



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of }
AMERICAN INSURANCE AGENCY, }
a corporation

Appearances:

For Appellant: Alfred B. Weiler, Attorney, (by brief)

For Respondent: Chas. J. McColgan, Franchise Tax Commissioner,
(by brief)

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 upon the protest of American Insurance Agency to his proposed assessment of additional tax in the amount of \$874.63 for the taxable years ending December 31, 1937, and December 31, 1938, based upon the income of the company for the one year ended December 31, 1937. Upon consideration of the protest the Commissioner redetermined the additional tax to be \$350.39.

Appellant is a Washington corporation and qualified to do business in California on March 10, 1936. The income year of 1937 is the basis upon which the Commissioner has proposed to compute the tax for the second taxable year, and for the third taxable year pursuant to Section 13 of the Bank and Corporation Franchise Tax Act as amended by the Statutes of 1935, page 967, and by the Statutes of 1937, page 2331.

During 1937 Appellant received a gross income of \$9,585.83 from fees earned in its financing operations within the State of California. On its return, from that sum it deducted expenses amounting to \$7,987.16, showing a net income from California sources of \$1,598.57. Included in the deductions was an item of interest amounting to \$4,954.16. Although this interest was paid by Appellant in California, its deduction was disallowed by the Commissioner for both the 1937 and 1938 taxable years because Appellant had received in excess of the amount thereof, income from interest and dividends which were not included in the measure of the tax. Relying upon Section 8(b) of the Bank and Corporation Franchise Tax Act as amended by the Statutes of 1937, page 2326, the Commissioner urges that only interest deductible was that paid in excess of interest and dividends received and not included within the measure of the tax. The 1937 amendments effecting changes in the computation of taxes imposed by the Bank and Corporation

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Franchise Tax Act were **inapplicable** for taxable years commencing prior to January 1, 1938, (Statutes of 1937, page 2349). The amendment to Section 8(b) effected a change in the computation of taxes, and accordingly, did not apply with reference to the taxable year of 1937.

Prior to the 1937 amendment, Section 8 (Statutes of 1935, page 962) read, in part as follows:

"In computing 'net income' the following deductions shall be allowed: . . .

"(b) All interest paid or accrued during the income Year on indebtedness of the taxpayer."

No reason has; been advanced why the interest **was** not deductible for the taxable year 1937 under the above Provision. We are of the opinion that such interest deductions should have been' allowed **in** computing the net income for the taxable Year 1937.

Section 8 as amended in 1937 read, in part,

"In computing 'net income' the following deductions shall be allowed:

"(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, (other than dividends deductible under the provisions of subdivision (h) of this section and other than dividends from corporations, fifty per cent or more of the outstanding stock of which is owned by the taxpayer) which is not included in the measure of the tax imposed by this act."

It is not denied that Appellant received interest and dividend income, which were not included in the measure of tax, in excess of interest paid. Appellant contends that under a proper interpretation of this Section the deduction of this interest expense is not prohibited and that if it were prohibited, the provision **would be** unconstitutional for the reason that it would tax **extra-**territorial income and would result in double taxation and would discriminate without logical reason against foreign corporations having income outside of the State of California. The language of Section 8(b) is clear and in our opinion it does not permit the deduction of the interest item of \$4,954.16 in computing the tax for the taxable year-1938. It is Respondent's position that under the 16th Amendment, Congress may tax the gross income of corporations and whether or not deductions may be taken are matters of legislative grace. New Colonial Ice Co. v. Helvering, 292 U.S. 435. He also contends that Article XIII, Section 11 of the State Constitution is at least as broad as the 16th Amendment to the Federal Constitution. That section provides, in part,

"Income taxes may be assessed to and collected from... corporations . . .doing business in this State..in such cases and amounts, and in such manner, as shall be

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prescribed by law."

Respondent also contends that there is no unfair discrimination against foreign corporations, that the limitation on the deduction for interest paid is only on those corporations which received income from interest and dividends not included within the measure of the tax, that such corporations are in an advantageous position and are in a special class and may be taxed differently.

It is unnecessary to consider whether Section 8(b) as amended in 1937 is unconstitutional. This Board has stated on several occasions that the question of constitutionality is one of such gravity that decisions on it should be left to the courts.

Vortex Manufacturing Company, Board of Equalization
August 4, 1930

Universal Pictures Corp., Board of Equalization
August 4, 1930

Union Oil Co. of California, Board of Equalization
January 19, 1931

Douglas Aircraft Co. Inc., Board of Equalization
November 20, 1930

Petroleum Rectifying Co. of California, Board of Equalization
-- April 20, 1932

California National Bank of Sacramento, Board of Equalization
April 20, 1932

O R D E R

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

IT IS HEREBY ORDERED, ADJUDGED, AND DECREED that the action of Chas. J. McColgan, Franchise Tax Commissioner, upon the protest of American Insurance Agency in redetermining the additional tax to be \$350.39 for the taxable years ended December 31, 1937, and December 31, 1938, pursuant to Chapter 13, Statutes of 1929, as amended, be and the same is hereby modified as follows: Said Commissioner is hereby directed to allow the interest deduction of \$4,954.16 in computing the tax for the taxable year 1937. In all other respects the action of said Commissioner is hereby affirmed.

Done at Los Angeles, California, this 18th day of June, 1943,
by the State Board of Equalization.

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

ATTEST: Dixwell L. Pierce, Secretary