

CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 259

August 21, 1964

CORPORATIONS FORMERLY SUBJECT TO FRANCHISE TAX

Syllabus:

An opinion has been requested as to the proper application of section 23504 on the following facts.

Taxpayer filed a return under Chapter 2 of the Bank and Corporation Tax Law for income year ending December 31, 1958. The return reflected an income of \$10,000, for which a tax of \$400 was paid. The corporation discontinued doing business and withdrew as of June 30, 1959. At that time a refund of 6/12 of its tax (\$200) was made. During the period up to June 30, 1959, taxpayer had income of \$5,000 and income from sources in California of \$3,000 during the last six months of the year.

Based upon these facts a taxpayer concluded that the \$3,000 earned in the last six months of 1959 is not taxable under Chapter 3 by reason of section 23504.

Is such income exempt from tax under section 23504?

The proration provisions of section 23332 are designed to only require payment of the Chapter 2 tax for periods that a taxpayer has the right to do business in California.

Section 23501, on the other hand, imposes a tax under Chapter 3 on any income received from California sources during any period for which a tax was not paid under Chapter 2 measured by or according to net income. Under this section this Board may not levy a tax under Chapter 3 for any taxable year for which the taxpayer has already paid a tax measured by income under Chapter 2.

In addition, section 23503 provides that if a Chapter 3 tax is due and payable for a particular taxable year, any Chapter 2 tax which may have been paid for the same taxable year shall be offset against the Chapter 3 tax. The usual situation where this section has application is where a taxpayer does not "do business" in California but has income from sources in this State. For protective reasons the corporation then qualifies with the Secretary of State and thereafter pays the minimum tax for each subsequent year. Under section 23503 the minimum tax paid is offset against the Chapter 3 tax. Since the minimum tax is not measured by or according to income, section 23501 does not prevent the assessment of the Chapter 3 tax.

In this setting section 23504 then provides:

"Where a corporation formerly subject to tax under Chapter 2 becomes subject to tax under Chapter 3, it shall file an information return for the income year in which the change occurs. The tax for the year in which the change occurs will be assessed under Chapter 2 and not under Chapter 3. For years subsequent to the year in which the change occurs, the tax will be assessed under Chapter 3."

When this section is read in connection with its predecessor sections, it merely clarifies the tax treatment where a taxpayer ceases to do business and does not withdraw but continues to have income from California sources. In this instance there is no proration under section 23332 and the tax paid for the year of change, measured by the previous year's income, will be assessed under Chapter 2. Since a tax measured by income has been paid under Chapter 2 for the entire year of change, the income received from sources in this state after the cessation of business is not taxable.

Interpreting these sections in this manner the following conclusions are reached:

In the instant factual situation the assessment of tax is controlled by sections 23332 and 23501. Since taxpayer withdrew on June 30, 1958, proration of the Chapter 2 tax measured by the 1958 income was made. Since no Chapter 2 tax measured by income or profits was paid for the period July 1, 1959 to December 31, 1959, section 23501 authorizes a Chapter 3 tax on the income received during this period.

Attorney General Opinion NS 834 affirms our conclusion that a Chapter 3 tax cannot be imposed on income earned during any period for which a tax measured by income or profits was levied under Chapter 2.