

CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 128

June 20, 1958

INTEREST EQUIVALENT: COMPUTATION UNDER REGULATION 24126

Syllabus:

All dividends with a situs outside this State are to be included in the first alternative interest equivalent in Regulation 24121(b), except dividends from subsidiaries which are owned 50% or more by the reporting corporation.

Advice is requested whether all dividends with a situs outside of this State are to be disregarded in the first alternative interest equivalent computation in Regulation 24121(b).

The specific purpose of section 24121(b) was to limit the interest deductions of foreign corporations who had dividend income which was not includible in the measure of the tax. In Appeal of American Insurance Agency, State Board of Equalization, June 18, 1943, the Board approved the disallowance of interest expense on a foreign corporation to the extent that dividends and interest were not included in the measure of the tax.

The question then arose as to whether the parenthetical exclusion in section 24121(b) (i.e., dividends deductible under section 24121(j) and dividends from 50% or more owned subsidiaries) were applicable to dividends not having a situs in this State. Only dividends from 50% or more owned subsidiaries are to be disregarded in the alternative computation #1. Since dividends with a situs outside the State were not included in income in the first instance, no part of such dividends are deductible under section 24121(j), therefore, the entire amount must be used to measure the amount of interest expense to be disallowed under alternative computation #1. The regulation specifically sets forth that the exception as to section 24121(j) dividends was not applicable to dividends with a situs outside the State. However, to construe the statement as excluding all foreign dividends from the first alternative computation would render meaningless the limiting provisions of section 24121(b).