BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal Of)
)
C. E. TOBERMAN COMPANY)

Appearances:

For Appellant: C. E. Toberman, President

For Respondent: Burl D. Lack, Chief Counsel; Hebard P. Smith, Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to Section 25 of the Bank and Corporation Franchise Tax Act (Chapter 13, Statutes Of 1929, as amended) from the action of the Franchise Tax Commissioner (now succeeded by the Franchise Tax Board) on the protest of C. E. Toberman Company to a proposed assessment Of additional tax in the amount of $635.84 for the income year 1948.

Appellant was organized in 1912 to carry on a real estate business. In 1914 the Hollywood Improvement Company was created for the purpose of constructing buildings and handling them for Appellant. During the depression the Hollywood Improvement Company became involved in financial difficulties and in 1932 the El Capitan Building Company was formed for the purpose of separating a theater and department store building from the assets of the Hollywood Improvement Company, this property to be owned and managed by the newly formed corporation. The Home and Commercial Builders, Inc., was organized in 1939 to carry on certain real estate development activities. Appellant owns all the stock of Home and Commercial Builders, Inc., and all the stock and bonds of El Capitan Building Company. The three corporations have common officers and directors and are operated from the same office by the same personnel.

For the income year 1948, Appellant's real estate and insurance brokerage activities resulted in a net profit, but the operations of the El Capitan Building Company resulted in a net loss. The only activity of Home and Commercial Builders, Inc., during the year appears to have been the payment of taxes in the amount of $2252.53. The three corporations filed a consolidated return for this period on the basis that the filing of such a return is authorized by Section 14 of the Bank and Corporation Franchise Tax Act when the corporations are owned or controlled by the same interests and are operated as a single business. The Commissioner, however, being of the

opinion that the filing of the consolidated return was not authorized, has recomputed the tax of Appellant on the basis of its own income and levied the proposed assessment in question accordingly.

In support of its position Appellant states that consolidated returns were accepted by the Franchise Tax Commissioner for the years 1931 to 1934, inclusive; that a consolidated federal income tax return was filed by the corporations for 1948, the income year here involved; and that the corporations and their activities are closely allied or related and, therefore, consolidation is permitted by Section 14.

The acceptance of the consolidated state returns for the earlier years and of the federal return for 1948 furnishes no precedent or parallel, however, for the acceptance of a consolidated state return for 1948. Prior to 1935, Section 14 of the Bank and Corporation Franchise Tax Act expressly permitted the filing of consolidated returns. Stats. 1929, p. 26; Stats. 1931, p. 63; Stats. 1933, p. 690. While the 1935 amendment to the Section removing this privilege (Stats. 1935, p. 998) was applicable to the income year 1934 (Stats. 1935, p. 1246), the filing of the consolidated return for that year did not result in an understatement of tax liability inasmuch as each of the corporations involved had a net loss. So far as the federal return for 1948 is concerned, it should be observed that Section 141 of the Internal Revenue Code confers on affiliated corporations generally the privilege of filing consolidated returns. The California Act does not contain any provision as extensive as Section 141, the right to file a consolidated return granted by Section 13½ of that Act being restricted to an affiliated group of railroads.

The first paragraph of present Section 14 of the State law, upon which the Appellant necessarily relies, merely grants to the administrative agency authority to permit or require the filing of a combined report in certain cases and to impose the tax as though the combined net income was that of one corporation, or to distribute, apportion or allocate gross income or deductions between corporations, if it determines that such action is necessary in order to prevent evasion of taxes or clearly to reflect the income of the corporations involved. This provision, while slightly broader in scope, is of the same general character of Section 45 of the Internal Revenue Code and its wording clearly indicates that it is the California counterpart of that Section and is to be construed only as a grant of authority to the administrator. The Federal regulations have provided for a long period that Section 45 "... grants no right to a controlled taxpayer to apply its provisions, nor does it grant any right to compel the Commissioner to apply such provisions." Treasury Regulations: 111, Section 29.45-1; 103, Section 19.45-1; 101, Article 45-1; 94, Article 45-1; 86, Article 45-1. See also Sherman, a Case History of Section 45 (January, 1951) 29 Taxes 13.

We are of the opinion, accordingly, that Section 14 of the Bank and Corporation Franchise Tax Act does not authorize the filing by Appellant of a report in which its income is combined with that of its affiliates. The owners of Appellant's capital stock having elected to transact business through three separate corporations must, therefore, accept the tax consequences of that action. See Higgins v. Smith, 308 U.S. 473.

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 25 of the Bank and Corporation Franchise Tax Act (Chapter 13, Statutes of 1929, as amended), that the action of the Franchise Tax Commissioner (now succeeded by the Franchise Tax Board), on the protest of C. E. Toberman Company to a proposed assessment of additional tax in the amount of $635.84 for the income year 1948 be and the same is hereby sustained.

Done at Sacramento, California, this 15th day of February, 1951, by the State Board of Equalization.

J. H. Quinn, Chairman
Geo. R. Reilly, Member
J. L. Seawell, Member
Wm. G. Bonelli, Member

ATTEST: Dixwell L. Pierce, Secretary