BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
UNITED STATES OIL & ROYALTIES COMPANY)

Appearances:

For Appellants: Rolland T. Williams, Attorney

For Respondent: Chas. J. McColgan, Franchise Tax Commissioner

O P I N I O N

This is an appeal, pursuant to Section 25 of the Bank and Corporation Franchise Tax Act (Statutes 1929, Chapter 13, as amended), of United States Oil & Royalties Company, a corporation, against a proposed assessment of an additional tax in the amount of $155.69 based upon Appellant's net income for the taxable year ended December 31, 1930.

The Appellant contends that in computing its net income for the taxable year ended December 31, 1930, it was entitled to an additional deduction on account of depletion allowance based upon January 1, 1928 values of its oil and gas wells. The disallowance by the Commissioner of such deduction resulted in the proposed assessment of additional tax above noted.

Prior to its amendment in 1931, Section 8(g) of the Act, insofar as is relevant, provided that:

> "The basis upon which depletion is to be allowed in respect of any property shall be as provided in sections 113 and 114 of the said revenue act of 1928, (i.e., Federal Revenue Act of 1928).
>
> "In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph."

Under the above quoted provisions, the allowance for depletion in the case of oil and gas wells was to be at the rate of 27½% of the gross income from the wells, but was not to be less than if computed under Sections 113 and 114 of the Federal

Revenue Act of 1928, which provides for allowance of depletion upon the basis of cost or March 1, 1913 values, or under Section 19 of the state act which used January 1, 1928 as a basic date. Hence it would appear that whenever the values of oil and gas wells were greater on January 1, 1928 than the cost of the wells or greater than the values on March 1, 1913, the January 1, 1928 values would controlin computing the minimum allowance for depletion, resulting, of course, in the allowance Of a greater amount for depletion than would have been allowed had the minimum allowance been computed on the basis of cost, or on the basis of March 1, 1913 values.

In 1931, the above quoted provisions of Section 8(g) were amended (amendment effective February 27, 1931) to read as follows (the changes are indicated by underlineation):

> "The basis upon which depletion is to be allowed in respect of any property, except as hereinafter provided for oil and gas wells, shall be as provided in sections 113 and 114 of the said revenue act of 1928, or upon the basis provided in section 19 hereof.
>
> "In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed in the manner provided in sections 113 and 114 of said Revenue Act of 1928."

Under these provisions, as amended in 1931, depletion allowance, in the case of oil and gas wells, is to be computed at the rate of 27½ per cent of the gross income therefrom, as formerly, but is not to be less than if computed under Sections 113 and 114 of the Federal Revenue Act, that is, said allowance shall not be less than if computed on the basis of cost, or on the basis of March 1, 1913 values. Hence, although January 1, 1928 values may be used in the computation of depletion allowance for. other property, these values are no longer to be used in the computation of the minimum depletion allowance for oil and gas wells.

If the above amended provisions control the computation of income for the taxable year ended December 31, 1930, then we must hold that the Appellant was not entitled to an additiona depletion allowance based on January 1, 1928 values, and, consequently, we must affirm the ruling of the Commissioner. If, however, the provisions of Section 8 (g) as they existed prior to their amendment in 1931, are to be followed in the computation of income for the taxable year ended December 31, 1930, then it would seem that the Appellant is entitled to an additional allowance for depletion based upon January 1, 1928 values and, consequently, the Commissioner should be overruled.

Appellant vigorously contends that the amendment to Section 8(g) should not be considered as applying to the computation of income for the year ended December 31, 1930, for the reason that since it was not otherwise expressly provided, the amendment should be considered as applying prospectively and not retrospectively, whereas, to consider it as applying to the computation of income for the year ended December 31, 1930, inasmuch as it was not effective until February 27, 1931, would result in giving it a retrospective application.

We agree with Appellant that the amendment should be given a prospective, rather than a retrospective, application, but we are unable to concur in the view that the amendment, as applied to the computation of income for the year ended December 31, 1930, should be regarded as being retrospective. It is true, that as so applied, the amendment would change the method of computation of income for a year prior to its effective date, the result of which would be to change the amount of a tax which became a determined and accrued liability, under Section 4 of the Act, prior to the effective date of the amendment. 'Hence,? it would seem, that, as so applied, the amendment would be retroactive, But, in our opinion, the retroactivity is more apparent than real.

The application of the amendment to the computation of income for the year ended December 31, 1931, does not in any way affect taxes for a year prior to the effective date of the amendment. The income of Appellant for the year ended December 31, 1930, is used solely as a basis for computing Appellant's tax liability under the Act for the year 1931. This tax, although it accrued, under Section 4 of the Act, prior to the time the amendment in question became effective, is nevertheless a tax on Appellant for the privilege of *exercising* its corporate franchise throughout the year 1931, the current year as of the time the amendment became effective. We are unable to perceive why a change in the method of computing a tax should be considered retroactive because the change is applied" to the computation 'of the.tax for the year in which the change, became effective,

As stated by R. J. Traynor, Associate Professor of Law, University of California, at page 739 of the 1932 edition of Ballantine's California Corporation Laws,

> "The tax imposed in.1931 is not a retroactive tax but a tax for the current taxable year. It is difficult to see on what basis a taxpayer can claim that, regardless of legislative action, current taxes must be figured on the same basis on which past taxes have been assessed, or in fact on what grounds he can complain if the rates of current taxes were increased *or* if, indeed, additional taxes were imposed during the same year on the same subject."

