for premises which do not constitute taxable premises and rent received or due from exempt tenants.

- Schedule D—other deductions from base rent.
- Schedule CR-SL 2 and CR-SL2A —schedule of taxable premises (deductions claimed).

The final return for each year (Form CR-F) must be accompanied by the above detailed schedules, where required.

Form CR-SL 1, schedule of the taxable premises, must be included with each quarterly return, but neither the name of each landlord nor the details of deductions taken with respect to each individual premises need be furnished for the quarterly returns.

Taxpayers must maintain records to support gross rent, deductions and base rent reported on each quarterly return and on the final return.

STATE TAXATION, OTHER THAN NEW YORK

Conducted by:

THE COMMITTEE ON STATE TAXATION—OTHER THAN NEW YORK
HERBERT SITVER, CPA, Chairman

NEW JERSEY—CORPORATION TAX BUREAU NOT BOUND BY GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

In computing the net worth portion of the New Jersey Corporation Business Tax, the Division of Tax Appeals has recently ruled that a reserve for deferred income taxes, arising from the use of an accelerated method of depreciation for federal income tax purposes and the use of straight-line depreciation for financial accounting purposes, is not a true liability reserve but should be included in net worth as a surplus reserve. (*American Can Company v. Director, Division of Taxation*, Feb. 18, 1964). This determination was made even though the taxpayer had followed accounting principles set forth by Accounting Research Bulletin No. 44 (revised) issued by the American Institute of CPAs. The reserve, which was in excess of twenty million dollars, was set up in the books of the taxpayer and its subsidiaries, upon the advice of their accountants.

The issue was whether the Director of Taxation had made a reasonable determination of the value and validity of the assets and liabilities in arriving at the actual net worth of the taxpayer in accordance with sound accounting principles, notwithstanding that the taxpayer had kept its books pursuant to sound accounting practice.

The term "net worth" is defined by the Corporation Business Tax Act (1945) in N.J.S.A. 54:10A-4(d) to mean "*. . . the aggregate of the values disclosed by the books of the corporation for* (1) issued and outstanding

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FOR THE COMMITTEE ON STATE TAXATION OTHER THAN N. Y.

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capital stock, (2) paid-in or capital surplus, (3) earned surplus and undivided profits, (4) surplus reserves which can reasonably be expected to accrue to holders or owners of equitable shares, not including reasonable valuation reserves, such as reserves for depreciation. . . . *However, if in the opinion of the commissioner, the corporations books do not disclose fair valuations, the commissioner may make a reasonable determination of the net worth which, in his opinion, would reflect the fair value of the assets carried on the books of the corporation, in accordance with sound accounting principles, and such determination shall be used as net worth for the purpose of this act.*" (Emphasis supplied).

The Division of Tax Appeals ruled that the reserve is not a present valid liability. The possibility that the taxpayer will pay increased Federal taxes is conjectural and not reasonably foreseeable since the liability depends upon many factors such as general business conditions, actions of the Federal government and even factors which are under the control of the taxpayer's own actions. For example, a careful policy of replacement of the depreciable property, especially in the case of an expanding business, will totally avoid the increased taxes provided for in this reserve. Furthermore, the money represented by the reserve is presently available to the taxpayer. The Division noted that the taxpayer followed Accounting Research Bulletin No. 44 (revised) in setting up the reserve, but felt that this procedure is advisable merely for purposes of showing the existence of a possible liability. It concluded that this is not a sufficient basis to establish that the true net worth of the corporation should not reflect the amount of the reserve. Furthermore, the Division held that the taxpayer did not meet its burden of proof to establish that the Director acted unreasonably or violated any principles of accounting in arriving at his determination.

