



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
CITIZENS NATIONAL TRUST AND)
SAVINGS BANK OR RIVERSIDE)

Appearances:

For Appellant: Charles M. Ross

For Respondent: W. M. Walsh, Assistant Franchise Tax Commissioner; James J. Arditto, Franchise.

OP IN I ON

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., overruling the protest of Citizens National Trust and Savings Bank of Riverside, to his proposed assessment of additional tax of \$1,744.96 for the taxable year 1940.

Appellant, a national banking association, acquired the Edison building in 1939 for \$25,000.00 in cash and the exchange of two other parcels of real estate having an adjusted cost basis of \$21,799.40, making a total cost basis for the Edison building of \$46,799.40. In 1939 Appellant sold the building to Citizens National Securities Company, a wholly owned affiliate, for \$43,650.00, a loss of \$3,149.40 being sustained. The sale price to the affiliate is conceded to represent fair market value at date of sale.

The Commissioner contends that the affiliate was a mere instrumentality of the bank and that no loss was sustained on the transfer, there being an insufficient divestment of actual ownership and control.

The sole question with which we must concern ourselves is whether the corporate entity of the affiliate is to be respected or disregarded, for tax purposes.

The tax laws of the United States recognizes corporations as distinct entities and tax them differently and discriminatorily. It is only under exceptional circumstances that the separateness of the corporate entity must be disregarded.

Commissioner vs. Clark, 287 U. S. 410

Commissioner vs. Commonwealth Improvement Co. 287 U. S. 415

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In support of his position the Commissioner cites numerous cases most of which concern the efforts of individuals to divest themselves of command and control over property, to avoid the tax consequences of actual ownership. The courts rightfully frown on the use of such "alter ego" arrangements to evade taxes. The Commissioner particularly stresses the case of Higgins vs. Smith, 308 U. S. 473, involving the sale of property by an individual to a wholly owned corporation, obviously created to gain tax advantages.

The Citizens National Security Company was incorporated in 1910, as an affiliate, rather than a subservient subsidiary for the purpose of owning and operating the office building in which the bank was located and to hold, when occasion justified, certain assets considered to be objectionable under national banking laws. The practice of so employing an affiliate is widely used through the United States. The liquidity of a bank is enhanced by the elimination from its balance sheet of fixed assets such as bank premises. Conservative banks often organize an affiliate to hold title to bank premises as an alternative to writing down such assets to a nominal sum. Federal banking regulations preclude the ownership of real property by national banks, except when acquired for necessary banking premises, or through foreclosure, or cancellation, of debt previously contracted. Real estate of the latter type must be disposed of within five years.

It is therefore improper to impugn the motives of the bank, organized under national charter, in creating an affiliate, under State law, to exercise business functions that could not legally be performed by a national bank. Statements of the Commissioner, to the effect that officers and employees of the bank and the affiliate are identical, and that the officers received no compensation other than the salaries paid by the bank, are misleading, if not incorrect. Four employees of the affiliate worked exclusively for it; the bank paid \$1,000.00 per month to the affiliate to cover rent, compensation of officers and office expense. The affiliate was not operated as a department of the so-called parent corporation in the conduct of a unitary business; it exercised separate functions not consonant with banking practice. The Commissioner ignores the de jure relationship of the corporations and requires a de facto merger for tax purposes. The case of Higgins vs. Smith, above referred to, does not support his position, and the strong dissenting opinion therein recognizes the logic and practicality of respecting the separate entity of corporations not designed for the purpose of evading taxes. It leads nowhere to call the affiliated corporation a fiction where title to the building passed to it irrevocably and in good faith. To hold otherwise would merely postpone the taking of a loss actually sustained. On future disposition of the property by Citizens National Securities Corporation there will be a new reckoning of gain or loss with respect to such disposition. We must give great weight to the action, of the Treasury Department in allowing the loss of \$3 149.40 in determination of income tax liability of Appellant for the year 1939. Lacking the facilities for extensive audit of taxpayers, the Commissioner relies on reports of federal examining revenue agents in the determination of deficiencies, and we are strongly inclined, in marginal cases, to adopt the ruling of the Treasury Department where there is ample legal support therefor, and identical or similar statutes are involved,

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Innes vs. McColgan, 47 Cal. App (2d) 781

Union Oil Associates vs. Johnson, 2 Cal. (2d) 727

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 Citizens National Trust and Savings Bank of Riverside, to the proposed additional assessment of ~~\$1,744.98~~ for the taxable year 1940, pursuant to Chapter 13, Statutes of 1929, as amended, be, and the same is, hereby reversed, in so far as the disallowance of loss of ~~\$3,149.40~~ on sale of the Edison building is concerned. Said ruling is hereby set aside to that extent and the said Commissioner is hereby directed to proceed in conformity with this order.

Done at Sacramento, California, this 15th day of July, 1943, by the State Board of Equalization.

R. E. Collins, Chairman
J. H. Quinn, Kember
Geo. R. Reilly, Member

ATTEST: Dixwell L. Pierce, Secretary