. Its primary business operation was ranching. Incidental to its ranching operations, it sold real property in 1963 and 1965. It elected to report the gain from those sales on the installment basis pursuant to sections 24667 and 24668 of the Revenue and Taxation Code.<sup>1/</sup>

On December 13, 1972, appellant was liquidated. On the date of liquidation, all of appellant's stock was owned by the M. H. Sherman Foundation, Inc. (Foundation). The Foundation is a nonprofit corporation organized and operated under California law. The Foundation is an organization described in section 23701d and is, therefore, exempt from the California franchise tax. In the course of the liquidation, the Foundation exchanged its shares of appellant's stock for appellant's assets. Included in those assets were promissory notes evidencing unrealized deferred income from the prior installment sales.

On its final return, appellant did not report the unrealized profit which had not yet been received from the installment sales. However, respondent determined that, upon dissolution, section 24672 required the inclusion of the previously unreported income in appellant's measure of tax for the last period the tax was measured by net income. Accordingly, respondent issued a notice of proposed assessment reflecting the increased income. Appellant protested on the basis of subdivision (c) of section 24670 which provides that unreported installment income is not accelerated if distributed in a section 24502 liquidation where the basis of the distributed obligations is determined pursuant to subdivision (b)(1) of section 24504. Appellant's protest was denied and this appeal followed.

The issue for resolution is whether gain is accelerated on the transfer of installment obligations when a taxable corporation is liquidated by a tax exempt corporation.

<sup>1/</sup> Unless otherwise stated, all statutory references are to the Revenue and Taxation Code.

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Section 24672 provides:

(a) Where a taxpayer elects to report income arising from the sale or other disposition of property as provided in this article, and the **entire income therefrom has not been reported prior to the year that the taxpayer ceases to be subject to the tax measured by net income imposed under Chapter 2 or Chapter 3 of this part\*** Abatement shall not be allowed under the provisions of Sections 23331 to 23333, inclusive, **for any tax measured by unreported installment income arising from installment sales made during prior income years which is included in the measure of the tax by reason of this section or for installment income reported during the year preceding the year in which the taxpayer ceases to be subject to the tax imposed by this part.** Abatement shall be allowed for any tax measured by reported or unreported income arising from installment sales made during the income year preceding dissolution or withdrawal or cessation of business. This section shall not be applicable where the installment obligation is transferred pursuant to a reorganization as defined in Sections 24562 and 24563 to another taxpayer a party to the reorganization subject to tax under the same chapter as the transferor, or is transferred to any exempt nonprofit cemetery corporation as defined in Section 23701c of this code. The determination of any deficiency resulting from this section shall be made under the provisions of Chapter 20, Article 1, but the period of limitation under that article, and the accrual of interest under Chapter 21, Article 1, shall commence on the date the taxpayer ceases to be subject to the tax imposed under Chapter 2 or Chapter 3 of this part.

(b) "Cessation of business" as herein used means the failure to do business during an entire taxable year.

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The primary purpose of section 24672 is to ensure that, in the event of dissolution or cessation of business, deferred income from installment sales would not escape taxation under the Bank and Corporation Tax Law. (See Appeal of American Home Supply, Inc., Cal. St. Bd. of Equal., May 19, 1954.) This section has no federal counterpart. It was designed specifically to eliminate the advantage which a corporation might otherwise obtain under the prepayment provisions of the California law where the tax for the last year is measured by income of the preceding year. (Appeal of Contractors Investment Co., Inc., Cal. St. Bd. of Equal., Jan. 5, 1961.)

Section 24672 contains two exceptions to the general rule subjecting unreported income from installment sales to taxation upon dissolution or cessation of business,

The first exception is where the dissolution or cessation of business results from a "reorganization" as defined in sections 24562 and 24563. This exception is reasonable since, in a reorganization as defined by sections 24562 and 24563, there is a continuation of the original business enterprise in a modified form where the successor will be taxable on the deferred income of the transferor.

The second exception concerns a transfer to a nonprofit cemetery corporation. The inclusion of an exception for a specific exempt corporation is indicative of legislative intent not to include exempt organizations in general. It is well settled that when a statute expresses certain exceptions to a general rule, other exceptions are necessarily excluded. (Collins v. City and County of San Francisco, 112 Cal. App. 2d 719 [247 P. 2d 362].)

Appellant has not suggested that the transaction in question comes within either of the above mentioned exceptions. Since the Legislature did not exclude appellant's transfer of unreported installment income from the provisions of section 24672, it appears that such unreported income must be included in the measure of tax for the Past year in which appellant was subject to tax.

