BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

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

Appearances:

For Appellant: Joseph Mayer
Certified Public Accountant

For Respondent: Paul J. Petrozzi
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 Riverside Savings and Loan Association against proposed assessments of additional franchise tax in the amounts of **$3,895.40, $7,534.49, $9,390.83, $1,979.49** and **$1,744.79** for the income years 1962, 1963, 1964, 1965 and 1966, respectively.

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The sole issue to be decided is whether respondent properly determined appellant's bad debt reserve ratio for the years in question.

Appellant began doing business as a California corporation in 1901. It employs the accrual method of accounting and reports its California franchise tax on a calendar year basis. During the years in question appellant maintained a reserve for bad debts to which annual additions were made in the general manner prescribed by respondent's regulation 24348(a). [Cal. Admin. Code, tit. 18, reg. 24348(a).] Pursuant to that regulation, appellant determined its bad debt reserve ratio based upon its actual loss experience for the years 1928 through 1947 to be .424 percent of loans outstanding. After an audit respondent determined that a significant number of the losses claimed by appellant during the 1928 to 1947 period did not qualify as bad debt losses; and therefore respondent concluded that appellant should have used a bad debt reserve ratio of .154 percent instead of .424 percent. Respondent's adjustment to the ratio increased appellant's taxable income for the years in issue and resulted in the proposed assessments now before us.

Appellant apparently does not contest respondent's disallowance of certain bad debt losses for the years 1928 to 1947, which resulted in the downward adjustment of the bad debt reserve ratio. Rather, appellant attacks generally the reasonableness of respondent's method of computing the ratio. Appellant contends that instead of computing the ratio on the basis of past loss experience, the ratio should have been computed on the basis of present loss experience and future anticipated loss experience. Appellant's suggested approach is allegedly much more reasonable since it takes into account the ever changing economic climate in which savings and loan associations operate. Appellant cites Appeal of Pringle Tractor Co., decided by this board March 7, 1967, as support for its position.

Subdivision (a) of section 24348 of the Revenue and Taxation Code provides:

> (a) There shall be allowed as a deduction debts whichbecome worthless within the income year; or, in the discretion of the Franchise Tax Board,' a''reasonable addition to a reserve 'for bad debts. (Emphasis added.1

By enacting this provision, the Legislature made the reasonableness of an addition to a reserve for bad debts a matter within respondent's discretion. Accordingly, unless appellant can sustain the heavy burden of showing respondent's determination of the bad debt reserve ratio to have been arbitrary and capricious, respondent's discretion has not been abused and its determination must stand. (Appeal of La Jolla Federal Savings 'and Loan Association, Cal. St. Bd. of Equal., Aug. 5, 1968.)

Here, appellant has failed to show the requisite arbitrariness or capriciousness of respondent's determination. rndeed, such a showing would be impossible in light of the record in this case. The record reveals that while respondent permitted bad debt reserves of approximately $270,000 during the years in question, appellant only reported some $3,800 in actual losses on its returns for that period. Further, appellant's reliance on our decision in Appeal of Pringle Tractor Co., supra., is misplaced. That case is clearly distinguishable from the present one on several grounds. First, Pringle was not a case involving a savings and loan association. Since savings and loan associations are treated differently under respondent's regulations than other businesses, for purposes of determining additions to bad debt reserves, the method used by respondent in the instant case was not in issue in Pringle. Also, in Pringle we were impressed by the fact that appellant therein was aware in 1962 (the year in question) of the extreme likelihood of severe losses occurring in the following year, which led appellant to significantly increase its reserve for bad debts addition for 1962. Such losses did in fact occur in 1963. Here, the record reveals that no such dramatic increase in appellant's bad debt losses was either anticipated or occurred during any of the years in question.

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Based on the foregoing, we conclude that respondent properly determined appellant's bad debt reserve ratio for the years in question. Accordingly, respondent's assessment must be sustained.

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 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Riverside Savings and Loan Association against proposed assessments of additional franchise tax in the amounts of $3,895.40, $7,534.49, $9,390.83, $1,979.49 and $1,744.79 for the income years 1962, 1963, 1964, 1965 and 1966, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 15th day of December, 1976, by the State Board of Equalization-

_____, Chairman

_____, Member

_____, Member

_____, Member

_____, Member

ATTEST: _____, Executive Secretary