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PART TWO

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ANALYSIS

of the

BANK AND CORPORATION FRANCHISE TAX ACT

by

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January 1933
RECOMMENDATIONS REGARDING THE
BANK AND CORPORATION FRANCHISE TAX ACT
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PART II

If California retains the Bank and Corporation Franchise Tax Act and continues to tax certain corporations according to or measured by their net income there are several changes in the interests of understandability and fairness both to the taxpayer and to the State that must be made. Problems that demand immediate attention and suggested solutions of these problems are presented in the following pages, and, where deemed required, various proposed amendments set forth.

Section 3

The Real Estate Tax Offset is Probably Invalid and Should be Abolished

Although the constitution provides for the offset of personal property taxes for corporations other than banks, it does not expressly provide for any offset whatever for banks, and furthermore, as to the tax on banks, it expressly states that, "The amount of the tax shall be equivalent to 4% of their net income." The act was passed under this constitutional provision. Section 3 allows banks an offset of 10% of the taxes paid upon their real property with the proviso that the total amount of the offset shall not exceed 75% of the total tax under this section. That this provision violates the constitutional section is arguable on several grounds.

In the first place, if an offset is allowed banks, the tax is obviously not "4% of their net income" but something else, namely, 4% of their net income less the deductions allowed. Thus; the form of taxation is not that contemplated by the wording of subdivision 1 (a)
of the constitutional amendment. It must be noted, however, that subdivision 1 (b) of that amendment provides:

"The legislature, two-thirds of all of the members elected to each of the two houses voting in favor thereof, in lieu of such tax, may provide by law for any other form of taxation now or hereafter permitted by the congress of the United States respecting national banking associations; provided, that such form of taxation shall apply to all banks located within the limits of this State."

Although the statute might not conform with 1 (a) it might still be valid if the tax is one "permitted by the congress of the United States respecting national banking associations."

The legislature was apparently acting to accomplish the tax permitted by the fourth alternative of Section 5219, namely, a tax upon national banks, "according to or measured by their net income," therefore, the validity of the statute under 1 (b) and Section 5219 depends on whether or not the statute, with the offset provisions allowing deductions for real property taxes, provides for a tax "according to or measured by net income."

A contention that the statute does not provide a tax "according to or measured by net income" may be based upon the argument that to allow such offset is to levy a tax that is not strictly measured by net income but by net income less something else; for, although net income enters into the computation of the tax, the amount of the tax is nevertheless, seriously affected by a deduction whose amount is independent of income. Although the court might perhaps meet this objection with the simple proposition that the tax in question comes fairly within the meaning of the phrase, "according to or measured by net income" it is none-the-less true that the net income measures not the tax but merely a sum intermediate the calculations thereof.

The offset provision may possibly render the statute invalid in that it results not only in a discrimination between banks not contemplated by Section 5219 but in a discrimination that amounts to a denial of
equal protection of the laws prohibited by the Fourteenth Amendment to the federal constitution. An example will clearly bring out the nature of the discrimination effected by the offset provisions of the statute. Let us assume two national banks, Bank A and Bank B, with an equal net income of $100,000 a year so that upon this basis their franchise tax as 4% of that income would be $4,000 each. Bank A has real property upon which it pays $20,000 taxes. Bank B rents its premises, has no real property and therefore pays no real property taxes directly for which it may get an offset. Bank A gets a deduction of 10% of its real property taxes up to 75% of 4% of its net income or in other words, a deduction of $2,000. As a result Bank A pays a $2080 tax, ($2,000 plus 4% of the offset), while Bank B pays $4,000. According to their net income, these banks should be taxed equally, yet Bank B is required to pay a tax twice as great as that exacted from Bank A. It is no answer to say that Bank B has paid no real estate taxes directly and that this factor should affect the comparison. Section 5319 contemplates that, in addition to the usual ad valorem taxes upon real estate owned by them national banks may be taxed, "according to or measured by" their net income. To inject the element of real estate taxes paid as a direct offset from a tax calculated at a percentage of net income seems not only an unwarranted variation from the method prescribed but a denial of equal protection of the laws as well.

