BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
GLENDALE FEDERAL SAVINGS AND)
LOAN ASSOCIATION)

Appearances:

For Appellant: William W. Berryhill
General Counsel

Robert J. Wynne
Attorney at Law

For Respondent: A. Ben Jacobson
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 denying the claim of Glendale Federal Savings and Loan Association for refund of franchise tax in the amount of $393,635.00 for the income year 1962.

The issue presented is whether appellant was entitled to deduct a larger addition to its bad debt reserve in the year in question.

Appellant is a federal savings and loan association originally chartered as such in 1934 under the provisions of the Home Owners' Loan Act of 1933 (12 U.S.C.A. § 1461 et seq.). Like virtually every other savings and loan association operating in California, appellant has elected to use the reserve method of computing its bad debt

deduction and has selected the base period 1928-1947 for the purpose of determining its average ratio of losses to outstanding loans. Under the provisions of regulation: 24348(a)[1/] (hereafter "the regulation"), which governs bad debt deductions for savings and loan associations for income years beginning after December 31,1958, but before January 1, 1972, appellant has been required to compute its loan loss ratio by combining its own loss experience for the base period years it was in existence with the statewide savings and loan industry average loss experience for the prior base period years. On the basis of this computation, respondent Franchise Tax Board has permitted appellant to use a loan loss ratio of .284%, subject to a ceiling on the accumulated bad debt reserve of three times that percentage. In the refund claim giving rise to this appeal, appellant took the position that it should have been allowed a minimum ratio of 1.211% and a reserve ceiling of at least 6% of outstanding loans.

No contention is made that the regulation itself entitles appellant to a larger loss ratio than respondent has permitted. Rather, appellant's major argument is that the regulation, as applied, discriminates against appellant as a federal savings and loan association in violation of the express statutory prohibition contained in section 5(h) of the Home Owners' Loan Act of 1933, as amended (12 U.S.C.A. § 1464(h)).

Section 1464(h) provides as follows:

> No State, county, municipal, or local taxing authority shall impose any tax on such associations [federal savings and loan associations] or their franchise, capital, reserves, surplus, loans, or income greater than that imposed by such authority on other similar local mutual or cooperative thrift and home financing institutions.

It is clear that "This provision unequivocally bars discriminatory state taxation of the Federal Savings and Loan

1/ Cal. Admin. Code, title 18, § 24348(a).

Associations." (Laurens Federal Savings and Loan Association v. South Carolina Tax Commission, 365 U.S. 517 [5 L. Ed. 2d 749].) It is less clear, however, what test is to be used to determine the existence of the prohibited discrimination. The United States Supreme Court has never had occasion to decide whether a state's scheme of taxation violates the Congressional mandate contained in section 1464(h), and the relatively few decisions of lesser courts have not defined the precise meaning and scope of the section. We are not left entirely without guidance in this area, however, because there exists a long line of Supreme Court cases interpreting an analogous federal statute (Rev. Stat. § 5219, as amended, 12 U.S.C.A.§548) governing state taxation of national banks and their shareholders. Since appellant has relied on these decisions quite heavily to prove its case, we will look to them for direction.

Prior to its complete revision in 1969, section 548 authorized a state to tax national banks in any one of four specified ways in addition to taxation of their real property. Subject to certain conditions, a state could tax (1) national bank shares or (2) the dividends therefrom, or could impose a tax (3) on the net income of national banks or (4) according to or measured by their net income. If a state elected to tax the shares, section 548 stipulated that

> [T]he tax imposed shall not be at a greater rate than is assessed upon other moneyed capital in the hands of individual citizens of such State coming into competition with the business of national banks:....

In the case of a tax according to or measured by net income, which is the method of taxation adopted by California (see Rev. & Tax. Code, §23181), section 548 required that

> [T]he rate shall 'not be higher than the rate assessed upon other financial corporations nor higher than the highest of the rates assessed by the taxing State upon mercantile, manufacturing, and business corporations doing business within its limits:...

The Supreme Court has construed this statute in nearly three score cases, and from those cases has evolved. the principle that

> [T]he various restrictions it '[section 548] places on the permitted methods of taxation are designed to prohibit only those systems of state taxation which discriminate in practical operation against national banking associations or their shareholders as a class. (Emphasis added.) (Tradesmens Nat. Bank v. Oklahoma Tax Corn., 309 U.S. 560, 567 [84 L. Ed. 9473; accord, Michigan Nat. Bank v. Michigan, 365 U.S. 467 [5 L. Ed. 2d 710-j.)

