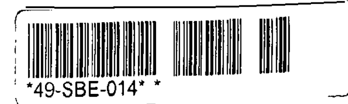

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
TITLE INSURANCE AND TRUST COMPANY)

Appearances:

For Appellanti Robert S. Thompson, Attorney at Law

For Respondent: W. M. Walsh, Assistant Franchise Tax Commissioner; Burl D. Lack, Chief Counsel; Mark Scholtz, Associate Tax Counsel

OPINION

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 on the protests of Title Insurance and Trust Company to proposed assessments of additional tax in the amounts of $6,008.67, $5,639.85 and $1,675.29 for the taxable years 1942, 1943 and 1944, respectively.

Appellant is engaged principally in the business of writing policies of title insurance and incidentally in the business of a general trust company, carrying on each such activity as a separat department. It is a single corporation, however, with but one set of officers, directors and stockholders.

For the purpose of facilitating over-all administrative control, centralizing common expenditures and providing a more complete public service, Appellant's home office activities for each department are performed in a building in Los Angeles which Appellant acquired in 1928 with insurance department funds and which it lists on its books as an asset of that department. Portions of the building not needed by either department are leased by Appellant to outsiders for specified rentals and the trust department is charged by the insurance department for the space it uses on a comparable rental basis.

During the years 1941, 1942 and 1943, Appellant, with respect to the premiums from its insurance business,. became liable for and paid the tax on gross insurance premiums imposed by the California Constitution, Section 14-3/4 of Article XIII thereof being applicable to the years 1941 and 1942, and Section 14-4/5 of that Article to the year 1943.

Section 14-3/4 included the following provision:

". . . This tax shall be in lieu of all other taxes and licenses, State, county and municipal, upon such

"companies or their property, except taxes upon their real estate ..."

Section 14-4/5, which was adopted at the general election of November 3, 1943, and became effective as to business done after December 31; 1942, contains similar language in Subdivision (i). In addition,.that subdivision provides,:

"That an insurer transacting title insurance in this State which has a trust department or does a trust business under the banking laws of this State is subject to taxation with respect to such trust department or trust business to the same extent and in the same manner as trust companies and the trust departments of banks doing business in this State."

Appellant has also, since 1929, as to its trust department activities, paid the tax imposed by the Rank and Corporation, Franchise Tax Act. Although it did so, it took the position, however, at least for years prior to 1943, that it was not liable for the tax because of the "in lieu" provision of Section 14-3/4, supra, and of a comparable provision in Section 14 of Article XIII of the State Constitution in effect prior to the adoption of Section 14-3/4 in 1938.

In its franchise tax returns for each of the taxable years here involved Appellant claimed deductions from gross income for the rentals charged to its trust department by its insurance department, the amount of the rental being $94,080 for each of the income years 1941, 1942 and 1943.

Contrary to Appellant's view of the matter, the Commissioner has considered Appellant's trust department activities prior to 1943, as well as all such activities after that date, as subject to the tax imposed by the Bank and Corporation Franchise Tax Act. Although he has denied that Appellant is entitled to a deduction in the total amount of the rentals charged by the insurance department to the trust department, on the space in the Los Angeles building occupied by the latter, he has, however, conceded that it is entitled to a deduction against the gross income of the trust department of an amount equal to the pro rata share of the entire operational expense and the depreciation of the building allocable to that space. He has, accordingly, disallowed such portion of the rentals charged during the income years 1941, 1942 and 1943 as exceeded such proportionate share.

Regarding, first, the payment of the franchise tax with reference to Appellant's trust department business prior to 1943, we are unable to concur in the Commissioner's contention that the "in lieu" provision of Section 14-3/4 or that in Section 14 previously in effect, did not exempt an insurance company from the payment of the franchise tax as to any of its non-insurance business activities. As we pointed out in Appeal of Security Title Insurance and Guarantee Company, June 22, 1938, in connection with a similar argument raised by the Commissioner therein,

our Supreme Court in Consolidated Title Securities Company v. Hopkins, 1 Cal. 2d 414, in considering the 1930 form of Section 14, construed the insurance company gross premiums tax thereby imposed as constituting the "'full measure' of the tax burden upon insurance companies, aside from the tax upon their real property . . ." We held, therefore, that the Security Title Insurance and Guarantee Company was not liable for the franchise tax as a condition to the exercise of its privilege of conducting a trust business.

We are not aware of any judicial authority issued since our decision in Appeal of Security Title Insurance and Guarantee Company requiring that we now hold otherwise. We do note, however, language in Section 14-4/5 of Article XIII further supporting that decision. It will be found in Subdivision (i), supra, expressly subjecting the trust business of a title insurance company to the franchise tax, and also in Subdivision (m), which states that Section 14-4/5 "is not intended to and does not change the law as it has previously existed with respect to the meaning of the words 'gross premiums, less return premiums, received,' as used in this section or as used in Section 14 or 14-3/4 of this Article." As for Subdivision (i), an inference may be drawn therefrom that the voters intended to change the preexisting tax status of title companies with respect to their trust company activities. People v. Weitzel, 201 Cal. 116. As for Subdivision (m), the fact that it was considered necessary or at least advisable, to include a declaration of intent of the character included therein is indicative of a purpose to change the law as to features not specified,

It is extremely difficult to believe that the addition to Subdivision (i) of the paragraph authorizing the taxation of the trust business of title insurance companies is a mere clarification of the prior law rather than a substantive change therein when the framers of Section 14-4/5 were so careful to state in Subdivision (m) that certain terms have the same meaning in that Section as in prior Sections 14 or 14-3/4. Surely, if they so specified as respects certain terms appearing in each of the Sections, they would certainly have stated that the addition to Subdivision (i) of the paragraph in question, wherein for the first time the trust business of a title insurance company was expressly made subject to taxation in the same manner and to the same extent as trust activities conducted by others, was not intended as a change in the prior law.

