



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
HANCOCK OIL COMPANY)

Appearances:

For Appellant: William H. Cree and John W. Brooks,
Long Beach
For Respondent: Reynold E. Blight, Franchise Tax
Commissioner

O P I N I O N

This is an appeal, pursuant to Section 25 of the Bank and Corporation Franchise Tax Act (Stats, 1929, Chap. 13), from the action of the Franchise Tax Commissioner in proposing an additional tax of \$1,427.67 based upon the net income of Hancock Oil Company for the year ended July 31, 1929.

There is no dispute as to the facts. Pursuant to a plan of reorganization, Hancock Oil Company transferred all of its assets to Hancock Oil Company of California. Both corporations were organized under the laws of Delaware and qualified to do business in California. The transfer was completed on August 31, 1929, and subsequent to that date Hancock Oil Company owned no property and transacted no business, unless the proceedings leading up to its dissolution on November 13, 1929, are regarded as "doing business,"

A return was filed with the Commissioner by the Appellant disclosing its net income for the year ended July 31, 1929. Upon the theory that it had exercised the right to do business in California but one month after the close of its taxable year ended July 31, 1929, that is, until the transfer of its operations to the successor corporation on August 31, 1929, the Appellant paid a tax computed at one-twelfth of the total liability which would have been calculated from its return. The Commissioner took the view that the proration must be upon the basis of the time elapsed from the beginning of the new taxable year, viz., August 7, 1929, until the date of dissolution, viz., November 13, 1929. This period would include three and a half months, so that the tax liability resulting from its use would be \$1,998.75 instead of \$571.08, as calculated by the taxpayer. It is the difference between these two figures, or \$1,427.67, which is the amount of the additional assessment proposed by the Commissioner.

The question before the Board for determination is whether the actual termination of business activities on August 31, 1929, when Hancock Oil Company of California succeeded to the affairs of the taxpayer, should control the liability for tax

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or whether that liability continued until the formal dissolution of the taxpayer **on** November 13, 1929. This involves a consideration of the provisions of Section 16 of Article XIII of the Constitution under authority of which Chapter 13, Statutes of 1929, was passed, as well as of the terms of that act itself..

The Constitution provides, in part, that:

"All **** business corporations doing business within the limits of this state **** shall annually pay to the state for the privilege of exercising their corporate franchises within this state a tax according to or measured by their net income ----". (Const. Art. XIII, Sec. 16, par. 2(a))

Similar language is to be found in Section 4 of the Bank and Corporation Franchise Tax Act, which further provides that "taxes under this section ---- shall accrue on the first day after the close of the 'taxable year', as defined in Section 11 hereof."

In Section 11 of the Act the definition is made thus:

"The term 'taxable year', as herein used, means the calendar year, or the fiscal year ending during such calendar year, upon the basis of which the net income is computed herein."

Section 13 of the Act provides that:

"Every bank and corporation shall within two months and fifteen days after the close of its taxable year, transmit to the commissioner a return in a form prescribed by him, specify for the taxable year, all such facts as he may by rule, or otherwise, require in order to carry out the provisions of this act; provided, that there shall be granted a general extension of time of two months in the case of returns required to be filed March 15, 1929, and of one month in the case of returns required to be filed April 15, 1929.

"On or before May 15, 1929, every bank or corporation with a fiscal year ended during the calendar year 1928 shall file a return covering such fiscal year, and its tax for the months of the year 1929, corresponding to the months of 1928 which fall within the **fiscal** year ended during 1928, shall be according to or measured by such proportionate part of the net income of that fiscal year as the number of months falling within the calendar year 1928 bears to the total number of months in the fiscal year ended during that calendar year.

"A bank which locates or commences to do business within the limits of this state, and a corporation which commences to do business in this state, after the effective date of this act, shall thereupon **prepay** the minimum tax hereunder, and upon the filing of its return within two months and **fifteen** days after the close of its taxable year its tax for that year shall be adjusted upon the basis of the net income received during that taxable year. Said return shall also, in accordance with

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sections 23 to 26 inclusive, be the basis for the tax of said bank or corporation for its second taxable year.