It is contended by Appellant that inasmuch as it filed its return for the year ended December 31, 1930 prior to February 27, 1931, the time the amendment became effective, the

effect of the amendment if followed in computing income for the year ended December 31, 1930 *is* to render, retrospectively, its return for said year, erroneous.

In this connection it is to be noted that returns for the year ended December 31, 1930, were not required to be filed until March 15 1931 (see Section 13 of the Act). If we should follow the suggestion of the Appellant, we should be compelled to hold that the amendment to Section 8(g) should be followed in computing income for the year ended December 31, 1930, which was reported subsequent to February 27, 1931, and prior to March 15, 1931. Yet to hold otherwise with respect to income for the same year which happened to have been reported Prior to February 27, 1931, would result in a gross and unreasonable discrimination between corporations in the computation of depletion allowance on account of oil and gas wells. We are of the opinion that such a discrimination should not be countenanced by this Board.

It is clear, as Appellent suggests, that the Act by virtue of the 1931 amendment to Section 8(g), in not permitting depletion allowance; in the case of oil and gas wells, to be computed on the basis of January 1, 1928 values, while permitting the allowance for depletion to be so computed in the case of all other property, discriminates against oil and gas companies. It is to be noticed also, that whenever January 1, 1928 values of oil and gas wells are greater than the cost of such wells, or greater than the March 1, 1913 values thereof, as is true in the instant case, the Act, as a result of the above amendment, may possibly be considered as imposing a tax on oil and gas companies measured in part by gains occurring prior to January 1, 1928.

Whether, in view of the above, the 1931 amendment to Section 8(g) is constitutional, is open to question. In accordance with our views as expressed in the Appeal of Vortox Manufacturing Company, decided by us on August 4, 1930, and in the Appeal of Petroleum Rectifying Company of California, decided by us on April 21, 1932, we are of the opinion that this point should not be considered by this Board. As conceived by us, our duty with respect to franchise tax appeals is, primarily, to construe the Act, and to determine the correct amount of tax due thereunder. The constitutionality of the Act, we think, should be left in most instances at least for the courts to determine.

The Appellant, in addition to its contentions with respect to the proper basis for computing the depletion allowance in the case of its oil and gas wells, contends that it should have been allowed as a deduction from its net *income for* the year ended December 31, 1930, the sum of $23,197.19, representing "net loss for prior year".

In support of this contention, Appellant argues that by the terms of Section 8(f) of the Act, the entire Federal Revenue Act of 1928 is incorporated into the state act, and that under the Federal Revenue Act of 1928, the above amount would have

been deductible as claimed.

Section 8(f) of the Act provides that in computing net income, deductions shall be allowed for

> "Exhaustion, wear and tear and obsolescence of property to be allowed upon the basis provided in sections 113 and 114 of that certain act of the Congress of the United States known as the "Revenue Act of 1928," which is hereby referred to and incorporated with the same force and effect as though fully set forth herein, or upon the basis provided in section 19 hereof."

It is possible to argue, in view of the use of the verb "is" instead of the verb "are" in the above section, that the entire Federal Revenue Act of 1928 was incorporated into the state act, rather than just Sections 113 and 114 of said Federal Revenue Act of 1928.

However, we are of the opinion even if it be conceded that the entire Federal Revenue Act of 1928 was incorporated into the state act that wherever there are specific provisions in the state act relating to certain subjects, these provisions should be considered as controlling rather than provisions of the Federal Revenue Act of 1928 incorporated into the state act in the above manner.

Section 8(d) of the Act prescribes the allowable deduction: from income on account of losses, net losses for prior years are not included within the allowable deductions mentioned. Hence, we are of the opinion that the above item of $23,197.19 representing "net loss for prior year" was properly disallowed as a deduction from Appellant's income for the year ended December 31, 1931.

O R D E R

Pursuant to the views expressed in the opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, that the action of Albert A. Manship, Franchise Tax Commissioner, in overruling the protest of United States Oil & Royalties Company, a corporation, against a proposed assessment of an additional tax of $155.69 with interest under Chapter 13, Statutes of 1929, be and the same is hereby sustained.

Done at Sacramento, California, this 10th day of May, 1932, by the State Board of Equalization,

R. E. Collins, Chairman
Fred E. Stewart, biember
H. G. Cattell, Member
Jno, C, Corbett, Member

ATTEST: Dixwell L. Pierce, Secretary