BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal Of)
)
HALE BROS. REALTY CO.)

Appearances:

For Appellant: Mr. William Gardiner, Manager and Auditor of the Real Estate and Tax Department of Appellant

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 (Stats. 1929, Chapter 13, as amended) from the action of the Franchise Tax Commissioner in overruling the protest of Hale Bros. Realty Co., a corporation, to a proposed assessment of an additional tax in the amount of $114.84 for the year 1931, based upon Appellant's return for the year ended December 31, 1930.

The sole issue involved in this appeal relates to the proper deduction which should be allowed appellant on account of federal income taxes accrued during the year 1930.

Under Section 8(c) of the Act as passed in 1929, the entire amount of federal income taxes accrued during the taxable year were allowed as a deduction. But, by an amendment to Section 8(c), effective February 27, 1931 (Stats. 1931, p. 60), it was provided that the deduction for federal income taxes

> "shall not exceed the amount which would constitute the federal income tax liability of the taxpayer if its net income subject to federal tax were reduced by the additional allowances permitted under the provisions of subsections (f) and (g) of this section and sections 19 and 20 hereof."

The accrued federal income tax liability of appellant for the year 1930 amounted to $10,021.92. This entire amount was taken as a deduction by appellant in the return covering the taxable year ended December 31, 1930, filed by appellant during the latter part of January 1931. The appellant also took as a deduction in the above return the sum of $34,884 on account of amortization of leasehold computed on the basis of the January 1, 1928 valuation thereof. This latter deduction was finally allowed by the Commissioner in its entirety in accordance with the provisions of subsection 8(f) of the Act

which provides that a deduction for exhaustion, wear and tear and obsolescence of property shall be allowed upon the basis of January 1, 1928 valuations of property in case of property acquired prior thereto. Inasmuch as the deduction for amortization of leasehold computed on the basis of the January 1, 1928 valuation thereof was not an allowable deduction for federal tax purposes, the Commissioner reduced the deduction for federal income taxes to $6,094.76 in accordance with the above quoted amendment to Section 8(c), and proposed the. additional assessment involved in this appeal.

The appellant contends, in effect, that since it filed its return for the taxable year ended December 31, 1930 Prior to the effective date of the amendment, the amendment should not be followed in computing its franchise tax for the Year 1931 according to or measured by its net income for the Preceding year.

A similar question was presented for our determination in the appeal of United States Oil and Royalties Company (decided by this Board on May 10 1932) and in the appeal of Corporation of America, et al fdecided by this Board on October 12, 1932). We there held that amendments to the Act effective February 27, 1931, should be followed in computing corporate franchise taxes for the year 1931 according to or measured by net income of the preceding year, notwithstanding the fact that the returns for the preceding year were filed prior to the effective date of the amendments. These appeals, we think, should be regarded as controlling our decision of the question under consideration in the instant appeal.

The appellant further contends, that even though the amendment is followed in computing its franchise tax for the year 1931, the deduction for amortization of leasehold is not an additional allowance of the kind contemplated by the amendment on account of which the deduction for federal income tax should be reduced below the amount actually accrued during the taxable year. In support of this contention, appellant argues that a deduction for amortization of leasehold is not generally considered as being in the nature of a depreciation or obsolescence item and hence should not be regarded as being an additional allowance permitted under subsection 8(f).

It should be noted, however, that unless a deduction for amortization of leasehold can be regarded as a deduction on account of depreciation or obsolescence of property within the meaning of section 8(f), a deduction for amortization of leasehold computed on the basis of January 1, 1928 valuations cannot be allowed, since there is no other provision of the Act which could possibly be considered as authorizing such an allowance. Hence, it would seem that if we are to hold that the Commissioner acted wrongfully in revising appellant's deduction for federal income tax accruals, we must also hold that the Commissioner acted wrongfully in allowing appellant a deduction for amortization of leasehold computed on the basis

of the January 1, 1928 valuation of the leasehold. The result of such a holding would be to subject appellant to a much larger tax than the additional tax proposed by the Commissioner.

As long as corporations are allowed to compute deductions for depreciation and obsolescence of property on the basis of January 1, 1928 valuations in the case of property acquired prior thereto, we believe that corporations should likewise be allowed to compute deductions for amortization of leaseholds acquired prior to January 1, 1928 on a similar basis. In our opinion, the provisions of section 8(f) authorizes such a procedure. Consequently, we hold that the Commissioner acted correctly in allowing appellant a deduction in the amount of $34,884 for amortization of leasehold computed on the basis of the January 1, 1928 valuation of the leasehold. Hence, we must hold that the Commissioner acted correctly in reducing the amount of the deduction for federal income tax liability accrued during the year 1930 to $6,094.76 in accordance with the amendment to section 8(c) of the Aot.

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 Hon. Chas. J. McColgan, Franchise Tax Commissioner, in overruling the protest of Hale Bros. Realty Co., a corporation, against a proposed assessment of an additional tax of $114.84 under Chapter 13, Statutes of 1929, based upon the net income of said corporation for the year ended December 31, 1930, be and the same is hereby sustained.

Done at Sacramento, California, this 17th day of February, 1933, by the State Board of Equalization.

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

Attest: Dixwell L. Pierce, Secretary