The foregoing conclusion is of course, confined in its application to the activities of the Appellant's trust department for the taxable year 1942, In view of Section 14-4/5(i), the right to engage in such activities in 1943 and thereafter is clearly subject to the franchise tax.

Referring, now, to the question of the rental deductions, we find Appellant arguing that since the enactment of Section 14-4/5 its insurance and trust departments are separate units for tax purposes, that deductions are allowable against gross income of the trust department in determining the tax payable by that department,

that the deductions are allowable to the same extent as between separate entities dealing at arm's length with each other, and that the rentals charged were not improper since they were equivalent to those paid by other tenants of the building,

Conceding the separateness of the two departments for tax purposes, and granting that the trust department is entitled to the usual deductions in the computation of its net income, it still is incumbent upon Appellant, as it is upon any taxpayer, to establish its right to any deduction claimed. White v. United States, 305 U.S. 281. Consequently, since here-deduction taken was for the payment of rent, Appellant has the burden of showing that it is entitled thereto under Section 8(a)(1) of the Bank and Corporation Franchise Tax Act, which permits as a deduction within the category of "ordinary and necessary expenses paid or incurred during the income year in carrying on business," any

> "rentals or other payments required to be made as a condition to the continued use or possession for business purposes of property to which the taxpayer has not taken or is not taking title or in which it has no equity."

As we understand this language, the allowance of a rental deduction is conditioned upon a showing that an expense for rent has actually been paid or incurred as to property which is owned by someone other than the taxpayer. It is our opinion that Appellant is unable to comply with this condition in view of the fact that the building involved is owned by none other than Appellant.

We see no reason for any different conclusion despite the necessary separation of Appellant's insurance and trust activities for tax purposes and to meet the requirements of our insurance and banking laws; See Insurance Code, Secs. 12392, et seq., and Bank Act (Rot 652, Deering's General Laws, Secs. 106, 107). Such separation constitutes at best a division of activities into two operating units, not the creation of distinct legal entities. This is emphasized by the circumstance that notwithstanding its departmental operations, Appellant has always, as to all its activities, held itself out as being but one corporation with a single group of officers, directors and stockholders.

Since? then, it appears that Appellant is merely one organization functioning through two departments, we cannot say that it is not the owner of the building with respect to its trust department for tax purposes simply because the structure is carried on the books of its insurance department as an asset of the latter, We believe that irrespective of the accounting aspects of the situation, Appellant is still the owner. Consequently, any rental charged to the trust department by the insurance department constituted a charge by Appellant to itself for the use of its own property, and the payment of that rental is, therefore, not within the purview of Section 8(a)(1),

Rental deductions taken for rent charged one legal entity

by another legal entity to which it is in some way related, e.g., where the relationship is that of parent and subsidiary corporation, or of a corporation and a partnership owning its entire stock, may under proper circumstances be allowable. The Welworth Realty. Co., 40 B.T.A. 97; Henry G. Bender, et al., T.C. Memo. OP., Dkts. 9694, 9695." Here, however, as we have already pointed out, we are not dealing with legal entities, but rather with one entity having two departments.

Appellant argues, in the alternative, that if it is not entitled to a rental deduction against its trust business income, it is nevertheless permitted a deduction of an amount representing a reasonable return upon the investment of its insurance department in that portion of the office building occupied by the trust department. We are unable, however, to find any provision of the law under which such a deduction is allowable, nor have we been referred to any.

The fact that we have concluded that the Appellant is entitled to deduct neither the amount of rental charged to its trust department nor a rental deduction based on a reasonable return to the insurance department for the building space occupied by the trust department does not completely deprive Appellant of a deduction against the trust department gross income on account of that department's occupancy of office space, As previously mentioned, the Commissioner has allowed a deduction from that income of a share of the total operational expense and the depreciation of the building proportionate to the space occupied by the trust department and the Appellant has agreed that the Commissioner's method of allocation of expense was proper if it was not entitled to a rental deduction under the theories advanced by it. Under the circumstances, accordingly, the action of the Commissioner as respects the allowance of a deduction to Appellant by reason of the occupancy of space by its trust department in the building owned by Appellant must be sustained for the taxable years 1943 and 1944.

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, pursuant to Section 25 of the Bank and Corporation Franchise Tax Act, that the action of Chas. J. McColgan, Franchise Tax Commissioner, on the protest of Title Insurance and Trust Company to a proposed assessment of additional tax in the amount of $6,008.67 for the taxable year 1942 be reversed and that the action of said Commissioner on the protests of said Company-to proposed assessments of additional tax in the amounts of $5,639.85 and $1,675.29 for the taxable years 1943 and 1944, respectively, be 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