BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of

FILOLI, INCORPORATED

Appearances:

For Appellant: Mr. F. M. Mielke of McCutchen, Olney, Mannon and Greene, Attorneys

For Respondent: Hon. 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 of 1929, Chapter 13, as amended) from the action of the Franchise Tax Commissioner in overruling the protest of Filoli, Incorporated, to a proposed assessment of an additional tax in the sum of $696.60 for the year ended December 31, 1930, and an additional tax in the sum of $8,017.66 for the year ended December 31, 1931.

It is to be noted that the appellant commenced doing business in this state on July 1, 1930. The additional assessmen-herein involved are for its first and second taxable years, that is, for the period from July 1, 1930, to December 31, 1930, inclusive, and for the period from January 1, 1931, to December 31, 1931, inclusive.

Under the second paragraph of Section 13 of the Act the tax of a corporation for its first taxable year is to be computed on its net income earned during that year. The additional assessment for the first taxable year, i.e., $696.60, was proposed solely because tha Commissioner included in appellant's income for the first taxable year the sum of $62,171.25, received by appellant during that year as interest on tax exempt securities. In view of the decision of the United States Supreme Court in the case of Pacific Company, Ltd., vs. Johnson, 76 L. Ed. 555, holding the Act valid notwithstanding the fact that interest from tax exempt improvement district bonds was included in the measure of the tax provided for in the Act, the Appellant has conceded that the Commissioner acted properly in including the above item of interest in computing appellant's tax for the first taxable year. Of the proposed assessment of $8,017.66 for the second taxable year, the-sum of $696.60 is due-to the inclusion of interest from tax exempt securities. Consequently, the amount in dispute is the difference between the above two figures,

i.e. $7,321.06. The problem with respect to this amount relates solely to the method followed by the Commissioner in computing appellant's tax for the second taxable year.

Prior to February 27, 1931, the Act provided, in effect, that the tax for the second taxable year of a corporation should be computed upon the basis of its net income for the first taxable year, whether the first taxable year was a period of twelve months or was a period of less duration. But on February 27, 1931, an amendment to the second paragraph of section 13 became effective providing that the return for the first taxable year should also be used as a basis for computing the tax for the second taxable year.

> "except that in every case in which the first taxable year of a bank or corporation constitutes, a period of less than twelve months, the net income to be used as the measure of the tax for the second taxable year shall be in the same proportion to the net income for the first taxable year as the number of months in the second taxable year bears to the number of months covered by the return for the first taxable year."

Under this amendment, the tax of a corporation for the second taxable year will be based partly upon fictitious income if its return for its first taxable year covered a period of less than twelve months, i.e. it will be based upon an estimate of what the income for an entire year would have been, computed upon the assumption that the income for each of the remaining corresponding fractions of the year would have been the same as the income for the fraction of the year in which the corporation actually did business.

It would seem that some such adjustment, as contemplated by the above amendment, should be made in computing the tax for the second taxable year of a corporation whose return for the first taxable year covered a period of less than twelve months. Otherwise, such a corporation would be permitted to do business during the whole of the second taxable year by paying a tax measured by income of only a portion of a year. Obvious inequalities would, of course, result. A corporation which did business for but one month during its first taxable year would be allowed to do business for the whole of the succeeding year by paying a tax measured by one month's income, whereas a corporation which did business for an entire year would have to pay a tax for the succeeding year measured by the income of a twelve months period.

But the appellant contends that nevertheless the amendment is unconstitutional for the reason that it does not provide for a tax measured by net income whereas section 15 of Article XIII of the Constitution, pursuant to which the Act was passed,

contemplates in subdivision 2a a tax according to or measured by net income. In the instant appeal, inasmuch as appellant did business for six months during its first taxable year, the Commissioner, acting pursuant to the amendment in question, doubled the income for the first taxable year in computing appellant's tax for the second taxable year. Appellant contends that the Commissioner acted erroneously in so doing, not because he did not accurately follow the amendment, but because the amendment should be considered unconstitutional and hence should not be followed. Appellant requests that we hold the amendment invalid, and consequently hold that appellant should not be required to pay the additional assessment insofar as that assessment resulted from doubling appellant's income for the first taxable year.

Generally, our policy has been not to consider attacks upon the constitutionality of legislation. Rather, we leave such matters for the courts to determine. Our views in this respect have been set forth by us on a number of occasions, particularly in the appeal of Vortox Manufacturing Company decided by us on August 4, 1930. Although we might hold unconstitutional a particular provision of law if we regarded it as being clearly unconstitutional, and if such action were necessary for the proper disposition of a matter duly presented to us for consideration we certainly would not do so if the provision might under any reasonable construction be considered valid. The amendment in question in the instant appeal, is not in Our opinion, so clearly unconstitutional as to warrant our holding it invalid. Considering the purpose for which the amendment was adopted, and considering the obvious inequalities, above noted, which would result if it were held invalid, we think that it might, reasonably considered, be held to impose a tax measured by "net income" as that term is used in subdivision 2a of section 16 of Article XIII of the constitution. Rut even if it cannot be said that the amendment imposes a tax measured by "net income" within the meaning of that term as used in the above mentioned provision of the constitution, nevertheless we think it might reasonably be argued that the amendment is constitutional.

