

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA



In the Matter of the Appeal of)
LELAND J. ALLEN.)

Appearances:

For Appellant: Leland J. Allen, Attorney at Law
For Respondent: Burl D. Lack; Chief Counsel;
Paul L. Ross, Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to Section 18593 of the Revenue and Taxation Code from the action of the Franchise Tax Commissioner on the protest of Leland J. Allen to a proposed assessment of additional personal income tax in the amount of \$1,114.35 for the year 1940,

The Appellant, an attorney, was engaged in 1933 by I. O. Sutphin to represent Sutphin in his claim to a five percent royalty interest in an oil leasehold in California. It was agreed that the Appellant should receive in return for his services fifty percent of the five percent interest and of the accumulations thereon if he was successful in establishing Sutphin's claim. This claim was finally established in favor of Appellant's client on February 29, 1940, and the Appellant's share of the royalty interest and the accumulations thereon were assigned to him in that year.

The Appellant claims the right to spread these amounts of income received in 1940 over the entire period during which his services were rendered, as was provided for in 1941 by the enactment of Section 7.1 of the Personal Income Tax Act (now Section 17054 of the Revenue and Taxation Code). He also maintains that he is entitled to 27½ percent depletion upon his income from the accumulation on the royalty which he received in 1940, and that the Commissioner's valuation of the royalty interest at the time he received it at \$3,483.90 was excessive.

The Commissioner contends that Section 7.1 of the Personal Income Tax Act is unconstitutional as applied in this situation to the year prior to its passage in that otherwise it would result in a gift of public money in violation of Section 31 of Article IV of the State Constitution. We have recently had occasion to refer to our reluctance as an administrative agency to become a final arbiter of constitutional questions in these appeals. As pointed out in our opinion in the appeal of F. T. and Fumiko Mitsuuchi (January 5, 1949), it is only by upholding the

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position of the Commissioner that Section 7.1 of the Act is invalid as applied to years prior to 1941 that a judicial determination may be had on the question. In fact, in that opinion we cited another matter (Appeal of Ralph G. Lindstrom, July 15, 1943), which also involved the applicability of Section 7.1 to the determination of liability for 1940 and in which, after referring to an opinion of the Attorney General of October 3, 1941, holding that the Section as so retrospectively applied would be violative of Section 31 of Article IV of the California Constitution, we upheld the position of the Commissioner. Consistently with this practice, his position on the constitutional question must be sustained herein.

The claim made by the Appellant for a deduction for depletion as respects the royalty interest prior to 1940 was also raised by him before the United States Tax Court in a proceeding relating to his federal income tax liability. That Court, however, rejected the claim. Leland J. Allen, 5 T.C. 1232. Upon the basis of its decision and the authorities cited therein the action of the Commissioner must be sustained in this connection on the ground that the Appellant did not have the required economic interest in the oil and gas in place prior to 1940 to be entitled to a deduction for depletion.

The only evidence before us in support of Appellant's claim that the valuation of the royalty interest by the Commissioner was excessive is the testimony of a geologist who was familiar with the property. Upon being requested to state the value of the $2\frac{1}{2}$ per cent royalty interest, he testified that as to both wells it would be about \$100.00 or \$200.00. On cross examination he admitted that he could not state how much gas there was in the ground in 1940. As to the possibility of further production of oil and gas from the wells, he stated merely that there would be none until they were redrilled. In reply to a question whether there was any oil or gas in the ground in April, 1940, he stated that it was largely immaterial in view of the collapse of the casing in one of the wells.

The testimony of this witness indicates that he was thinking in terms of the two wells, rather than the entire royalty interest, and that he did not take into account the possibility of future production that might result if the wells were redrilled, which was later done, or if new wells were drilled. As the Commissioner's valuation is prima facie correct, and this evidence, in our opinion, does not satisfy the burden of proof resting upon the Appellant to establish that the Commissioner erred in the valuation he placed on the royalty interest, the Commissioner must be sustained on this point.

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O R D E R

Pursuant to the views of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to Section 18595 of the Revenue and Taxation Code, that the action of Chas. J. McColgan, Franchise Tax Commissioner on the protest of Leland J. Allen to a proposed assessment of additional personal income tax in the amount of \$1,114.35 for the year 1940 be and the same is hereby sustained.

Done at Sacramento, California, this 27th day of January, 1949, by the State Board of Equalization.

Wm. G. Bonelli, Chairman
J. H. Quinn, Member
J. L. Seawell, Member
Geo. R. Reilly, Member

ATTEST: Dixwell L. Pierce, Secretary