



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

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

Appearances:

For Appellant: Price, Postel & Parma, Attorneys at Law
For Respondent: Burl D. Lack, Chief Counsel;
John S. Warren, Associate Tax 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 protests of Citizens Savings and Loan Association to proposed assessments of additional franchise tax in the amounts of \$3,054.79 and \$4,347.66 for the income years 1952 and 1953, respectively.

The sole issue in this appeal is the propriety of the disallowance by the Franchise Tax Board of deductions claimed by Appellant for bad debt expense on a reserve basis for the years in question.

Appellant has been in business in California since 1887, first as a building and loan association and later as a savings and loan association. For many years Appellant has maintained loan reserve accounts to meet losses in general as required by California's Building and Loan Association Law (now Savings and Loan Association Law) and by the Federal Savings and Loan Insurance Corporation. It did not maintain a separate reserve for bad debts and, at least since the year 1928, has not incurred any actual bad debt losses. For the income years 1952 and 1953, it nevertheless claimed deductions on its franchise tax returns as additions to a bad debt reserve. In 1956, Appellant for the first time requested and received from the Franchise Tax Board permission to deduct for bad debts on the reserve method.

Section 24348 (formerly 24121f) of the Revenue and Taxation Code allows a deduction for bad debts "... or, in the discretion of the Franchise Tax Board, a reasonable addition to a reserve for bad debts."

The regulations of the Franchise Tax Board provide that a taxpayer-ma-y--elect either the reserve or the specific charge off method in his first return, subject to approval by the

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Franchise Tax Board, and that permission of the Franchise Tax Board must be requested before a change in method is adopted. The regulations also provide that a taxpayer who has established the reserve method and maintained proper reserve accounts may deduct a reasonable addition to the reserve. (Title 18, California Administrative Code, Sections 24121f(1) and 24121f(4).) These regulations were issued on June 28, 1952.

In an appeal involving facts substantially identical to those now before us, we have previously upheld the action of the Franchise Tax Board in disallowing deductions for bad debts on the reserve method.-(Appeal of Silver Gate Building and Loan Association, Cal. St. Bd. of Equal?, Aug.19, 1957 (CCH, 2 Cal. Tax Cases, Par. 200-379), (P-H, St. & Loc. Tax Serv., Cal., Par. 13,165).)

In the course of our opinion we pointed out that the association there involved was aware of a certain ruling made by the Franchise Tax Commissioner in 1943, specifically requiring building or savings and loan associations to file a statement of their election to use the reserve method. We also pointed out that return instructions sent to such associations in the years 1950 through 1952 specified that permission must be obtained to use the reserve method. Regulation 24121f (supra) was not published until after the first of the two income years involved in that appeal.

The only distinction advanced by Appellant here is that it was unaware of the 1943 ruling of the Franchise Tax Commissioner. Appellant does not deny, however, that it received the above-mentioned return instructions. Moreover, Regulation 24121f (supra) made it clear that the adoption of a reserve method was subject to the approval of the Franchise Tax Board, even if, as Appellant argues, the 1952 return was its "first return" within the meaning of the regulation. Obviously, the Franchise Tax Board did not approve the use of that method in the 1952 or the 1953 return.

The following statement in the Silver Gate opinion is applicable here:

"The Legislature by its enactment of Section 24348 of the Code has made the deduction of a reasonable addition to a reserve for bad debts subject to the discretion of the Franchise Tax Board. Unless the disallowance by the Franchise Tax Board of the deduction claimed by Appellant was arbitrary and capricious, constituting a clear abuse of the discretion vested in that Board, its action must be sustained. No such abuse of discretion has been demonstrated. In many years of operation Appellant

