



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
LA REE POWDRE SHOPPES)

Appearances:

For Appellant: W. G. Peterson, President of said corporation; Howell Purdue, Attorney
For Respondent: Reynold E. Blight, Franchise Tax Commissioner

O P I N I O N

This is an appeal under Section 25 of the Bank and Corporation Franchise Tax Act (Chapter 13, Statutes of 1929) from an action of the Franchise Tax Commissioner in overruling the protest of La Ree Poudre Shoppes against a proposed assessment of an additional tax based upon the return of said corporation for the year ended December 31, 1928.

The sole point involved in this appeal is whether Appellant is entitled to use as an offset under Sections 4 and 26 of the Act an amount equivalent to ten per cent of \$798.50 representing taxes paid by the corporation on certain real property occupied by it in the City of Los Angeles. It appeal without contradiction that La Ree Poudre Shoppes leases a portion of a building erected upon a lot in that city as to which the record title is vested in Raymond W. Huntsberger and Helen H. Cooper, The entire property, both land and improvements, is assessed to the record owners. In turn, it was leased to C. H. Baker, a corporation, which has subleased a smaller portion to the Appellant which occupies the premises so leased and, under the terms of its agreement, is required to pay the prorata of the taxes on the entire premises apportioned to that part thereof occupied by it.

The accuracy of the proration and the fact of the payment of the real property taxes by the Appellant in this way are not questioned by the Commissioner who has denied the allowance of the offset upon the ground that Sections 4 and 26 of the Act, relating to the offset of local property taxes, mention specifically that each corporation is entitled to offset for taxes paid upon its property. From this he has concluded that no corporation may claim an offset on account of taxes paid upon property not owned by it, since he regards the use of the possessive pronoun as expressly limiting the offset to this extent.

Section 16 of Article XIII of the constitution, under authority of which the Bank and Corporation Franchise Tax Act

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was passed, provides in part that "such tax shall be subject to offset, in a manner to be prescribed by law, in the amount of personal property taxes paid by such corporations to the state or political subdivisions thereof." There is further provision in this same section of the constitution that the Legislature, by two-thirds vote, may change by law "the percentage, amount or nature of offset." The Bank and Corporate Franchise Tax Act was adopted by a two-thirds vote such as is described in the constitution.

It will be observed that the constitution makes no mention of the offset of real property taxes so that if such procedure is to be justified it must be upon the assumption that the power granted to the Legislature to change the "nature" of the offset is sufficiently broad to add thereto real property tax. There are grave questions of constitutionality involved as has been ably pointed out by Professor Roger J. Traynor of the University of California in an article on "National Bank Taxation in California" appearing in the California Law Review. The precise problem is discussed by Professor Traynor in 17 California Law Review 502, et seq.

Because of the extreme delicacy and the far-reaching importance of the constitutional questions raised our Board, as an administrative agency acting only in a quasi judicial capacity, does not feel warranted in attempting to pass upon the problem involved in this appeal in its full significance. Therefore, we shall assume, without deciding, that the Legislature had the power to extend the offset so as to include real property taxes. The question then raised is whether or not the Legislature intended to further change the nature of the offset by confining it to taxes paid on property owned by the claimant corporation. An affirmative answer to this question would involve the assumption that the use of the possessive pronoun "its" was merely fortuitous and was not intended to restrict the offset to property actually owned by the taxpayer.

A somewhat similar problem was before the Supreme Court of this State in the case of Morgan Adams, Inc. v. County of Los Angeles, 80 Cal. Dec. 57. The Court was called upon to determine whether the use of the possessive pronoun "their" in section 14 of Article XIII of the constitution specifying what property is "operative" under the system of gross receipts taxation employed with reference to certain utilities restricts operative property to that actually owned by the utilities. Reference was made to the case of Hopkins v. Southern California Telephone Company 275 U.S. 393, in which Mr. Justice McReynolds who delivered the opinion of the Court, pointed out that the object of the gross receipts system of taxation was to substitute for an ad valorem tax a tax measured by the gross earning capacity of property used in certain lines of business so that if a corporation, taxable under this plan, owned only half of the property used to produce the gross revenue, unless permitted to claim the property leased as operative also, it would be subject to just double the rate of taxation applied to a corporation owning all of its operative property. Continuing his analysis of the situation, Mr. Justice McReynolds pointed out

