BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF. CALIFORNIA

In the Matter of the Appeal of)
)
PIONEER INVESTORS SAVINGS AND)
LOAN ASSOCIATION)

Appearances:

For Appellant: Ernest Leff, Vice-President and General Counsel; Neil R. Bersch, Certified Public Accountant

For Respondent: Peter S. Pierson
Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to section 26077 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claim of Pioneer Investors Savings and Loan Association for refund of franchise tax in the amount of $300,000 for the income year 1958,

Appellant is a savings and loan association, incorporated under California law, On December 30, 1964, after this appeal was filed, its name was-changed to American Savings and Loan of California,

During the period of 1928 through 1941 appellant incurred bad debt losses ranging from $1,687 to $1,570,902 in each year, representing from .02 percent to 30 percent of *its*, outstanding loans. Thereafter, it incurred no bad debt losses until 1956, when it lost $76,640, representing .1 percent of its outstanding loans, In 1958, it incurred, a loss of $410.

Pursuant to an informal ruling issued by respondent Franchise Tax Board in 1943, applying to all savings and loan associations, appellant elected to use the reserve method of accounting for its bad debts. As permitted by the ruling, it added to its reserve and deducted for each of the income years 1942 through 1958, a sum equal to .2 percent of its outstanding loans. As of December 31, 1958, appellant's accumulated reserve resulting from these additions amounted to $1,188,544, or 1.3 percent of its outstanding loans.

Subsequently, respondent adopted a formal regulation applying to savings and loan associations, (Cal. Admin. Code, tit. 18, reg. 24348(a).) This regulation permitted a choice of methods for computing deductible additions to a bad debt reserve. One of the methods allowed an annual deduction of a percentage of loans equivalent to the average ratio of losses to loans during the 20-year period of 1928 through 1947. The application of the regulation was expressly limited to income years beginning after 1958.

Early in 1963, appellant claimed a refund for the income year 1958, based on increasing its bad debt deduction for that income year to approximately 3 percent of the loans outstanding at the end of that year. This percentage represented appellant's average loss ratio for the 20-year period of 1928 through 1947. Respondent disallowed the claim on the ground that the deduction previously taken by appellant was adequate, and this appeal followed.

Section 24348 of the Revenue and Taxation Code provides in part that "There shall be allowed as a deduction debts which become worthless within the income year; or, in the discretion of the Franchise Tax Board, a reasonable addition to a reserve for bad debts."

The refund claim in question was apparently impelled by respondent's adoption of regulation 24348(a). The regulation, however, does not apply to the income year 1958, nor does the liberalized approach of that regulation compel a conclusion that appellant's original reserve for 1958 was unreasonably small.

Appellant has referred to various amounts of loss reserves required of it by the California Savings and Loan Commissioner before and after 1958. None of the amounts referred to, however, exceeds the sum of the bad debt reserve maintained for franchise tax purposes. It is also alleged by

appellant that it incurred losses of more than $366,000 in 1962. But tncse losses were substantially less than the bad debt reserve in 1958 and, more cogently, they must have constituted an even smaller percentage of the accumulated reserve as of 1962.

The case of Union National Bank of Youngstown v. United States, 237 F. Supp. 753, is cited by appellant for the proposition that in determining an addition to a bad debt reserve. it is improper to use a formula which conflicts with the taxpayer's, actual experience. The heart of that decision, as we understand it, is that the taxpayer bank was discriminated against by being deprived of the use of a formula based in part on the experience of other banks during a depression year in which the taxpayer commenced business. Respondent has not discriminated against appellant, Rather, appellant is seeking to use a more liberal formula than its competitors were permitted to use for the income year 1958,

Bearing in mind the fact that appellant incurred losses in only two of the years from 1942 to 1958, totaling approximately $77,000, we conclude that its reserve in excess of a million dollars at the end of 1958 was adequate.

Although the issue has not specifically been raised, there appears to be an additional reason why appellant is not entitled to the refund which it seeks, The federal courts, construing a statute substantially the same as section 24348 of the Revenue and Taxation Code, have established the rule that a taxpayer may not retroactively increase its bad debt reserve. (Farmville Oil & Fertilizer Co. v. Commissioner, 78 F.2d 83; Rogan v. Commercial Discount Co., 149 F.2d 585, cert. denied, 326 U.S. 764, [90 L. Ed, 460]. Cf. Rio Grande Building and Loan Association, 36 T.C. 657,) If there is any ground for applying a different rule here, it is not discernible from the record before us.

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 26077 of the Revenue and Taxation Code, that the

action of the Franchise Tax Board in denying the claim of Pioneer Investors Savings and Loan Association for refund of franchise tax in the amount of $300,000 for the income year 1958 be and the same is hereby sustained,

Done at Sacramento, California, this 4th day of January, 1966, by the State Board of Equalization.

_____, Chairman

_____, Member

_____, Member.

_____, Member

_____, Member

ATTEST: _____, Secretary