STATE OF KANSAS

Office of the Attorney General

1st Floor, State Capitol Bldg. (913) 296-2215 Topeka, Kansas 66612

Curt T. Schneider
Attorney General

January 13, 1976

ATTORNEY GENERAL OPINION NO. 75-462a

The Honorable Elwill M. Shanahan
Secretary of State
2nd Floor - State Capitol Building
Topeka, Kansas 66612

Re: Corporations--Franchise Tax

Synopsis: Undistributed earnings of banking corporation in which majority of stock is held by parent corporation should not be included in determining amount of franchise tax due from latter corporation, unless latter corporation treats said retained undistributed earnings as its own asset in reporting its assets, liabilities and net worth under K.S.A. 17-7503(c).

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Dear Secretary Shanahan:

I write to supplement Opinion No. 75-462, concerning the corporate franchise tax due from Midwest Bancorporation, Inc. In the earlier opinion, we discussed whether the undistributed earnings retained by Farmers State Bank and Trust Company, Hays, Kansas, were to be considered in computing the corporate franchise tax due from Midwest, the primary asset of which is its investment in excess of ninety percent of the outstanding shares of Farmers State.

K.S.A. 17-7501(d) defines the "shareholder's equity" upon which the franchise tax shall be based as the sum of:

> "(1) Paid-in capital stock, except that paid-in capital stock shall not include any capital stock issued by a corporation and reacquired by such corporation through

> gift, purchase or otherwise and available for resale or retirement; (2) capital paid in, in excess of par; and (3) retained earnings. . . ."

Midwest has urged that because the retained earnings are those of Farmers State, and have not been distributed to the stockholders, including Midwest, that the retained earnings of Farmers State should not be attributed to Midwest for the purpose of determining its franchise tax liability. In my earlier opinion on this question, I agreed with this position, that the definition of shareholder's equity does not include retained earnings of a subsidiary which are retained in undistributed form by the subsidiary, and to which the parent has not yet received. Thus, certainly, Midwest need not have reported these retained earnings on its reports.

However, you indicate that examination of the balance sheet of the report indicates that, using an equity method of accounting, the undistributed earnings have indeed been included as an asset of the corporation. K.S.A. 17-7503(a)(8) requires that the annual report of every domestic corporation organized for profit include a "complete and detailed statement of the assets, liabilities and net worth of the corporation." Midwest urges that the fact that it has adopted and utilized an equity method of accounting for the purpose of determining and describing its assets and liabilities, and thus included the retained earnings of Farmers State as an asset of Midwest on the balance sheet of the latter, it is nonetheless not an asset of the latter for the determination of its corporate franchise tax liability.

The method of accounting used by the taxpayer is an entirely permissible method of computing its assets and liabilities. Once it has chosen to treat an asset of Farmers State, such as its retained earnings, as its own asset, however, in reporting its, *i.e.*, the taxpayer's, assets, liabilities and net worth, it ill becomes the taxpayer to thereafter disclaim that same asset in computing its franchise tax liability, which must be determined according to the financial data furnished by the taxpayer in its balance sheet prepared in accordance with K.S.A. 17-7503(a)(8), *supra*. In effect, the taxpayer has claimed the undistributed retained earnings of Farmers State as its own asset on its balance sheet, and sought to deduct that asset in the computation of its franchise tax. No such deduction is permitted by K.S.A. 17-7501(d). If the taxpayer chooses to treat the retained earnings of Farmers State as its own for the reporting of its assets, liabilities and net worth, it cannot thereafter deduct those same retained earnings in the computation of the "shareholder's equity" upon which the franchise tax is based. That assessment is a tax, and any taxpayer seeking a deduction therefrom must establish a clear legal basis therefor. We agree that if the taxpayer chose not to report these retained earnings as its own, it would be legally privileged to do so, relying upon the separate corporate entities of the two corporations as a basis for disclaiming any right to the yet undistributed earnings. However, once the taxpayer, in reporting its assets, liabilities and net worth under K.S.A. 17-7503 chooses to treat the retained earnings of Farmers State as its own, they must be treated as its own for other purposes under the corporation code, including the computation of the franchise tax.

Yours very truly,

Curt Schneider

CURT T. SCHNEIDER
Attorney General

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