BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of	)	
	)	No. 86R-1849-CB
BAY CITIES SPAY-NEUTER CLINIC, INC.	)	

For Appellant: Eugene C. Cowell
Certified Public Accountant

For Respondent: Kathleen M. Morris
Counsel

O P I N I O N

This appeal is made pursuant to section 26075, subdivision (a),1/ of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claim of Bay Cities Spay-Neuter Clinic, Inc., for refund of franchise tax in the amount of $3,497 for the income year 1982.

1/ Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as in effect for the income year in issue.

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The issue presented by this appeal is whether amounts received for a covenant not to compete may be reported on the installment method of reporting gain.

On April 30, 1982, appellant, an accrual basis taxpayer, sold its spay-and-neuter clinic that was located in Hayward, California. The items sold consisted of all of the equipment, furniture and fixtures, and the customer list. Additionally, appellant sold a covenant not to compete for $70,000. Appellant continued to operate its other spay-and-neuter clinic which was located in Milpitas.

Appellant's 1982 tax return included an election to use the installment method of reporting the amount received for the covenant not to compete. Specifically, appellant included payments received in the amount of $33,370 as reportable gain for income tax purposes. Respondent disallowed the use of the installment method of reporting the gain on the covenant not to compete because that method is only available for the sale of property. Respondent stated that the sale of a covenant not to compete is not considered a sale of property. Therefore, respondent required appellant to report the entire gain of $69,794 (sale price for the covenant not to compete of $70,000 less selling expenses of $206 in the year of sale.) Appellant paid the tax and filed an amended 1982 return, claiming a refund based on its argument that payments received for a covenant not to compete can be reported on the installment basis.

Installment reporting of gain is statutorily limited to dispositions of property. (Rev. & Tax. Code, § 24667; I.R.C. § 453.) Since section 24667 is substantially similar to section 453 of the Internal Revenue Code, federal precedent is persuasive in the proper interpretation and application of the California statute. (Meanley v. McColgan, 49 Cal.App.2d 203, 209 [121 P.2d 45] (1942).)

Courts have treated payments for covenants not to compete as in the nature of compensation for services instead of as gain from the sale of property. (See Balthrope v. Commissioner, 356 F.2d 28 (5th Cir. 1966).) Because payments received for a covenant not to compete are not viewed as arising from the sale or disposition of property, the installment method is not available. (See Sorensen v. Commissioner, 22 T.C. 321 (1954).) Accordingly, the action of the Franchise Tax Board in denying the claim of Bay Cities Spay-Neuter Clinic, Inc., for refund of franchise tax in the amount of $3,497 for the year 1982 is sustained.

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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, pursuant to section 26077 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claim of Bay Cities Spay-Neuter Clinic, Inc., for refund of franchise tax in the amount of $3,497 for the income year 1982, be and the same is hereby sustained.

Done at Sacramento , California, this 12th day of September, 1990, by the State Board of Equalization, with Board Members Mr. Collis, Mr. Dronenburg, Mr. Bennett, and Ms. Scott present.

Conway H. Collis, Chairman

Ernest J. Dronenburg, Jr., Member

William M. Bennett, Member

Windie Scott*, Member

_____, Member

*For Gray Davis, per Government Code section 7.9