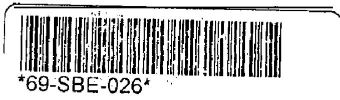

*69-SBE-026*

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )
)
PREFERRED SAVINGS AND LOAN ASSOCIATION )

**Appearances:**

For Appellant4 Joseph Mayer
Certified Public Accountant.

Robert F. Jordan
Certified Public Accountant

For Respondent: Gary Paul Kane
Counsel

## O P I N I O N

This appeal is made pursuant to section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Preferred Savings and Loan Association against proposed assessments of additional franchise tax in the amounts of $1,216.66 and $1,852.20 for the income years 1964 and 1965, respectively.

The primary issues presented by this appeal are whether gain realized when real property is bought in by the creditor at a foreclosure sale should be recognized at the time of foreclosure, and if so, whether an appraisal of such property is a proper method of determining the fair market value of the property received.

Appellant, a California savings and loan association, commenced business on January 10, 1963. Since its formation much of its business activity has consisted of making loans secured by deeds of trust or mortgages on real property,. It elected to use the reserve method of accounting for bad, debts.

During 1964 and 1965 appellant foreclosed on a number of the mortgages which it held. In many instances appellant bought the property at the foreclosure sale, bidding an amount equal to the loan balance plus foreclosure costs. Most of the parcels thus acquired were subsequently resold. Appraisers employed by appellant determined the fair market value of each parcel at the time of foreclosure. Appellant considered the bid in price of the property as equivalent to its fair market value, and therefore treated no gain as occurring until the subsequent sale, at which time it credited a gain to its reserve for bad debts.

The following table contains the data on those properties which appellant acquired at foreclosure sales during 1964 and 1965 and subsequently resold:

| No. | Foreclosure Date | Loan Balance Plus Foreclosure costs | Appraised Value | Date Resold | Sales Price |
|---|---|---|---|---|---|
| 101 | 10-15-64 | $ 8,004.64 | $ 9,192 | 2-8-65 | $ 9,100 |
| 102 | 10-1-64 | 9,282.86 | 10,750 | 2-8-65 | 10,800 |
| 103 | 10-1-64 | 9,350.08 | 10,750 | 2-8-65 | 10,800 |
| 104 | 10-2-64 | 10,547.97 | 11,900 | 8-2-65 | 12,500 |
| 105 | 10-2-64 | 10,616.85 | 12,100 | * | * |
| 106 | 10-1-64 | 10,094.30 | 11,000 | * | * |
| 107 | 12-18-64 | 13,014.27 | 14,800 | * | * |
| 108 | 2-19-65 | 12,726.43 | 14,900 | 3-31-65 | 14,950 |
| 109 | 7-23-65 | 11,287.48 | 13,800 | * | * |
| 110 | 8-26-65 | 16,260.77 | 18,700 | * | * |
| 111 | 12-17-65 | 10,038.86 | 12,600 | * | * |
| 112 | 12-22-65 | 15,271.34 | 19,400 | * | * |
| 113 | 12-31-65 | 5,855.66 | 11,500 | * | * |

* Sold to third persons after 1965

Appellant states that the ultimate sales of these 13 properties involved loans with terms considerably more favorable than those provided in the usual loan contract, and that these terms were necessary because of the difficulty of selling these properties.

Respondent determined that taxable gain should be recognized when each property was reacquired, and that gain should be measured by the amount which the appraised fair market value of the property exceeded the amount of

the successful bid. Appellant contends that gains should not be recognized at the time when property is bid in -by the creditor.

Respondent's regulation specifically provides that if the creditor buys in the mortgaged or pledged property, loss or gain is realized measured by the difference between the amount of those obligations of the debtor which are applied to the purchase or. bid price of the property and the fair market value of the property. (Cal. Admin. Cbde, tit. 18, reg. 24121f (3), subd. (a).) Itis well recognized that respondent's regulations are entitled to great weight. Furthermore, the former federal counterpart of this regulation was specifically upheld. (Nichols v. Commissioner, 141 F.2d [illegible]; Hadley Falls Trust Co. v. United States, 110 F.2d 887.) As was stated in Nichols v. Commissioner, supra at p. 876, the regulation is based upon the theory that the mortgagee exchanges the obligations of the debtor and receives the fair market value of the property.

