① Deduction by Credit U[illegible] funds invested in a Credit Union B

66-SBE-038

② Deduction from sale of office furniture to non-members

③ Deduction of interest expense on borrowed funds.

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of)
)
LOS ANGELES FIREMEN'S CREDIT UNION, INC.)

For Appellant: F. Moldenhauer
Certified Public Accountant

For Respondent: Crawford H. Thomas
Chief Counsel

Dennis Todd
Legal Assistant

O P I N I O N

These appeals are made pursuant to section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of Los Angeles Firemen's Credit Union, Inc., against proposed assessments of additional franchise tax in the amounts of $1,119.72, $2,711.69, $2,702.91, $1,453.52, $2,630.05, and $6,056.84 for the income years ended October 31, 1958, 1959, 1960, 1961, 1962, and 1963, respectively.

The proposed assessments concern the application of section 24405 of the Revenue and Taxation Code, which allows cooperative or mutual associations such as appellant credit union to deduct from the measure of their franchise taxes "... all income resulting from or arising out of business activities for or with their members carried on by them or their agents; or when done on a nonprofit basis for or with nonmembers ..."

The questions presented are (1) whether appellant may deduct income from investments of funds in credit unions which are not members of appellant; (2) whether appellant may deduct income from the sale of office furniture and equipment to nonmembers; and (3) whether appellant may deduct interest expense on borrowed funds. Questions substantially identical with all of these have been considered in prior cases.

1. The first question is substantially the same as that which was answered in Woodland Production Credit Ass'n v. Franchise Tax Board, 225 Cal. App. 2d 293 [37 Cal. Rptr. 231]. There, a credit association in the business of making loans to its members received interest from investments in United States bonds. Reasoning that section 24405 was intended to exclude from tax the savings or price adjustments produced by a cooperative in carrying out the purpose for its existence, the court concluded that the statutory phrase "business activities" applies only to a cooperative's transactions with or as agent for its patrons. The court held that the investment of reserves or surplus in interest-bearing securities is not a business activity for the purpose of the statute and that the bond interest was, therefore, not deductible. Based upon the Woodland case, we have denied to a credit union a deduction of income from investments of funds with a savings and loan association. (Appeal of So. Calif. Central Credit Union, Cal. St. Bd. of Equal., Feb. 3, 1965.)

Appellant has referred to a letter of February 1963 in which respondent advised Orange County Teachers Credit Union that income from loans to another credit union was deductible. In July 1963, however, respondent informed Orange County Teachers Credit Union that its February letter was intended to apply to those cases where the borrower was a member of the lender.

Upon the authority of Woodland Production Credit Ass'n v. Franchise Tax Board, supra, and consistent with our decision in Appeal of So. Calif. Central Credit Union, supra, appellant may not deduct income from its investments of funds in credit unions which are not members of appellant. Those investments are not the "business activities" referred to in section 24405.

2. For the same reason, appellant may not deduct the income from the sale of office equipment and supplies to nonmembers. We have previously held, under the predecessor of section 24405, that an association could not deduct the income from the sale of an automobile used in its business. (Appeal of Calif. Pine Box Distributors, Sept. 15, 1949.)

3. In Appeal of So. Calif. Central Credit Union, supra, we held that the credit union there involved could not deduct interest expense incurred in borrowing funds. We stated that:

> Clearly, appellant's purpose in securing additional funds was to meet the demand of its members for loans. The cost of borrowing such funds, therefore, is allocable to business done with members. Since the income from business with members is not taxable,

> the expenses allocable thereto are not deductible. (Rev. & Tax. Code § 24425; Security-First Nat'l Bank v. Franchise Tax Board, 55 Cal. 2d 407, 424 [11 Cal. Rptr. 289, 359 P.2d 625], appeal dismissed, 386 U.S. 3 [7 L. Ed. 2d 16].)

No distinguishing facts or arguments have been presented in the case now before us. We conclude, therefore, that appellant is not entitled to deduct the interest expense which it incurred in borrowing funds.

Consistent with prior decisions on questions substantially the same as those presented here, we must sustain respondent's action in disallowing the deductions claimed by appellant.

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 protests of Los Angeles Firemen's Credit Union, Inc., against proposed assessments of additional franchise tax in the amounts of $1,119.72, $2,711.69, $2,702.91, $1,453.52, $2,630.05, and $6,056.84 for the income years ended October 31, 1958, 1959, 1960, 1961, 1962, and 1963, respectively, be and the same is hereby sustained.

Done at Pasadena, California, this 28th day of June, 1966, by the State Board of Equalization.

_____, Chairman

_____, Member

_____, Member

_____, Member

_____, Member

ATTEST: _____, Acting Secretary