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that "These difficulties cannot be avoided by saying the lessee will not pay assessments against the lessor and therefore cannot complain. Leases are commonly made with reference to taxation. When the lessor discharges the tax the lessee pays rent **accordingly.**" In view of these considerations both the Supreme Court of the United States and the Supreme Court of California came to the conclusion that the use of the possessive pronoun "**their**" with reference to the operative property of utilities taxed on a gross receipts basis **did not** restrict that property to such as was owned outright by the companies and that the true test of whether or **not** property should be regarded as operative turns upon the use to which it is put by the state taxpayer.

Although the situations are not strictly analogous we think that the parallel between the question before the Courts with reference to the operative property of utilities and the question before us with reference to the nature of the **property** to which the offset provision of the Bank and Corporation Franchise Tax Act extends is sufficiently close to afford us guidance. The obvious intent of the offset provision was to permit corporations which were subject to local tax burdens to use these payments in partial satisfaction of a state tax based upon net income. Reference to the Final Report of the California Tax Commission upon whose recommendation the present system of taxing banks and corporations was adopted discloses that the eventual design was to substitute these taxes based on income for the personal property taxes which would otherwise be paid by the corporations. The Legislature extended the offset to include ten per cent of the real property taxes. Since the tax is based on income and since the ability to pay it is manifestly affected by the **tax** payments which a corporation may make either directly to the fiscal officials of the government or indirectly through an agreement with its lessor we think that a reasonable interpretation leads to the conclusion that the use of the word "**its**" was not intended to confine the offset for taxes to those paid on property **actually** owned by the taxpayer.

From the language of the constitution, which we have already quoted, it is clear that no such limitation was there intended. If it lay within the power of the Legislature to change the nature of the offset so as to include taxes paid on real property (which we have assumed without deciding), we think it follows **necessarily** that the Legislature could have further changed the nature of the offset so as to restrict it to taxes paid on property actually owned by the corporations. However, in the light of the circumstances to which we have alluded and in view of the conclusions of the Courts with reference to a problem of a similar character we conclude that the Legislature did not intend to limit the offset in this manner. In our opinion, the **Appellant** is entitled to the offset claim, i.e. ten per cent of the real property taxes paid by it on the premises occupied by the corporation in the City of Los Angeles. Naturally, if the offset is thus allowed, it should not be allowed to any other corporation involved in the transaction since the intent of the statute must be to

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consider any particular taxes as an offset but once. Care should be taken by the Commissioner in this and in similar cases to see that only one corporation is permitted to claim a particular tax payment as an offset,

When the tax of the Appellant is calculated in accordance with our views the computations are as follows:

Item 39	Net Income for State Purposes	\$3,850.79
Item 41	Four Per Cent	154.03
Item 42	Offset Allowable	22.40
Item 43		131.63
Item 44	Four Per Cent of the Offset	.90
Item 45	Total Tax Assessed	132.53
Item 46	Self-assessed and Paid	43.13
Item 47	Revised Additional Tax	89.40

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, that the action of Reynold E. Blight, Franchise Tax Commissioner, in overruling the protest of La Ree Poudre Shoppes, a corporation, against a proposed additional assessment based upon a return for the year ended December 31, 1928, under Chapter 13, Statutes of 1929, be and the same is hereby modified and the amount of tax is determined as \$132.53. Albert A. Manship-, Franchise Tax Commissioner, is hereby directed to note the deficiency in the payment of the tax as determined by this Order and to proceed in conformity therewith pursuant to the statute in such cases made and provided.

Done at Sacramento, California, this 20th day of January, 1931, by the State Board of Equalization.

Jno. C. Corbett, Chairman
R. E. Collins, Member
H. G. Cattell, Member
Fred E. Stewart, Member

ATTEST: Dixwell L. Pierce, Secretary