From an accounting concept, this decision, which the taxpayer is appealing, is difficult to accept since the taxpayer could do no less but to set up the reserve as a liability in order to comply with SEC requirements and Bulletin No. 44 (revised). It is interesting to note that, in a letter dated April 15, 1959, the Committee on Accounting Procedure of the AICPA referred to Bulletin No. 44 (revised) and stated that the deferred tax account should be shown in the balance sheet as a liability or a deferred credit. Significantly, it went on to state: ". . . A provision in recognition of the deferral of income taxes, being required for the proper determination of net income, should not at the same time result in a credit to earned surplus or to any other account included in the stockholders' equity section of the balance sheet." Thus, American Can's net worth properly reflected "the aggregate of the values disclosed by the books of the corporation" as required by the statute.

Taxwise, however, this decision is in accord with the interpretation by the New Jersey courts of the statutory authority of the Director to adjust values for purposes of the Corporation Business Tax. (*R. H. Macy & Co., Inc. v. Director, Division of Taxation,* 77 N. J. Super. 155 (App. Div. 1962), affirmed 41 N. J. 3 (1963); discussed in this column March, 1964). In that case, Macy was using the Lifo method of valuing inventory but the Director determined that Fifo would give a closer approximation of inventory values and thus result in a more realistic determination of net worth. The N. J. Superior Court concluded that so long as the Director is not arbitrary and uses sound accounting principles in his determination, then, by virtue of the statute, his determination will control irrespective of the taxpayers own use

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of proper accounting principles.

These cases, which may adversely affect many corporations filing the N. J. Corporation Business tax return, bear serious forebodings since, in reality, they are interpreting the statute in a manner which imposes upon taxpayers accounting concepts set by the Director of Taxation rather than permitting taxpayers to rely upon the advice of their independent accountants in applying sound accounting principles. Although for tax purposes a state has the sovereign right to so legislate, it is submitted that this should not be the intent or purpose of any taxing statute.

CALIFORNIA—NO REFUND OF FRANCHISE TAXES FOR CORPORATE REORGANIZATIONS

California franchise tax is assessed for the privilege of doing business in the state. Payment is due on the 15th day of the third month of the privilege year and the liability is based on the income of the preceding year.

When a corporation dissolves, the franchise tax liability for the final year is prorated, based on the number of months prior to dissolution. In many instances the dissolution results in a refund since the tax for the full privilege year was paid on the basis of the earnings for the prior year. The tax for the period prior to dissolution is a percentage of the full tax for the year based on the number of months prior to dissolution divided by 12.

In certain types of reorganization, the transferee and transferor corporations are considered to continue for franchise tax purposes and, therefore, no refund of tax will result. Section 23251 of the California Revenue and Taxation Code defines reorganization to include:

- A transfer of all or a substantial portion of a corporation's business or property to another corporation, with continuing control (80%)
- A mere change in identity, form, or place of organization
- A merger or consolidation
- A liquidating distribution of all or a substantial portion of the corporation's property to a corporation stockholder, where the stockholder continues all or a substantial portion of the business. Where one corporation purchases substantially all the stock of another corporation, in order to obtain its assets in a subsequent liquidation within two years, the transaction will not be considered a reorganization within Section 23251

In a recent case, *Heating Equipment Mfg. Co. v. Franchise Tax Board* (California District Court of Appeals, First District, Division One, July 2, 1964) the acquisition of all the outstanding shares of stock of one corporation in exchange for stock in the acquiring corporation, followed by a liquidation of the acquired corporation and distribution of all the assets to the acquiring corporation, was held to be a reorganization under Section 23251 of the California Revenue and Taxation Code.

The Internal Revenue Service had ruled that the acquisition constituted a reorganization within the meaning of Section 368(a)(1)(B) of the Internal Revenue Code (stock for stock) and, therefore, no gain or loss was recognized for federal income tax purposes. The California law does not include this type transaction within its definition of reorganization and, therefore, the acquired company claimed a refund of California franchise tax due to dissolution.

The court held that the acquisition and subsequent liquidation was in effect a merger and, therefore, a refund was precluded by Section 23251 of the California law. The merger need not be a statutory merger in order to be

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