

ADOPTED 8/2/95

95-SBE-014-A

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
WEST VALLEY LAND MANAGEMENT CO.,) No. 91A-0302
0477600, TAXPAYER, AND MARVIN)
MALMUTH AND EDWIN MALMUTH,)
ASSUMERS AND/OR TRANSFEREES)

For Appellant: Edwin Malmuth
President

For Respondent: David T. Gemmingen
Tax Counsel

ORDER DENYING PETITION FOR REHEARING AND
SUBSTITUTING OPINION

Upon consideration of the petition filed October 29, 1993, by respondent for rehearing of the above-referenced appeal, we are of the opinion that none of the grounds set forth therein constitute cause for the granting thereof and, accordingly, it is hereby ordered that the petition be and the same is hereby denied. Good cause appearing therefor, it is also hereby ordered that our original opinion in this appeal, dated September 30, 1993, be withdrawn in its entirety and the following opinion be substituted therefor.

OPINION

This appeal is made pursuant to section 19045 (formerly section 25666, subdivision (b))^{1/} of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of West Valley Land Management Co., 0477600, Taxpayer, and Marvin Malmuth and Edwin Malmuth, Assumers and/or Transferees, against a proposed assessment of additional franchise tax in the amount of \$82,104 for the income year ended October 31, 1989.

The question presented is whether the unreported income from an installment sale in appellant's last year of operation was required to be included in the measure of appellant's franchise tax for that year.

Appellant, a California corporation, began business in this state on September 14, 1964. It elected S corporation status for federal purposes in 1985 and for state purposes in 1987. On July 19, 1989, appellant adopted a plan of complete dissolution. On September 15, 1989, appellant made an installment sale of its major asset and, thereafter, did no business. On September 20, 1989, appellant requested a Tax Clearance Certificate from respondent in furtherance of its dissolution. On December 21, 1989, appellant filed its final return. On that return, it did not report any income from the installment sale.

Respondent determined, relying upon section 24672, that the unreported income from the installment sale was required to be included in the measure of appellant's tax for the income year ended October 31, 1989, because that was the last year in which appellant was subject to tax on its net income. Appellant, on the other hand, reads section 24672 to allow unreported installment sale income to escape taxation in a corporation's final year of operation.

In pertinent part, subdivision (a) of section 24672 provides:

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, the unreported income shall be included in the measure of the tax for the last year in which the taxpayer is 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

^{1/} Unless otherwise specified, all section references hereinafter in the text of this opinion are to sections of the Revenue and Taxation Code as in effect for the income year in issue.

income arising from installment sales made during the income year preceding dissolution or withdrawal or cessation of business. . . . (Emphasis added.)

This board has determined that the primary purpose of section 24672 is to ensure that, in the event of dissolution or cessation of business, deferred income from installment sales does not escape taxation under the Bank and Corporation Tax Law. (See Appeal of C-M Ranch Co., etc., Cal. St. Bd. of Equal., July 26, 1976; Appeal of American Home Supply, Inc., Cal. St. Bd. of Equal., May 19, 1954.) This section has no federal counterpart, and 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 the income of the preceding year. (Appeal of C-M Ranch Co., etc., supra; Appeal of Contractors Investment Co., Inc., Cal. St. Bd. of Equal., Jan. 5, 1961.)

The abatement language contained in subdivision (a) of section 24672 pertains to corporations which dissolved or withdrew before January 1, 1973, and, thus, is not relevant in the instant appeal. The abatement language refers expressly to sections 23331 through 23333, inclusive.^{2/} Section 23331 provides that the effective date of dissolution of a corporation is when the appropriate papers are filed with the Secretary of State. Sections 23332.5 and 23333 deal with the final year's tax and dissolution of a financial corporation. Section 23332, however, concerns the computation of tax for the year of a corporation's dissolution or withdrawal. Subdivision (b) of the section states: "The provisions of subdivision (a) [computation of tax] shall be applied only with respect to taxpayers which dissolve or withdraw before January 1, 1973. . . ."

Under prior law, the tax on commencing corporations was generally based upon their net income for their initial period and to that figure was added a prepayment for the next year based upon that same income but at the tax rate applicable to the second year. Upon dissolution, the tax for the final (generally a short) taxable year was based on a prorated amount of the prepaid tax based on the income of the preceding full income year. Any overpayment of the prepaid tax was abated and refunded. (See Rev. & Tax. Code, § 23332, subd. (a), and former Cal. Code Regs., tit. 18, § 23331-23334, subd. (b).)

Currently, the tax on a commencing corporation is the minimum tax (Rev. & Tax. Code, § 23151.1 subd.(a)), and the tax for the year in which it ceases to do business is according to or measured by its net income for the next preceding income year, plus an amount according to or measured by its net income for the income year in which it ceased doing business. (See Rev. & Tax.

^{2/} In fact, the third sentence of section 24672, subdivision (a), which contains the permissive abatement provision, was originally enacted as part of the second sentence, which proscribes abatement under sections 23331 through 23333, inclusive. (See Stats. 1951, ch. 345, § 7, p. 795.)^{2/} Unless otherwise specified, all section references hereinafter in the text of this opinion are to sections of the Revenue and Taxation Code as in effect for the income year in issue.

^{2/} In fact, the third sentence of section 24672, subdivision (a), which contains the permissive abatement provision, was originally enacted as part of the second sentence, which proscribes abatement under sections 23331 through 23333, inclusive. (See Stats. 1951, ch. 345, § 7, p. 795.)

Code, § 23151.1, subd. (d).)

Respondent correctly determined that section 24672, which accelerates the recognition of income on an installment note when a corporation dissolves or otherwise ceases to be subject to the franchise tax or the corporate income tax, is applicable in this instance. Section 24667, which incorporates Internal Revenue Code sections 453 and 453B, does not preclude the application of section 24672; instead, it complements section 24672 by requiring a further analysis of the tax consequences, if any, resulting from the distribution of the installment note by the liquidating corporation to its shareholders. In other words, sections 24672 and 24667 concern different situations.

For the above reasons, respondent's action in this matter will be sustained.

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 19048 of the Revenue and Taxation Code, that the petition of the Franchise Tax Board for rehearing of the appeal of West Valley Land Management Co., 0477600, Taxpayer, and Marvin Malmuth and Edwin Malmuth, Assumers and/or Transferees, from the action of the Franchise Tax Board on its protest against a proposed assessment of additional franchise tax in the amount of \$82,104 for the income year ended October 31, 1989, be and the same is hereby denied, and that our order of September 30, 1993, be and the same is hereby affirmed.

Done at Sacramento, California, this 2nd day of August, 1995, by the State Board of Equalization, with Board Members Mr. Klehs, Mr. Dronenburg, Mr. Andal, Mr. Sherman and Mr. Halverson present.

Johan Klehs _____, Chairman

Ernest J. Dronenburg, Jr. _____, Member

Dean F. Andal _____, Member

Brad J. Sherman _____, Member

Rex Halverson* _____, Member

*For Kathleen Connell, per Government Code section 7.9.