BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
GREAT NORTHERN RAILWAY COMPANY)

O P I N I O N

This appeal is made pursuant to Section 25 of the Bank and Corporation Franchise Tax Act (Chapter 13, Statutes of 1929, as amended) from the action of the Franchise Tax Commissioner in overruling the protest of Great Northern Railway Company to his proposed assessments of additional tax in the amounts of $1620.00 and $598.87 for the taxable years ended December 31, 1937, and December 31, 1938, respectively, based on the income for the years ended December 31, 1936, and December 31, 1937, respectively. Appellant acting through its attorneys Earl & Hall & Gerdes by Chaffee E. Hall, and Chas. J. McColgan, Franchise Tax Commissioner, have submitted the appeal for decision upon the memoranda on file and without an oral hearing.

During the income year 1936 the interest expense of Appellant amounted to $18,163,762.22, of which the sum of $6,241,673.80 was interest expense upon bonds of the taxpayer, which are a continuation of securities issued for the acquisition of capital stock of the Chicago, Burlington & Quincy Railroad Company. In its return for the taxable year 1937, Appellant had deducted the entire interest expense in computing the net income subject to allocation. The proposed assessment for that year increases the net income subject to allocation by $6,241,673.80.

During the income year 1937 Appellant had interest expense of $4,001,964.37 in connection with said bonds and had income from dividends in the amount of $1,660,358.00 on stock of the Chicago, Burlington & Quincy Railroad Company. The proposed assessment for the taxable year 1938 increases the net income subject to allocation by $2,341,606.37, being the differencebetween said interest expense and said dividends.

For the taxable year 1937 the question involved is as follows:

Is a foreign corporation, not domiciled within the State and conducting part of the unitary business in California, entitled to deduct interest on bonds, the proceeds of which were used to acquire stock in another corporation, where such stock does not have a business situs in California and where such interest is not an expense of the unitary business. It is the position of the Franchise Tax Commissioner that as the dividends

received on such stock were not included in the measure of the franchise tax, the interest expense allocable thereto is not deductible from California income.

So far as the taxable year 1937 is concerned, the same question was on November 15, 1939 decided by this Board adversely to Appellant in an appeal by Appellant with respect to the taxable year 1936. Appellant contends that that decision by the Board was in error and was based on a misinterpretation of Section 8(b). That section prior to its amendment in 1937 read as follows: "b. All interest paid or accrued during the income year on indebtedness of the taxpayer." (Statutes of 1935, p. 962).

As amended by the Statutes of 1937, page 2326, Section 8(b), reads, in part, as follows:

> "(b) All interest paid or accrued during the income year on indebtedness of the taxpayer to the extent in excess of income of the taxpayer from interest and dividends. . . . which is not included in the measure of the tax imposed by this Act."

Appellant contends that "a change in the phraseology of the law by amendments will be deemed as intended to make a change in the law." Gallichotte v. California, etc, Assn., 23d C. A. ( ) 570, 579. Changes in phraseology, however, may be for the purpose of clarification. Union League Club v. Johnson, 18 Cal. (2d) 275. The Change in the tatute was made long before the previous decision of this Board. In accordance with the views and for the reason expressed in our opinion in the former appeal we must hold that the Commissioner acted properly in computing the net income subject to allocation without the benefit of the interest deduction of $6,241,673.80.

For the taxable year 1938 there was in effect the 1937 amendment to Section 8(b) to which reference has already been made and also the 1937 amendment to Section 9. Section 9 as amended by the Statutes of 1937, page 2329, reads in part, as follows:

> "In computing net income no deduction shall be allowed for:
> " .....
> "(d) Any amount otherwise allowable as a deduction which is allocable to one or more classes of income not included in the measure of the tax imposed by this Act."

Appellant contends that of two apparently conflicting provisions such as Section 8(b) and Section 9(d), the specific (in this case Section 8(b)) must control the general. It appears, however, that Section 8(b) is not the more specific. The two sections must be read together and Section 9(d) limits the deduc-

tions which may be taken under Section 8. Furthermore, under Section 10, as amended by Statutes of 1935, page 965, "if the entire business. .. is not done within this State, the tax shall be according to or measured by that portion thereof which is derived from business done within the State" which shall be determined by a "method of allocation as is fairly calculated to assign to the State the portion of net income reasonably attributable to the business done within this State and to avoid subjecting the taxpayer to double taxation." The tax would not be measured by net income from business done within this State if in arriving at that income a deduction were allowed for-interest and other expenses incurred in connection with the earning of income having no relation to California business. It is our opinion that the interest expense, to the extent disallowed by the Franchise Tax Commissioner was not a proper deduction from allocable income, and that the action of the Commissioner in overruling the Appellant's protest against the proposed assessment of additional tax in the amount of $598.87 for the taxable year ended December 31, 1938, should be sustained.

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. J. McColgan, Franchise Tax Commissioner, in overruling the protest of Great Northern Railway Company to proposed assessments of additional tax in the amounts of $1,620.00 and $598.87 for the taxable years ended December 31, 1937, and December 31, 1938, respectively, pursuant to Chapter 13, Statutes of 1929 as amended, be, and the same is hereby sustained.

Done at Sacramento, California, this 14th day of June, 1943, by the State Board of Equalization.

R. E. Collins, Chairman
Wm. G. Bonelli, Member
J. H. Quinn, Member
Geo. R. Reilly, Member

ATTEST: Dixwell L. Pierce, Secretary