BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
WESTERN LOAN AND BUILDING COMPANY)

Appearances:

For Appellant: R. B. Ritchie, its Secretary

For Respondent: James J. Arditto, Franchise Tax Counsel.

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 protests of Western Loan and Building Company to the Commissioner's proposed assessment of additional tax in the amount of $2,430.35 for the taxable year ended December 31, 1938.

Appellant is organized under the laws of the State of Utah and is qualified and has been doing business in California and in other western states as a building and loan association. The normal activities of the Appellant in California are those of the usual building and loan association; namely, the lending of its shareholders' capital on first mortgage loans. Because of economic conditions in the years from 1930 to 1933, the Appellant acquired a considerable amount of California real property through foreclosure. During the income year involved in this appeal, the Appellant engaged in operating and selling those properties for the purpose of converting them into cash and other securities recognized as normal investments for building and loan associations

The question involved in this appeal is whether the Respondent acted correctly in using a separate accounting of Appellant's California operations to ascertain that portion of Appellant's income which is taxable by the State of California. Other questions were raised in the briefs but the parties have disposed of those matters by stipulation as will be hereinafter noted.

Appellant contends that its taxable net income should be determined by allocation formula and relies chiefly on the decision in Butler Brothers v. McColgan, 315 U. S. 501, 86 L. Ed. 991. It is the Appellant's position that in instances where a corporation has income attributable to sources both within and without the State, the tax shall be measured by the net income derived from or attributable to sources within the State, and that determination of such income must be made by an allocation formula. Appellant's argument is that its Corporate functions are of a unitary character

and that its funds and all of its activities are under jurisdiction of its executive officers in the general office of the company in Utah. Its activities in reference to advertising, insurance, execution of deeds and other documents relating to real estate transaction, relationship with shareholders and accounting control are all centralized in its executive offficers.

The Respondent maintains that Section 10 of the Dank 'and Corporation Franchise Tax Act was enacted for the purpose of fairly allocating to California that portion of a corporation's income which is attributable thereto and that the section provides that the method which will reach such a result shall be used. His position is that in the case of building and loan associations, and in particular in the case with which we are here concerned, that portion of a corporation's income which is fairly allocable or attributable to sources in California can best be determined by resorting to separate accounting.

The decision in Butler Brothers v. McColgan (supra) does not compel the use of an allocation formula in all cases. Section 10 itself provides that the portion of the income taxable in California may be determined ".... by such other method of allocation that is fairly calculated to determine net income derived from or attributable to sources within this State." Allocation by formula is employed where it is impossible to determine the income realized from each transaction which contributes to the total income in the case of a unitary business; and where the intangible benefits which follow increased volume justify assuming that selling or operating in each state is productive to substantially the same extent.

The operations of building and loan associations are peculiarly subject to separate accounting. Their activities are quite different from the activities of corporations engaged in a mercantile business. The various states in which Appellant operates restrict the activities of such associations within their respectiv jurisdictions. The California statutes specifically provide that a foreign building and loan association operating in California must use separate accounting methods. Section 12.04(a) of the California Building and Loan Association Act, as amended (Chapter 451, Statutes of 1935; Deering's Gen. Laws, 1937, Act 986), provide: in part as follows:

> "Funds, etc., in state to be kept separate. The capital of any such foreign association assigned to its business in this State, and all funds and investments of money received by any such foreign association in this State or for or in connection with its business in this State, and all accounts and transactions of said business transacted by any such foreign association in this state, shall be kept separate and apart from the general business, assets and accounts of such foreign association in the same manner as if the business of such foreign association conducted within this State were that of a separate and independent domestic association. ...."

In this case it is possible to determine the gross income

from investments, activites and sales of property in each State. Real estate transactions in Utah, or in some other state, do not affect the gain or loss realized on such transactions occurring in California. The income realized from California transactions is localized and gain or loss therefrom can be attributed accurately to California through separate accounting allocation.

Other questions relating to "allowable" or "allowed" depreciation in connection with reducing the cost basis of certain properties sold by the Appellant and relating to a claimed deduction for interest accrued on outstanding "First Recovery Certificates" issued by Appellant have been disposed of by a stipulation duly filed herein, By the terms of that stipulation it is agreed that, if the action of the Commissioner is sustained in his separate accounting allocation, the proper amount of tax due herein is the sum of $1,852.77, and that in such case the assessment should be reduced to that amount.

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 Charles J. McColgan, Franchise Tax Commissioner, in overruling the protest of Western Loan and Building Company to a proposed assessment of additional tax in the amount of $2,430.35 for the taxable year ended December 31, 1938, pursuant to Chapter 13, Statutes of 1929, as amended, is hereby modified by reducing the amount of the assessment to the sum of $1,852.77, and as so modified the same is hereby affirmed.

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

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

ATTEST: Dixwell L. Pierce, Secretary