



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
NAHAS DEPARTMENT STORE NO. 1, INC.)

For Appellant: Fred J. Turk
Certified Public Accountant

For Respondent: Crawford H. Thomas
Chief Counsel

Richard C. Creegan
Counsel

O P I N I O N

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 Nahas Department Store No. 1, Inc., for refund of franchise tax in the amount of \$251.27 for the income year ended January 31, 1971.

The questions presented are: (1) whether appellant, which dissolved during its taxable year

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ended January 31, 1971, is entitled to a refund of a part of the franchise tax it paid for that year: and (2) whether appellant is entitled to a refund of the estimated tax it paid during its income year ended January 31, 1971, for the subsequent taxable year. The answer to both questions depends on whether appellant's dissolution resulted from a "reorganization" within the meaning of Revenue and Taxation Code section 23251.1/

Appellant was a closely held California corporation. It began business on August 1, 1956, operating a department store which specialized in retail sales of wearing apparel and home items. As of January 31, 1970, appellant was associated with eight similar stores, each operated by a separate partnership.

Nahas Enterprises was incorporated in California on February 2, 1970, and began business on or about the same date.' It adopted a fiscal year concurrent with appellant's fiscal year, which ended on January 31. On or about August 6, 1970, Nahas Enterprises issued shares of its capital stock to the shareholders of appellant in exchange for all of appellant's stock. Nahas Enterprises also issued its stock in exchange for the partnership interests of all the partners in the eight partnerships which operated the other department stores. Following these transactions, appellant was liquidated pursuant to section 24502, and all of its assets were distributed to Nahas Enterprises, its sole shareholder at the time. Nahas Enterprises agreed to assume all of appellant's liabilities, including its tax liabilities, and appellant filed a Certificate of Winding Up and Dissolution on August 21, 1970. Nahas Enterprises continued to operate appellant's business without substantial change.

Appellant filed a closing franchise tax return for the period February 1, 1970, to August 31, 1970. The

1/ All section references are to the Revenue and Taxation Code unless otherwise designated.

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net income from operations was reported as \$7,659.22, but instead of reporting a tax liability the return showed a refund due in the total amount of \$251.27. The total refund consisted of:

a. \$114.21, representing 5/12 of the \$274.11 franchise tax paid by appellant for the taxable year ended January 31, 1971.

b. \$137.06, representing the payment made by appellant on its estimated franchise tax for the taxable year ended January 31, 1972.

Nahas Enterprises filed a franchise tax return as a commencing corporation for its income year ended January 31, 1971. The return did not include the \$7,659.22 net income realized by appellant from February 1, 1970, to August 31, 1970. When respondent noted this fact it elected to assess the tax on this amount of income against appellant instead of revising the taxable income of Nahas Enterprises. The assessment was calculated to be \$536.15, and the \$137.06 payment of estimated tax made by appellant was applied against the assessment. Respondent then determined that appellant was not entitled to a refund of the prorated \$114.21 of tax paid for the taxable year ended January 31, 1971, and denied the entire claim for refund. This appeal followed.

Section 23332 states that a corporation which is dissolved or withdraws from this state during any taxable year shall pay franchise tax only for the months **of that** year which precede the effective date **of dissolution** or withdrawal. This provision is limited, however, by the qualification that:

The taxes levied under this chapter shall not be subject to abatement or refund because of the cessation of business or corporate existence of any taxpayer pursuant to a reorganization, consolidation, or merger (as defined by Section 23251).... (Rev. & Tax. Code, § 23332, subd. (a).)

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Section 23251 provides that:

The term "reorganization" as used in **this** chapter means... (d) a distribution in **liquidation** (other than a distribution to which Section 24504(b) (2) applies) by a bank or corporation of all or a substantial portion of its business or property to a bank or corporation stockholder, and the bank or corporation stockholder continues all **or** a substantial portion of the business of the liquidated bank or corporation....

We agree with respondent that the transactions of the instant appeal fall precisely within the terms of subdivision **(d)** of section 23251: there was a distribution in liquidation: the distribution was not subject to section 24504, subdivision (b)(2); the distribution consisted of all the assets of appellant: the distribution was made to a corporation stockholder: and the corporation stockholder continued all or a substantial portion of the business of the liquidated corporation. It follows that appellant ceased to exist as the result of a reorganization and we must therefore affirm respondent's action in denying the refund of **any** part of appellant's franchise tax paid for its taxable year ended January 31, 1971.

Whether appellant is entitled to a refund of \$137.06 depends on whether respondent properly assessed a tax against appellant on its net gain for the first seven months of 1970. The propriety of the assessment is **determined by** the terms of section 23253:

Where, pursuant to a reorganization, all or a substantial portion of the business or property of a taxpayer, a party to the reorganization, is transferred to another taxpayer, a party to the reorganization:

(a) The net gain of the transferor from the business or property so transferred to any taxpayer for the taxable year in which

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the transfer occurs, shall be included in the measure of the tax on the transferee for the taxable year succeeding the taxable year in which the transfer occurs if the taxable year of the transferee in which the transfer occurs ends at the same time as or before the time the taxable year of the transferor in which the transfer occurs ends....

The rule of section 23253 is emphasized and clarified by section 23254:

Where income of the transferor is required to be included in the computation of a tax on the transferee, such income shall not thereafter be included in the measure of a tax on the transferor.

Since we have already determined that a reorganization occurred in which all of the assets of appellant were transferred to Nahas Enterprises, and since Nahas Enterprises used a fiscal year coincident with appellant's fiscal year, the provisions of sections 23253 and 23254 apply. The language of these sections is clear and mandatory. The \$7,659.22 net income realized by appellant from February 1, 1970, to August 31, 1970, must be included in the measure of tax on Nahas Enterprises for its taxable year ended January 31, 1972. That income cannot be used to measure a tax on appellant. The fact that a lower tax results if the income is taxed to appellant does not justify **respondent's** failure to follow the explicit **statutory mandate**. The assessment against appellant being improper, there is no basis for denying the refund of the \$137.06 which was paid by appellant as estimated tax for its taxable year ended January 31, 1972. Accordingly, respondent's action in this regard will be reversed.

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,