Applying this guiding principle to section 1464(h), our task becomes one of determining whether it may be said that the regulation discriminates in practical operation against federal savings and loan associations as a class, when the treatment they receive under the regulation is compared to that received by "other similar local mutual or cooperative thrift and home financing institutions. "

Appellant' contends that such discrimination exists in general against federal savings and loan associations originally chartered as such ("originally chartered federals"), and against appellant in particular.' Originally chartered federals are discriminated against, itis said, because they are effectively denied the use of the large statewide industry loss experience of the Great Depression by -virtue of the fact that, for the most part, they were created during the worst loss years (1933-1937) of that period.2/ Discrimination against

2/The reason that originally chartered federals created during the years 1933-1937 do not get the full benefit of Depression experience is that, for purposes of the loan loss ratio, the regulation requires them to use their own actual loss experience for the years they were in existence and, because of the extremely conservative lending practices followed at that time, they had virtually no bad debt losses on the loans they. originated; It should be noted, however, that state savings and loan associations created during the years 1933-1937 are in exactly the same position as their federal counterparts.

appellant is said to follow from the fact that its loan loss ratio under the regulation is lower than that of (1) every savings and loan association formed after 1947, (2) substantially every savings and loan association formed prior to 1932 (or successors in interest to such associations), and (3) three of the four largest savings and loan associations in California, all three of which are major competitors of appellant. 3/

A careful review of the stipulated facts and appellant's uncontroverted allegations leads us to conclude that the challenged regulation does not discriminate in practical operation against federal associations as a class. Indeed, appellant really has made no attempt to prove such widespread discrimination. Rather, appellant has sought to establish only that "originally chartered federals" created during the depths of the Great Depression are disadvantaged under the regulation. Obviously, this "class" of federal associations does not constitute the whole class of federal institutions since it includes neither later created "originally chartered federals" nor federal associations converted from state charter. When these two categories of federal associations are included in the class for purposes of applying the test of Tradesmens Nat. Bank, as we believe they must be, it becomes apparent that the regulation does not discriminate against the entire class. Originally chartered federals organized after 1947, for example, are permitted by the regulation to use a loss ratio computed entirely on the basis of the average losses experienced by the California

3/The three major competitors referred to were formed prior to 1932 and thus must be state-chartered institutions since the organization of federal associations was not possible prior to enactment of the Home Owners' Loan Act of 1933. It is stipulated that respondent permits these three associations to use loss experience factors ranging from approximately 6 to 10 percentage points higher and from approximately 3 to 4½ times greater than the factor appellant has been allowed to use.

savings and loan industry during the base period 1928-1947. The resulting ratio of .6% is clearly quite favorable to such associations. Moreover, appellant itself has indicated how favorable the **regulation can be to a** federal association by suggesting that it has operated to relieve one of appellant's major competitors (a federal converted from a pre-1928 state charter) from all, or nearly all, franchise tax liability since 1960.4/

Just as the evidence does not prove discrimination against the entire class of federal savings and loan associations, neither does it establish discrimination, against appellant in particular, as compared to its major state-chartered competitors. As far as section 1464(h) is concerned, the treatment of federal associations is to be compared to that given "other similar local mutual or cooperative thrift and home financing institutions." Since appellant has indicated that its state-chartered competitors are stock, rather than mutual or cooperative, institutions, it is problematical whether a comparison between appellant and those competitors is even relevant under section 1464(h). If the thrust of the comparison was aimed more at the constitutional question of whether appellant has been discriminated against as a federal instrumentality, the answer is that its lower loss experience factor has nothing whatever to do with its status as a federal institution. As appellant admitted at the hearing, a state association identical in all respects to appellant would have exactly the same factor as appellant.

4/The regulation's treatment of federal associations converted from state charter', and state associations converted from federal charter, is further evidence of nondiscrimination against federal associations. Under the regulation,, a conversion going either way works absolutely no change in the allowable loss ratio. Consequently, the size of the loss ratio allowed each association cannot be dependent on the association's status as a state or federal institution.

Appellant's attempt to show discrimination against it as compared to associations (state and federal) formed in other years does not appear to present an issue under section 1464(h). In essence, this part of appellant's argument raises the equal protection question previously decided in the Appeal of Fullerton Savings and Loan Association, Cal. St. Bd. of Equal., June 2, 1969, where we held that the regulation does not unreasonably and arbitrarily discriminate between savings and loan associations on the basis, of their dates of creation. We adhere to that determination.

Appellant has made a number of other arguments on brief, many of them long laid to rest in our prior decisions. We see no reason to reopen such well settled matters. Appellant's other secondary contentions have been considered, and we find them all to be without merit.

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 theref or,

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 denying the claim of Glendale Federal Savings and Loan Association for refund of franchise tax in the amount of $393,635.00 for the income year 1962, be and the same is hereby sustained.

Done at Sacramento, California, this 9th day of April, 1973, by the State Board of Equalization.

William G. Bonelli, Chairman

Ray C. Reeves, Member

Ben W. Lynch, Member

_____, Member

_____, Member

ATTEST: W. W. Sumpf, Secretary