



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of }
FIRST FEDERAL SAVINGS AND LOAN }
ASSOCIATION OF HOLLYWOOD }

Appearances:

For Appellant: Leo L. Rosen, Certified Public Accountant

For Respondent: W. M. Walsh, Assistant Franchise Commissioner; Frank M. Keesling, Franchise Tax Counsel; Clyde Bondeson, Senior Franchise Tax Auditor

O P I N I O N

This appeal is made pursuant to Section 27 of the Bank and Corporation Franchise Tax Act (Chapter 13, Statutes of 1929, as amended) from the action of the Franchise Tax Commissioner in denying the claim of the **First** Federal Savings and Loan Association of Hollywood for a refund of taxes in the total amount of \$1,075.45 paid for the taxable years ended ~~December 31, 1935,~~ 1936, 1937 and 1938. The Appellant concedes herein the correctness of the action of the Commissioner with respect to \$13.32 of that amount and appeals from his action with respect to the balance of \$1,062.13.

The only question presented by the appeal is the deductibility by Appellant in its returns of income of additions to a reserve account it is required to establish and maintain under Section 11(a) of the Rules and Regulations of the Federal Savings and Loan Insurance Corporation. Although the Appellant made additions to the reserve account during the years in question in amounts exceeding the minimum amount prescribed by that section, three-tenths of one per cent of the aggregate of the insured accounts standing **on** its books at the beginning of the fiscal year until the net credits to the reserve account amount to five per cent of all insured accounts, it claims as a deduction from its net income only such minimum amount for each year. The Commissioner denied the deductibility of the amounts added to the reserve account upon the grounds (1) that the account was **not** established and maintained solely for bad debts but that other losses might also be charged against it, Section 11 (a) of the Rules and Regulations providing that the reserve account should be set up " ..for the sole purpose absorbing losses....", the additions to the account not, accordingly, falling within the provisions of Section 8(e) of the Bank and Corporation Franchise Tax Act authorizing the deduction of a reasonable addition to a reserve for bad debts, and (2) that the reasonableness of the additions to the account had not been established.

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At the hearing of the appeal it was clearly established, however, that the reserve account was maintained solely for use in connection with bad debts and that only losses of that character were charged against it. Any losses that might arise from sales of property would not be charged against the account. Other reserve accounts were maintained by the Appellant for use in connection with other types of losses. No evidence whatever was introduced in support of the Commissioner's contention that losses other than those arising from bad debts had been or might be charged against this particular reserve account.

With respect to the reasonableness of the additions made by Appellant to the reserve account during the years in question and for which a deduction is claimed, it appears that the minimum reserve requirements established by the Rules and Regulation of the Federal Savings and Loan Insurance Corporation are based upon extensive research on the experience of building and loan associations over a period of approximately fifty years. Saving and loan associations are encouraged to make additions to the reserve in amounts in excess of the minimum requirement and, so far as Appellant's officers are aware, no association in the state regards the minimum requirement as adequate and all create reserves in excess of that requirement.

As of December 31, 1937, the Appellant's reserve account stood at \$11,850.67, while total loans as of that date were about \$2,800,000, the balance of the reserve account constituting only about four-tenths of one per cent of the loans. After deducting loans insured by the Federal Housing Administration, even as to which Appellant states it is possible to sustain a loss, the balance in the account is only six-tenths of one per cent of the loans. In view of these facts the additions to the reserve account during the years in question claimed by Appellant as deductions were reasonable and the Commissioner's contention that such additions were arbitrary is unfounded.

We have concluded, accordingly, that the deductions claimed by the Appellant from its gross income for the years 1934, 1935, 1936 and 1937 as additions to the reserve account in question are deductible as additions to a reserve for bad debts pursuant to Section 8(e) of the Bank and Corporation Franchise Tax Act and that the action of the Commissioner in disallowing such deductions and in denying the Appellant's claim for refund with respect thereto was improper.

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 Hon. Chas. J. McColgan, Franchise Tax Commissioner, in denying the claim of the First Federal Savings and Loan Association of Hollywood for refund of taxes in the total amount of \$1 075.45 paid for the taxable years ended December 31, 1935, 1936, 1937 and 1938 be and the same is hereby modified. Said action is

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reversed insofar as the Commissioner denied the claim for refund to the extent of \$1,062.13 thereof and said action is sustained with respect to the denial of the balance of \$13.32 of said claim. The Commissioner is hereby directed to refund or to give credit to the First Federal Savings and Loan Association of Hollywood for said amount of \$1,062.13 paid by said Association for said years and otherwise to proceed in conformity with this order.

Done at Sacramento, California, this 26th day of September, 1939, by the State Board of Equalization.

R. E. Collins, Chairman
Fred E. Stewart, Member
Wm. G. Bonelli, Member
George R. Reilly, Member

ATTEST: Dixwell L. Pierce, Secretary