Discrimination within the meaning of the equal protection of the laws clause is defined as "the act of treating differently two persons or things, under like circumstance" (Mr. Justice Brandeis, dissenting in National Life Insurance Co. v. United States (1928) 277 U.S. 508,48 Sup. Ct. 591, 597). When different treatment is accorded two persons and one invokes the equal protection clause, the question to be decided is whether there is any dissimilarity between their situations of a kind and degree which will justify the unlike treatment complained of.
In the case supposed the unlike treatment consists of unequal franchise-taxes—measured-by-net-income imposed upon two banks whose net incomes are identical. The dissimilarity of situation, which creates and must justify the inequality of taxation, is the circumstance that one of the banks owns real property and the other does not. It is submitted that there is no relation whatsoever between the unlike treatment here involved and the dissimilarity of situation upon which it rests. It is questionable whether ownership of real estate or ownership of anything else is a sufficient basis for exemption from franchise taxes imposed upon others of the same class as the favored taxpayer.

Another constitutional problem is raised by the offset of real property taxes under the provisions of Section 4 of the statute. The constitutional provision for a tax offset for financial mercantile, manufacturing and business corporations, specifically mentions personal property taxes but does not mention real property taxes, viz:

"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, but the offset shall not exceed ninety per cent of such state tax." (Emphasis added).

And subdivision 3 of the constitutional provision reads:

"The Legislature, two-thirds of all the members elected to each of the two houses voting in favor thereof, may change by law the rates of tax, or the percentage, amount or nature of offset provided for in paragraphs 1 and 2 hereof." (Emphasis added).

The question immediately arises whether the word "nature" as used in the constitutional provision will be so construed by the courts as to justify the offset of real property taxes paid upon the corporations' property as provided in Section 4 of the statute.

It should be noted that besides the provision for offset of a percentage of real property taxes the statute differs from the amendment in eliminating an offset for personal property taxes paid to the state and allows an offset for taxes paid "upon" the corporations' property.
rather than taxes paid "by" the corporations as provided in the constitutional provision. (The corporate franchise tax assessed under Section 14d of Article XIII would seem clearly to be a personal property tax paid to the state in view of the definition of "property" contained in Section 1 of Article XIII, namely: "The word 'Property' as used in this article and section, is hereby declared to include moneys, credits, bond stocks, dues, franchisee, and all other matters and things, real, personal and mixed capable of private ownership ...." See also, People v. Alaska S.S. Co. (1920) 182 U.S. 202. To have permitted the franchise tax for 1929 to be offset by the 1928 franchise tax would have reduced the 1929 tax in most instances to a relatively insignificant amount and in many instances to nothing at all. If any substantial revenue was to be expected from the new tax it was absolutely necessary to eliminate the provision for offset of personal property taxes paid to the state.

It might be plausibly argued that eliminating the offset for personal property taxes paid to the state and allowing an offset for taxes paid "upon"the corporations' property changed the "nature" of the offset within the authority of subdivision 3 of the amendment, but, in providing for an offset of real property taxes, something additional is added which can hardly be considered the "offset provided for." The offset the "nature"of which may be changed, is the offset "provided for"in paragraph 2. Real property tax offsets are not mentioned in that paragraph. Is it merely "changing the nature of the offset provided for" to add an entirely new offset? If the word "nature" is broad enough to cover the offset of real property taxes paid in this state, it should be broad enough to cover the offset of taxes paid in any other state, or in fact, to cover any kind of offset the legislature sees fit to grant.

Proposed Amendment:

Repeal the second paragraph of Section 3.
The commission which recommended the personal property tax offset admitted that it was defensible only as a temporary expedient until all personal property taxes should be abolished and a state wide income tax on all corporations and individuals should be established. In the words of the commission, "It was obvious from the beginning that the allowance of the offset would involve certain administrative difficulties and would offer opportunities for abuse through collusion with the local assessors, which would grow more and more serious with the passage of time... As a permanent feature the offset provision is faulty..." (Final Report of the California Tax Commission, 1929, p. 78)

If all personal property taxes are not abolished and the present offset remains in the Bank and Corporation Franchise Tax Act, the corporations taxable thereunder will be given an advantage not afforded other taxpayers. Prior to the enactment of this act all taxpayers were taxed upon their property, and according to Article XIII section 1 of the state constitution: "All property in the state except as otherwise in this constitution provided not exempt under the laws of the United States shall be taxed in proportion to its value, to be ascertained as provided by law, or as hereinafter provided. The word 'property' as used in this article and section, is hereby declared to include moneys, credits, bonds, stocks, dues, franchises, and all other matters and things real, personal and mixed, capable of private ownership; ..."