It is to be noted that subdivision 2b of section 16 of Article XIII of the Constitution provides that:

> "The legislature, two-thirds of all of the members elected to each of the two houses voting in favor thereof, may provide by law for the taxation by any other method authorized in this constitution of the corporations, or the franchises, subject to be taxed pursuant to subdivision a of paragraph 2 of this section or subdivision d of section 14 of this article.?'

If the Legislature, when it adopted the amendment in question, did not provide for a tax "according to *or measured* by net income" as argued by Appellant, then it would seem that the Legislature must have provided for the taxation of corporations or corporate franchises subject to be taxed pursuant to subdivision a of paragraph 2 of Section 16 of subdivision d of Section-14 by an "other method." We know of no provision in the constitution which prohibits the Legislature from levying a tax measured by net income for a period less than a year, increased in that proportion which the number of months in an entire year bears to the number of months in the period during which the income was earned. Consequently, it would seem that this "other method" is a method "authorized in this constitution" since it would be unreasonable to construe the phrase "authorized in this constitution" as meaning "expressly set forth in this constitution'! inasmuch as only one other method for taxing corporate franchises is expressly set forth in the constitution, namely the method set forth in subdivision d of Section 14 of Article XXII.

We do not wish to be taken as holding that the above argument is controlling or is conclusive. It is, however, an argument which could be made in support of the validity of the amendment, and is an argument which we think merits serious consideration. At least, it demonstrates that the amendment is not clearly unconstitutional. Hence, in accordance with the policy which we have adopted, we will, for the purposes of this and similar appeals, consider the amendment valid, at least until a competent tribunal determines the amendment to be invalid.

Appellant also raises a question as to the proper allowance for offset from its tax for the second taxable year. Under Sections 4 and 26 of the Act, ten per cent of real property taxes and one hundred per cent of personal property taxes paid locally during the taxable year may be offset against the tax provided for in the Act up to seventy-five per cent of said tax. In accordance with these provisions, the Commissioner allowed Appellant an offset against its tax for its first taxable year on account of taxes paid locally during that year, and inasmuch as the tax for the second taxable year is to be computed on the basis of the return for the first taxable year, used the same taxes paid locally in computing an offset against the second taxable year. Appellant insists that if its net income earned during its first taxable year is to be doubled in computing its tax for the second taxable year, its offset on account of its real estate taxes should also be doubled. In support of this contention, Appellant points out that it did business only during the latter half of the year 1930 and only paid one installment of 'real estate taxes and consequently received an offset from its second year's tax only on account of one installment of real estate taxes, Appellant insists that this results in a discrimination between it and corporations doing business during the whole of the year 1930 which were allowed an offset based upon two installments of real estate taxes. Insofar as the Act requires that this result be reached,

Appellant contends it is unconstitutional.

Certainly, the Act does not purport to discriminate between corporations with respect to offset of real estate taxes. All corporations are allowed an offset of ten per cent of their real estate taxes paid locally during the taxable year, subject to the limitation that the total offset for all taxes shall not exceed seventy-five per cent of the franchise tax. If appellant is discriminated against with respect to the amount of offset allowed on account of real estate taxes paid, as compared to other corporations, it must be because it paid less real estate taxes than other corporations. In no event may more than ten per cent of real estate taxes paid be offset. If other corporations received an offset which appellant did not receive such other corporations must have paid to political subdivisions of the state ten times the amount of that offset in the form of real estate taxes. If there is any discrimination, it would seem that these other corporations are the ones discriminated against rather than appellant.

Furthermore, it is to be noted that appellant received two offsets on account of the real estate taxes it paid during the year 1930, one offset on account of those taxes against its tax for the year 1930, its first taxable year, and another offset on account of the same taxes against its tax for the year 1931, its second taxable year. Other corporations, not commencing to do business for the first time, and doing business during the whole of the year 1930, were allowed to offset their real estate taxes paid during the year 1930 only once, that is, against their franchise tax for the year 1931.

It should also be noted that although appellant paid only one installment of real estate taxes during the year 1930, it nevertheless paid the full amount of personal property taxes for the year 1930, since personal property taxes are not paid in installments (Section 3746 of the Political Code). Thus, although appellant paid a franchise tax for only one-half of the year 1930, it received as an offset against that tax, an entire year's personal property taxes. Consequently, we see no reason for appellant to complain of its real estate offset, particularly in view of the fact that one hundred per cent of personal property taxes can be offset whereas only ten per cent of real estate taxes may be offset against the franchise tax.

For the above reasons, we must hold that appellant was not entitled to have any part of its offset against its franchise tax for the year 1931 doubled.

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 Chas. 3. McColgan, Franchise Tax Commissioner, in overruling the protest of Filoli, Incorporated, against a proposed assessment of an additional tax of $696.60 for the year ended December 31, 1930, and an additional tax of $8,017.66 for the year ended December 31, 1931, under Chapter 13, Statutes of 1929, as amended, be, and the same is, hereby sustained.

Done at Sacramento, California this 17th day of October, 1932.

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

Attest: D. L. Pierce, Secretary