

CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 199

April 24, 1957

GROSS INCOME: TAXABILITY OF DEALER RESERVES

Syllabus:

When installment contracts are discounted to banks by dealers the amounts withheld by the banks to be placed in dealer reserves to protect the bank against losses are taxable to the dealer at the time the notes are sold to the bank. Shoemaker-Nash Inc. v C.I.R., 41 BTA 417, Superior Motor Sales Inc., State Board of Equalization, Feb. 1, 1956, followed.

Taxpayer is in the business of selling farm machinery. It discounts its contracts with a bank under a document titled a "repurchase agreement". The bank retains 5% of every contract purchased from the taxpayer and this amount is placed in a dealer reserve to protect the bank against losses. All amounts placed in the reserve may be applied against amounts due the bank. The agreement provides that "all amounts so withheld may, at the discretion of the Bank, be reduced from time to time by release to the dealer". Advice has been requested as to when the amounts withheld by the bank become taxable income to the dealer. Held; Such amounts become taxable to the dealer at the time the notes are sold to the bank.

Two divergent views have been taken regarding the taxability of these dealer reserve accounts. Under one view the credits to the reserve are not taxable until actually received by the dealer. Keasby & Mattison v U.S., 141 F2d 163. The other cases hold that the amounts in question become taxable at the time that the notes are sold to the bank. Shoemaker-Nash Inc. v C.I.R., 41 BTA 417, Appeal of Superior Motor Sales Inc., State Board of Equalization, Feb. 1, 1956, Appeal of Harrison Pontiac, State Board of Equalization, May 29, 1952.

In its original opinion in the Superior Motor Sales Inc. appeal and in its opinion denying a petition for rehearing, dated February 5, 1957, the Board of Equalization considered both of the above views, decided that the two lines of authority could not be reconciled on the basis of particular provisions in the discount agreements and held that it will continue to follow the Shoemaker-Nash rule as the power rule for these cases. The Internal Revenue Service has adopted the same position in Rev. Rul. 57-2 IRB 57-1. Under these circumstances this Board will follow the same rule and held that such reserves are taxable to the dealer at the time the notes are sold to the banks.