In order to avoid this result, appellant relies on section 24670 which provides, in part:

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(a) If an installment obligation is satisfied at other than its face value or distributed, transmitted, sold, or otherwise disposed of, gain or loss shall result to the extent of the difference between the basis of the obligation and---

- (1) The amount realized, in the case of satisfaction at other than face value or a sale or exchange; or
- (2) The fair market value of the obligation at the time of distribution, transmission, or disposition, in the case of the distribution, transmission, or disposition otherwise than by sale or exchange.

Any gain or loss so resulting shall be considered = resulting from the sale or exchange of the property in respect of which the installment obligation was received.

(b) The basis of an installment 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.

(c) (1) If-

- (A) An installment obligation is distributed in a liquidation to which Section 24502 (relating to complete liquidation of subsidiaries) applies; and
- (B) The basis of such obligation in the hands of the distributee is determined under Section 24504 (b) (1);

then no gain or loss with respect to the distribution of such obligation shall be recognized by the distributing corporation.

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In prior decisions we have held that where a dissolving corporation distributes installment obligations in the **taxable year** to which section 24672 is being applied, section 24670 **must be** applied to **limit** section 24672 "unreported income" to the **difference** between the **fair market value** of the **installment obligations** at the time of distribution and the taxpayer's basis in those obligations. (Appeal of Admiral Building Co., Cal. St. Bd. of Equal., March 22, 1971; Appeal of Contractors Investment Co., Inc., supra; Appeal of Pioneer Development Co., Inc., Cal. St. Bd. of Equal., Jan. 5, 1961.) The parties agree that, in this respect, section 24670 has been applied correctly.

However, it is appellant's position that **subdivision (c) (1)** of section 24670 prohibits the recognition of any gain on the transfer of the **installment obligation** to the **Foundation**. That **subdivision** provides that **no gain shall be recognized** where **installment obligations are distributed** in a section 24502 liquidation where the basis of the distributed obligations is **determined pursuant to subdivision (b) (1)** of section 24504.

With one exception, the requirements for a section 24502 liquidation are present. That exception concerns the provision in section 24502 which states that "[n]o gain or loss shall be recognized on the receipt by a corporation of property distributed in complete liquidation of another corporation." (Emphasis added.) Thus, a section 24502 liquidation can occur only if property is distributed to an entity capable of taking as a corporation.

Section 23038, which defines a "corporation", provides, in part:

"Corporation" includes every corporation except:

- (a) Banks
- (b) Corporations expressly exempt from the tax by this part or the Constitution of this state.

Since the Foundation, a tax exempt corporation, is specifically excluded from the definition of a corporation, it appears that it cannot be a party to a section 24502 liquidation. (Cf. Appeal of Canham llairies, Inc., Cal. St. Bd. of Equal., March 29, 1949 (dictum); FTBLR No. 028, Dec. 5, 1958,)

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In its attempt to avoid the definition of "corporation", appellant relies on section 23030 which states:

Except where the context otherwise requires,  
the definitions given in this chapter govern  
the construction of this part.

In arguing that the "context otherwise requires" that the definition of "corporation" include a tax exempt corporation, appellant advances several contentions.

The first reason advanced for giving the word "corporation" its plain meaning when used in section 24502 is that this is done in the corresponding federal provision, section 332 of the Internal Revenue Code of 1954. However, respondent has pointed out that a critical difference between federal law and California law in this area is that an incorporated tax exempt organization is not excluded from the federal definition of "corporation." In view of this basic difference, appellant's reliance on federal law is inappropriate.

Next, appellant suggests that the income in question would not have been taxable if the liquidation had been carried out under other sections of the Revenue and Taxation Code. Thus, appellant maintains, it is appropriate to look to those other sections in interpreting section 24502. Initially, we note that it is not at all clear that the transaction would have escaped taxation by the route appellant suggests. In any event, tax consequences depend upon what was done and not upon what might have been done. (Appeal of Bonzer, Inc., Cal. St. Bd. of Equal., Feb. 5, 1968.)

Appellant has advanced other similar arguments which we have considered and found without merit.

We believe that the Legislature did not intend to allow transactions such as the one under consideration to escape taxation. In order to effectuate this intent it is necessary to apply the statutory definition of "corporation" contained in section 23038. Since that definition excludes tax exempt corporations, the Foundation cannot qualify as a corporate distributee within the section 24502 exception to section 24670. Accordingly, the unreported income from the installment sales must be included in the measure of tax for the last year in which appellant was subject to tax.

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ORDER

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 C-M Ranch Company, Taxpayer, and M.H. Sherman Foundation, Inc., Assumer and Transferee, against a proposed assessment of additinal franchise tax in the amount of \$75,746.42 for the income year 1971, be and the same is hereby modified in accordance with respondent's concession. In all other respects the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this 26th day of July 1976, by the State Board of Equalization.

Sullivan L. Barnes, Chairman  
George L. Lacey, Member  
Frank L. Herin, Member  
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\_\_\_\_\_, Member

ATTEST: W.H. Dunlop, Executive Secretary