The gross receipts tax on public utilities is a property tax and is justifiable when imposed upon utilities engaged in interstate commerce only as a property tax. (Pullman Co. v. Richardson, 185 Cal. 484, 361 U.S. 330). In other words corporations until 1929 were taxed upon their property the same as other taxpayers in the state. The franchise tax measured by corporate excess was designed to reach other property values not touched by the other real and personal property taxes. The corporate excess or the difference between the value of the corporation's
outstanding stocks and bonds as determined by market quotation, the earnings of the company, or otherwise, and the value of its tangible or physical properties" (Miller and Lux v. Richardson (1920) 132 Cal. 115) was just as much property as any tangible property owned by the corporation and was taxable as such. (Adams Express Co. v. Ky. (1897) 188 U.S. 171; Adams Express Co. v. Ohio State Auditor (1897) 185 U.S. 194). The present act substitutes a tax measured by net income for the tax on corporate excess. If a net income tax is substituted for a tax on some of the property of certain corporations fairness and equality would seem to demand that a net income tax should be substituted for the tax on some of the property of other corporations and individual taxpayers. This discrimination would seem to be objectionable enough but to go farther and permit an offset from the income tax of personal property taxes, adding thereby one discrimination to another, is indefensible. If corporations are allowed an offset from the tax, substituted for the tax on some of their property why should not other taxpayers be allowed an offset from the tax on some of their property?

In view of the wide power of the state to classify for purposes of taxation it is doubtful if any attack can be made by corporations other than national banks upon the personal property tax offset on constitutional grounds. As regards national banks, however, a very serious constitutional objection may be raised. Section 5219 of the United States Revised Statutes provides that the rate of tax on national banks "shall not be higher than the rate assessed upon other financial corporations nor higher than the highest of the rates assessed by the taxing state upon mercantile, manufacturing and business corporations doing business within its limits." If a four per cent rate is imposed upon banks and the same rate upon other corporations but the other corporations are allowed to offset their tax so that the rate upon them is actually less than 4% there would seem to be a clear violation of the restriction in Section 5219. This conclusion, however, is by no means free from doubt. National banks are not taxed upon their personal
property but corporations other than banks and public utilities are so taxed. The state as a matter of fact does not impose a discriminatory tax burden upon banks but even with the personal property tax offset actually imposes, when compared with the bank tax, a discriminatory burden upon other corporations. But inasmuch as national banks cannot be taxed upon their personal property (Rosenblatt v. Johnston (1881) 104 U.S. 462) it may be argued that when franchise taxes, or their equivalent, are imposed upon national banks, state banks, and other corporations, and a percentage of the amount of personal property taxes paid by the other corporations is allowed as an offset from the franchise tax, national banks are deprived of their exemption from personal property taxes and in effect, contrary to the provisions of Section 5219, required to pay personal property taxes to the state. (National Life Insurance Co. v. United States (1928) 277 U.S. 508, 48 Sup. Ct. 591; see 17 California Law Review 504-507 for an analysis of this case and its relation to the offset provisions of the California statute).

Recommendation:
Repeal the second paragraph of Section 4.
Effect of Elimination of Offsets

Economic analysis with statistics in support thereof prepared by Mr. McCollgan to be inserted here.

The offset has reduced the yield ...........$ ..........$

Rate of Tax to produce same yield without offsets ...........
Section 4 (Continued)

Massachusetts or Business Trusts are not Taxable Under the Act

The words "for the privilege of exercising its corporate franchises" probably prohibits the levying of the tax upon Massachusetts or business trusts, joint stock associations and limited partnerships.

Section 16 of Article XIII of the constitution is perhaps responsible for this provision. That section states that the tax is on "corporations" and is "for the privilege of exercising their corporate franchises" so that even if the statute omitted the language quoted it might be held that the constitutional section limited the tax to formally created corporations only. There is no reason why business trusts should be exempt from this tax and perhaps the same is true of joint stock associations and limited partnerships. For most business and financial purposes organizations of this kind are indistinguishable from corporations. The State Board of Equalization in its report for 1923-24 stated at page 9 that business trusts are becoming quite common in this state and since they came directly into competition with, as well as frequently take the place of, California business corporations which are required to pay a franchise tax in this state it would be quite proper to put such organizations on the same or similar basis and require a business tax from them also. In view of the fact that they enjoy the same privileges and advantages as other business organizations which are required to pay a tax for such privileges, the board felt that equitable treatment would require that they also be subjected to a tax on license. They are taxable as corporations under the federal revenue act. (Hecht v. Mutley (1924) 265 U.S. 144, 44 Sup. Ct. 462)