"Any bank or corporation which is dissolved during any taxable year shall only be obliged to pay a tax hereunder for the months of the taxable year prior to such dissolution according to or measured by such proportionate part of the net income of the preceding taxable year as the number of months of the taxable year during which such corporation is dissolved and prior to such dissolution bears to the entire taxable year. In any event, each such corporation shall pay a minimum tax of twenty-five dollars for such period.

"The tax liability imposed under this act shall attach whether a bank or corporation has a taxable year of twelve months or of lesser duration." (Stats. 1929, Chap. 13, Sec. 13)

We have resorted to the provisions of the statute as they were when this assessment was proposed, since we regard them as controlling. It should be noted that the law has recently been changed in some respects by acts of the 1931 Legislature.

From these provisions it appears that what is contemplated is a tax on a corporation for the privilege of "exercising its corporate franchises in this state." It further appears that the imposition of the tax is to be confined to those corporations which are doing business here, so that the mere possession of corporate franchises, if unexercised, is not taxable. Although the tax is described as annual there is a clear intent to impose it only during such time as a corporation may be engaged in business.

The Commissioner relies upon the letter of Section 13, stating that in the event a corporation is dissolved, the tax for the year in which the dissolution occurs must be computed up to the date of dissolution. He insists that we should ignore the fact that the taxpayer ceased doing business two and a half months prior to its formal dissolution and turned all of its property over to a successor corporation which has been carrying on the business continuously since then.

However, we are impressed with the consideration that this is a tax on the actual exercise of the right of a foreign corporation to do business in California. The old corporation, i.e., Hancock Oil Company, paid for that privilege up to the close of its taxable year ended July 31, 1929. It exercised the privilege for *only* one month beyond then, and paid for that privilege on the basis of one-twelfth of its annual tax. Immediately thereafter, another foreign corporation took over the same business and assumed a tax liability commencing on September 1, 1929, and measured by the net income from that very business. **This second** corporation, viz., Hancock Oil Company of California, must pay for the privilege of carrying on the business in a corporate capacity from the date of the transfer and there is certainly a practical injustice in requiring the first corporation to pay a similar tax when it has disposed of all its property and is no longer in any commercial activity. Regardless of what may be

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the letter of the law, there is, after all, but one business and, in a properly balanced method of taxation, that should be taxed but once.

There is no hint here of tax evasion. The reorganization appears to have been effected for legitimate commercial reasons. We do not believe it should be penalized by requiring two corporations each to pay a tax on the same business for a period of two and one-half months during which only one of them was doing any business. When, pursuant to a plan of reorganization one corporation assigns all of its properties to another and ceases all activities, save the institution of dissolution proceedings which are completed in due course, a reasonable interpretation of the statute entitles the first corporation to a proration of its tax as of the date of transfer to the second, assuming that there are no circumstances indicating an attempt on the part of the interests involved to avoid the normal accrual of taxes. To hold otherwise would produce manifestly unfair results and, in our opinion, would make the tax an unconstitutional exaction.

As already indicated, the tax is applicable only to corporations doing business, and to attempt to tax two corporations, one doing business and the other doing no business, on the basis of the net income from the same business, is, so far as we can see, without constitutional justification. It is no answer to say that in taxing one the current income will be used while in taxing the other past income will be the basis. In each case the income is only a measure and what is being taxed is the privilege of doing the same business in a corporate capacity. We think the design of the constitution was to tax corporations for the privilege of exercising their corporate franchises so that for all business done in a corporate capacity a tax would be paid measured by the ability of that business to produce income. We do not believe that the people could have intended to tax the same business twice even to two corporations.

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, that the action of Reynold E. Blight, Franchise Tax Commissioner, in overruling the protest of Hancock Oil Company, a corporation, against a proposed assessment of an additional tax of \$1,427.67 based on the net income of said corporation for the year ended July 31, 1929, be and the same is hereby reversed. Said ruling is hereby set aside and the Franchise Tax Commissioner is hereby directed to proceed in conformity with this order.

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Done at Sacramento, California, this 11th day of March,
1931, by the State Board of Equalization.

Jno. C. Corbett, Chairman
H. G. Cattell, Member
R. E. Collins, Member
Fred E. Stewart, Member

ATTEST: Dixwell L. Pierce, Secretary