BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of

FIRST FEDERAL SAVINGS AND LOAN ASSOCIATION
OF BEVERLY WILLS

Appearances:

For Appellant: Leo Shapiro, Attorney at Law

For Respondent: Burl D. Lack, Chief Counsel; Crawford Ii. Thomas, Associate Tax Counsel, Paul Ross, Associate Tax Counsel

OPINION

This appeal is made pursuant to Section 27 of the Bank and Corporation Franchise Tax Act (Chapter 13, Statutes of 1929, as amended) from the action of the Franchise Tax Commissioner in denying the claim of First Federal Savings and Loan Association of Beverly Hills for a refund of tax in the amount of $259.32 for the taxable year 1944.

Appellant is a mutual share Federal savings and loan association created pursuant to the Federal Home Owner's Loan Act of 1933 (12 U.S.C.; Sec. 1464, et seq.) and doing business in California. As such, it is entitled by Chapter 525 of the California Statutes of 1939, at page 1910, (Act 988, Deering's General Laws) to all rights and privileges of building and loan associations organized under the California Building and Loan Association Act (Stats. 1931, Chap. 269, at page 483; Act 986, Deering's General Laws) and is subject to the tax imposed by the Bank and Corporation Franchise Tax Act '(12 U.S.C., Sec. 1464).

During the year here in question, Subdivision (j) of Section 8 of the Bank and Corporation Franchise Tax Act read as follows:

> "(j) In the case of a building and loan association organized and operating wholly or partly on a mutual' plan, the return paid or credited on or apportioned to the withdrawable shares of such association, but not exceeding the return such shares would receive computed at the average rate paid by all such associations in this State, or by such association in a particular locality, as the Building and Loan Commissioner of this State may determine, on money borrowed or obtained through the issue during the income year of the association of all classes of

> "notes and investment certificates not evidencing any proprietary interest in the association, such rate to be determined by the Building and Loan Commissioner and certified by him to the Franchise Tax Commissioner on or before the first day of March of each year."

In computing its net income in its franchise tax return for the taxable year involved, Appellant deducted the total amount actually paid on or credited or apportioned to its withdrawable shares, that total, however, being more than that allowable on the basis of the rate fixed by the Building and Loan Commissioner pursuant to Section S(j). The Franchise Tax Commissioner disallowed the excess and issued his proposed assessment accordingly. Following the payment of the assessment the refund claim giving rise to the present appeal was filed and subsequently denied.

Appellant argues that the Commissioner's action was erroneous for the following reasons:

(1) Because Section S(j) is unconstitutional in that:

(a) It is so vague and ambiguous as to constitute an unlawful delegation of legislative power to the Building and Loan Commissioner in making his determination under the Section.

(b) It discriminates against mutual share associations and in favor of the guarantee stock type, the latter being entitled under Section 8(d) of the Bank and Corporation Franchise Tax Act to deduct without limitation all interest paid on investment certificates issued by them.

(2) Because in acting under Section S(j) the Building and Loan Commissioner erroneously arrived at an average rate based on non-proprietary notes and investment certificates outstanding, rather than on those issued, during the income year.

In view of our long-standing policy not to act as the final arbiter of constitutional questions involved in appeals of this nature, we must uphold the Franchise Tax Commissioner's action herein as against the constitutional issues raised. As we have recently pointed out, it is only by so doing that we leave open an opportunity for a judicial determination of those issues. Appeal of F. T. and Fumiko Mitsuuchi, January 5, 1949.

In fact, it is difficult to see wherein a determination that Section 8(j) is unconstitutional would be of any benefit to the Appellant. The mere declaration of the unconstitutionality Of the provision would not entitle it to a deduction in the amount claimed, but might rather deprive it of any deduction on account of the payment of the dividends to the holders of its

withdrawable shares. It has been suggested that the amount of the dividends would then be deductible as a business expense under Subdivision (a) or as interest under Subdivision (b) of Section 8. Quite irrespective of how shareholders of mutual building and loan associations may be regarded as a matter of policy for other purposes (see, e.g., In re Pacific Coast Building-y Loan Association, 15 Cal. 2d 134, as respects the nature of the membership in the case of insolvency), the fact remains that the shareholders possess at least some of the attributes of proprietors (see Fidelity Savings and Loan Association v. Burnet, 65 Fed. 2d 477) and for tax purposes the Legislature, during the year here in question, did not regard dividends of the associations either as business expenses or interest. Additional evidence of this is to be found in the fact that when the Legislature did see fit in 1945 to permit as a matter of policy the deduction of the entire amount of the dividends (Stats, 1945, p. 1787), it did so by making special provision for the deduction through an amendment of Subdivision (j), rather than by including the dividends under the deductions authorized by Subdivisions (a) or (b) of Section 8.

As for the matter of the erroneous average rate determination by the Building and Loan Commissioner, Appellant relies upon a letter dated July 28, 1944, from the Building and Loan Commissioner to the Franchise Tax Commissioner, in which, in discussing Section 8(j), the opinion is expressed that the "section is needlessly complicated and ambiguous, and the computation requires. . .is impossible to make." The letter also stated:

> "The Building and Loan Commissioner does not require associations to report interest paid on money borrowed or certificates issued in one year separately from interest paid on notes and certificates previously outstanding. To do so would require quite a bit of additional bookkeeping for the association, and additional work for us. Therefore we have tried to ascertain, as accurately as possible, the average rate paid on all notes and certificates outstand& during the year. We have made the computation by taking the average of the total amount of certificates outstanding on June 30th and December 31st, and dividing the result into the total amount of interest paid during the year. Of course, the resulting rate is inaccurate, but it is the best that can be obtained."

The letter was evidently written for the purpose of enlisting the Franchise Tax Commissioner's support for an amendment to Section 8(j). Amendatory language was even suggested, this being substantially the same as that subsequently enacted in 1945 as above mentioned,

Appellant has submitted no evidence whatever respecting the effect on the rate fixed by the Building and Loan Commissioner of the error which it asserts he made in the determination of that rate. For all that appears in the record before us, the error, if any, may have resulted in a higher rate and, therefore, a larger deduction from gross income than was authorized. Even though it be granted, accordingly, that the statements made in the letter indicate some departure from the formula set forth in Section 8(j), Appellant has not established that it is entitled by virtue of that departure to a deduction in any greater amount than that allowed by the Commissioner.

ORDER

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, pursuant to Section 2'7 of the Bank and Corporation Franchise Tax Act that the action of Chas. J. McColgan, Franchise Tax Commissioner, in denying the claim of First Federal Savings and Loan Association of Beverly Hills for a refund of tax in the amount of $259.32 for the taxable year 1944 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. l-I. Quinn, Member
J. L. Seawell, Member
Geo, R. Reilly, Member

ATTEST: Dixwell L. Pierce, Secretary