BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
WILMINGTON TRANSFER AND STORAGE COMPANY)

Appearances:

For Appellant: W. Torrence Stockman, Attorney; C. B. Carter President of Appellant Corporation
For Respondent: Chas. J. McColgan, Franchise Tax Commissioni

O P I N I O N

This is an appeal pursuant to Section 25 of the Bank and Corporation Franchise Tax Act (Chapter 13, Stats. 1929, as amended) from the action of the Franchise Tax Commissioner in overruling the protest of Wilmington Transfer and Storage Company, a corporation, to a proposed assessment of an additional tax in the amount of $434.14 for the year 1931, based upon its return for the period ended December 31, 1930.

It appears that Appellant is engaged in the highway transportation business and also in the storage business, the highway transportation business being of such a character as to subject Appellant to taxation under Section 15 of Article XIII of the Constitution on its gross receipts from such business in lieu of all other taxes and licenses on its property used exclusively in the business.

In its return for the year ended December 31, 1930, Appellant reported a net loss from its entire activities of $951.41. The Commissioner, however, segregated Appellant's transportation business accounts from its storage business accounts. This segregation showed a net loss attributable to the transportation business of $14,535.01, and a net income attributable to the storage business of $13,583.60. Disregarding the loss from the transportation business, the Commissioner proceeded to compute Appellant's tax liability under the Act on the basis of the net income from the storage business and proposed the additional assessment in question.

Notwithstanding the fact that Appellant is taxable under Section 15 of Article XIII of the Constitution, it would seem that Appellant, because it engaged in the storage business, is also taxable under the Act inasmuch as the gross receipts tax imposed under Section 15 is in lieu only of taxes and licenses on property used exclusively in the highway transportation business, Appellant does not contend otherwise, But Appellant does contend that its business should be treated as a unit and" not segregated, and, since it made no net income from its entire activities, that it should be subjectto no tax under the Act in excess of the minimum regardless of whether or not it made net

income from its storage business activities. It is further contended by Appellant that the Commissioner erred in not offsetting taxes paid by it to the state on its gross receipts from its transportation business against the taxes, if any, due from it under the Act according to or measured by its net income, and that the Commissioner erred in not allowing as a deduction a loss alleged to have been sustained by it during the year 1930, from the sale of certain real estate. These contentions will be considered in the order stated.

Section 16 of Article XIII of the Constitution provides that certain specified corporations "shall annually pay to the state for the privilege of exercising their corporate franchises within this State a tax according to or measured by their net income." Similarly, the Bank and Corporation Franchise Tax Act, passed pursuant to Section 16, provides, in Section 4, that each of the corporations specified in Section 16 "shall annually pay to the state for the privilege of exercising its corporate franchises within this State, a tax according to or measured by its net income."

Ordinarily, the term "net income" as used in the above quoted provisions, unquestionably refers to the *net* income from a corporation's entire activities and not to the net income from any particular department or departments of a corporation's business,, Hence, it would seem that it would not ordinarily be proper for the Commissioner to measure a tax by the net income from one department of a corporation's business and to disregard the losses sustained in other departments. Inasmuch as no exception is made with reference to corporations which are taxable under the Act and which are also subject to special in lieu taxation on gross receipts, it is arguable that the same rule should apply in the computation of Appellant's tax liability under the Act.

It would seem, however, that if Appellant had realized net income from its transportation business, such net income could not be included in the measure of the tax imposed by the Act. Clearly, if Appellant had engaged only in the transportation business, it would not be subject to a tax under the Act measured by its net income from such business. No different result should obtain with respect to such net income because Appellant engaged in the storage business as well as the transportation business, notwithstanding the fact that Appellant, by engaging in the storage business, became subject to taxation under the Act "according to or measured by its net income." To include the net income from the transportation business in the measure of the tax imposed by the Act would not only result, in double taxation, but would, we think be contrary to the express provisions of Section 15 of Article XIII of the Constitution.

Consequently, it would seem that the provisions of Section 16 of Article XIII of the Constitution and of the Act imposing a tax on corporations according to or measured by "net income" when applied to a corporation like Appellant, have reference only to the corporation's net income which is derived from activities other than the transportation business. Appellant contends however, that where a loss is sustained from the operation of

the transportation business, the tax should be measured, not by the net income from activities other than the transportation business, but by the net income from the corporation's entire activities, or, which is the same thing, by the net income from such other activities less the loss from the transportation business.

In view of the above discussion, it would appear that this contention is necessarily predicated on the assumption that the term "net income" as used in the Act and in the constitutional provision pursuant to which the Act was passed has reference to one thing when a corporation like Appellant makes net income from its transportation business, and to something else when the corporation sustains a loss in the operation of its transportation business.

In our opinion, the term should be construed as having the same meaning, and the tax should be measured by the same net income regardless of whether the transportation business is operated at a loss or at a profit. If a corporation's accounts must be segregated when it realizes net income from its transportation business, and the tax measured only by its net income from other activities, then a similar segregation should be made where the transportation business is operated at a loss, and the tax should be measured by the net income from such other activities. Hence, we conclude that the Commissioner did not err in segregating Appellant's accounts and in measuring the tax by the net income from Appellant's storage business, disregarding the loss from the transportation business.

In this connection; it should be noted that if a different conclusion were reached, corporations like Appellant would be placed in a decidedly advantageous position with respect to taxation under the Act as compared to other corporations. If such a corporation should realize net income from its transportation business, its tax liability under the Act would not be increased but if the corporation should sustain a loss from its transportation business, the tax imposed by the Act would be reduced by reason of such loss. We do not believe that any such result was intended.