Appellant further claims that respondent is inconsistently handling the application of the tax to bid ins by a mortgagee. Pursuant to another of respondent's regulations appellant points out that where a loss, occurs at the time of bid in, the loss may be regarded as a bad debt loss to be charged against the bad debt reserve, rather than directly to profit and loss, 'or its recognition may even be deferred until the property is subsequently sold, at which time it may then be charged against the reserve. (Cal. Admin. Code, tit. 18, reg. 24348(a), subd. (5)(ii).) Appellant contrasts this with the gain situation where these options are not available and where any gain upon acquisition or upon subsequent sale must be treated as present income. However, where the reserve method is used a loss has already been anticipated and economically provided for (5 Mertens, Law of Federal Income Taxation, § 30.73) while a gain upon acquisition or subsequent sale has not been anticipated.

Appellant also points out that for the years under consideration the Internal Revenue Service did not regard the gains as taxable at the time of bid in. However, the federal law was changed in 1962 so as to provide a method of treating the bid ins and subsequent sales in the manner desired by appellant. (Int. Rev., Code of 1954, § 595.) Similar legislation was 'enacted. by the California Legislature in 1967, but was specifically applicable only to income years beginning after December 31, 1967. (Rev. & Tax. Code, § 24348.5.) On the basis of the law In effect during the years in

question, we must agree with respondent's conclusion that gain was realized at the time the property was reacquired by appellant.

Appellant next contends that appraisals should not be blindly accepted in determining the fair market value of property at the time it is bid in, but that appraised values must be actually tested by sales and even by subsequent collections on the notes receivable in order to determine whether or not reacquisitions by appellant actually resulted in a profit. Appellant notes that respondent+ regulations provide that the fair market value of reacquired property shall be presumed to be the amount for which the property is bid in by the taxpayer, in the absence of clear and convincing proof to the contrary. (Cal. Admin. Code, tit. 18, reg. 24121f(3), subd. (a).) However, in the five instances where the property was resold during 1965, only in one instance did the subsequent sale price fail to exceed the value determined by appraisers employed by appellant, and even in that instance the subsequent sale price closely approximated the appraised value. Furthermore, respondent's regulations authorize the use of competent appraisals to establish the loss sustained on account of foreclosures where the collateral is taken over by the taxpayer association. Such a method of determining gain is not precluded by the regulations. We conclude that the appraisals constituted clear and convincing proof of the fair market value of the properties reacquired by appellant.

Another issue was stressed by appellant at the oral hearing of this matter. Appellant maintains that it has not been allowed a sufficient offset against franchise tax liability for personal property taxes paid to Santa Barbara County.

Appellant paid as taxes to the Santa Barbara County tax collector $759.53 and $619.98 during the income years 1964 and 1965, respectively with $425.33 of the property taxes attributable to 1964 and $336.10 of the property taxes for 1965 relating to properties which were trade fixtures. Business property statement8 submitted by appellant to the county assessor prior to receipt of tax bills from the tax collector indicate appellant was aware that a substantial amount of its property was in the nature of improvements rather than unattached office furniture. Respondent refused to offset against appellant's franchise tax liability that portion of the taxes paid attributable to trade fixtures, on the ground that, taxes paid on trade fixtures were taxes on real property which could not serve. as an offset.

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The bills sent to appellant by the county property tax collector simply lumped together under personal property the assessed value of the trade fixtures and other property of appellant which actually constituted personal property., The total value of the trade fixtures was not separately listed. Appellant contends that since the county denominated all the property as personal property, offset of the entire amount of tax paid should be allowed. The law does not support this contention,

Section 23184 of the Revenue and Taxation Code provides, in pertinent part:

> Financial corporations may offset against the franchise tax the amounts paid during the income year to this state or to any county, city, town or other political subdivisions of the state as personal property taxes,. ...

Trade fixtures are properly classified as real property for purposes of property taxation. (Trabue Pittman Corp. v. County of Los Angeles, 29 Cal. 2d 385 [175 P.2d 512]; Simms v. County of Los Angeles, 35 Cal. 2d 303 [217 P.2d 936].) The fact that all the property may have been inadvertently denominated personal property does not compel the conclusion that the taxes are therefore personal property taxes. The classification of taxes as" real or personal property taxes is to be determined by the true nature of the property upon which the taxes are assessed. (Appeal of Catalina View Oil Co., Cal. St. Bd. of Equal., April 20, 1932.)

## ORDER

Pursuant to the views expressed in the opinion of the board on file in this proceeding,' and good cause appearing therefor,

Appeal of Preferred Savings and Loan Association

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Preferred Savings and Loan Association against proposed assessments of additional franchise tax in the amounts of $1,216.66 and $1,852.20 for the income years 1964 and 1965, respectively, be and the same is hereby sustained..

Done at Sacramento, California, this 7th day of August, 1969, by the State Board of Equalization.

John W. Lynch, Chairman

_______________, Member

_______________, Member

Paul R. Leake, Member

_______________, Member

ATTEST: _______________, Secretary