The second contention of Appellant to the effect that the tax imposed under the Act should be offset by the gross receipts tax paid to the state pursuant to Section 15 of Article XIII of the Constitution need not, we think, be given extended consideration. It is true, as noted by Appellant, that Section 16 of Article XIII of the Constitution provides that the tax thereby imposed on corporations "according to or measured by their net income" should be subject to offset in the amount of personal property taxes paid by such corporations to the state as well as to the political subdivisions of the state, It is equally true that, although the Legislature is given the power to change the percentage, amount or nature of the offset, and in pursuance of this power has modified the offset for personal property taxes paid to the political subdivisions of the state, the Legislature has not in express terms provided either that no offset should be allowed for personal property taxes paid to the state or that such taxes should be allowed as an offset in any different amount than as specified in the Constitution.

It should be noted, however, that although the gross receipt:

tax imposed pursuant to Section 15 of Article XIII of the Constitution has been held to be essentially a property tax (Alward v. Johnson, 208 Cal. 359), it has never been held to be a personal property tax, nor has any method been provided for ascertaining what portion, if any, of such tax should be regarded as a tax on personal property. Hence, it is questionable whether Section 16 of Article XIII contemplated that an offset should be allowed for the tax imposed pursuant to Section 15 of Article XIII.

Furthermore, it should be noted that Section 16 provides th: the tax thereby imposed shall be subject to offset "in a manner to be prescribed by law." Inasmuch as the Legislature has not prescribed the manner for allowing an offset for personal propert taxes paid to the state, it would seem that such taxes could not be allowed as an offset. Finally, we think that the Legislature in expressly providing for an offset for personal property taxes paid to the political subdivisions of the state without making any mention of personal property taxes paid to the state, evinced an intention to exclude the allowance of an offset for such taxe: thereby changing either the percentage, amount or nature of offs provided in Section 16 of Article XIII of the Constitution.

The proper determination of Appellant's third and final contention, namely, that the Commissioner erred in not allowing as a deduction a loss alleged to have been sustained from the sale of certain real estate depends, we think, on the construction to be given to Section 19 of the Act which provides that in the case of property acquired prior to January 1, 1928, and disposed of thereafter, the basis shall be the fair market value thereof as of said date.

It appears that Appellant purchased certain real estate prior to January 1, 1928 at a cost of $17,667.44 and sold it during the year 1930 for $14,316.93, thus sustaining an actual loss of $3,005.42 from the transaction. Appellant contends, however, that the fair market value of the property on January 1, 1928 was $28,978.95, and that the difference between this figure and the selling price is the amount of loss which should be allowed as a deduction in accordance with the provisions of Section 19 of the Act.

Although a literal reading of Section 19 would support Appellant's contention, we are of the opinion that Section 19 should not be construed as requiring that the tax imposed by the Act be measured by a greater income than was actually realiz or as permitting the deduction of a greater loss than was actual: sustained. This conclusion is in accord with decisions of the: United States Supreme Court in construing provisions of the Federal Revenue Act similar to the provision in Section 19 of the State Act.

Thus, in Goodrich v. Edwards, 255 U.S. 257, it was held that a taxpayer did not realize taxable net income from the sale of property although the sale price ($269,346.25) was greater than the fair market value of the property ($148,635.50) on the basic date, i.e., March 1, 1913, inasmuch as the sale price was less than the cost of the property. In United States v. Flanner

268 U.S. 98, it was held that a taxpayer did not sustain a deductible loss from the sale of property although the sale price ($95,175) was less than the fair market value ($116,325) on the basic date inasmuch as the sale price was greater than the cost of the property. In the course of its opinion, the Court stated:

> "So we think it should be held that the Act of 1918 imposed a tax and allowed a deduction to the extent only that an actual gain was derived or an actual loss sustained from the investment, and the provisions in reference to the market value on March 1, 1913, was applicable only where there was such an actual gain or loss, that is, that this provision was merely a limitation upon the amount of the actual gain or loss that would otherwise have been taxable or deductible."

For further discussion of the above cases and their application to the state Act, see R. J. Traynor, Associate Professor of Law, University of California, Chapter XX of the 1932 Edition of Ballantine's California Corporation Laws, pp. 724-730.

In accordance with the construction of Section 19 of the Act above indicated, we must hold that Appellant should not be allowed to deduct as a loss from the sale of the property in question any amount in excess of the actual loss sustained by Appellant from the sale of said property, However, inasmuch as the Commissioner failed to allow any deduction on account of the loss sustained by Appellant from the sale of said property, his action in overruling Appellant's protest to the proposed additional assessment must be modified, and Appellant's tax liability under the Act recomputed accordingly.

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 the Franchise Tax Commissioner in overruling the protest of Wilmington Transfer and Storage Company, a corporation, against a proposed assessment of an additional tax in the amount of $434.14, based upon the net income of said corporation for the period ended December 31, 1930, be and the same is hereby modified. Said action *is* reversed insofar as the Cammissioner disallowed as a deduction the sum of $3,005.42, representing a loss sustained by said corporation from the sale of real estate during the year 1930. In all other respects, said action is sustained.

The correct amount of the tax to be assessed to the Wilmington Transfer and Storage Company is hereby determined as the amount produced by means of a computation which will include

the allowance as a deduction of the above amount in the calculation thereof. The Commissioner is hereby directed to proceed in conformity with this order and to send the said Wilmington Transfer and Storage Company a notice of assessment revised in accordance therewith.

Done at Sacramento, California, this 27th day of May, 1933, by the State Board of Equalization,

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

ATTEST: Dixwell L. Pierce, Secretary