This loophole in the law should be closed. In view of the recent decision of the California Court in Goldwater v. Oltman (1930) 80 Cal. Dec. 382, holding that members of a business trust may gain the advantage of immunity from partnership liability, (heretofore afforded only by incorporation or the formation of limited partnerships) if the de-
claration of trust is so drawn as to give shareholders or associates no substantial control over the trustee, it is quite likely that the number of such organizations will greatly increase in this state.

Can these associations be taxed under the act by defining the word "corporation" in such manner as to include them? Congress has so defined corporations in section 701 of the Federal Revenue Act of 1938. Congress, however, did not have a constitutional provision similar to section 16 expressly stating that "corporations" were to pay the tax, or language to the effect that the tax was "for the privilege of exercising their corporate franchises."

Section 16, however, provides that the legislature shall define "corporations". To define "corporations" to include organizations that for most business and financial purposes are indistinguishable from formally created corporations, that enjoy the same privileges and advantages, that come directly into competition with and take the place of corporations subject to the tax, could hardly be said to be an abuse of the power granted to define this term. It would seem therefore that the legislature may include these organizations in its definition of "corporations". It is doubtful, however, whether this is sufficient to enable the legislature to subject them to the tax under the act in view of the language of Section 16 not only that the tax is for the "privilege of exercising their corporate franchises" but is upon "corporations subject to be taxed pursuant to subdivision (d) of this article." It is thus not enough that they may be now considered corporations - they must also have been taxable under Section 14 (d). These organizations probably could be held to be corporations within the meaning of Section 14 in view of the broad definition of the word companies contained in the first paragraph of that section: "The word 'companies' as used in this section, shall include persons,
partnerships, joint stock associations, companies, and corporations. But as noted above, the difficulty is not so much whether or not they are corporations but whether they had any franchises subject to be taxed under 14 (d) for unless they did they are not taxable under Section 16. It would seem that associations of this kind operating simply by agreement between the members without any franchises are not exercising a "corporate franchise" within the meaning of Section 16 and that they did not have any franchises taxable under 14 (d).

If it were not for the provisions of Article IV Section 24 of the state constitution providing that "Every act shall embrace but one subject, which subject shall be expressed in its title" it might be possible to impose in one and the same statute a franchise tax on banks and corporations pursuant to Section 16 and under the reserved powers of the state an excise or license tax on the associations in question measured by net income. There can be little doubt that the state has power independently of Section 16 to tax these associations, but inasmuch as such tax would not be passed in pursuance of Section 16 it probably cannot be included in a statute whose title states that it is passed under that section nor can it have two titles, for it would then be embracing more than one subject.

Recommendation:

In view therefore of the probable invalidity of an attempt to reach these associations under the Bank and Corporation Franchise Tax Act it would seem advisable to enact a separate statute subjecting them to the tax. The separate statute, if the legislature desires to tax them according to net income could repeat or incorporate by reference the applicable provisions of the bank and corporation franchise tax act. If the state returned to the method provided in Section 14d for the taxation of the franchises of corporations a property tax should be levied upon the "going concern" value of these associations. Although the California Constitution does not in express language authorize such a tax express authority is unnecessary in view of the well established rule that the (cont. page 13)
or the value of the privilege of doing business with limited liability as quasi-corporations as well as upon the value of any secondary franchises possessed by them.

In any event, whether an income tax or a property tax is imposed upon these associations the problem will arise of learning when such associations do business here. There is no provision in the existing statutes that will enable those in charge of the administration of the revenue laws to determine the existence of such concerns in the state and to reach all of them, that are doing business here. It is therefore recommended that the legislature provide for the registration of business trusts with the Secretary of State and county clerk of any county in which they do business. Those administering the tax could then obtain the lists of such associations and require returns disclosing their taxable values and such other information that may be necessary to determine the tax that should be assessed upon them.

Section 5.

The Present Definition of "Doing Business" is Unsatisfactory

Even though there are no "transactions in the course of its business by a corporation created under the laws of this state or by a foreign corporation qualified to do business in this state" such corporations are, under the latest definition, by legislative fiat, "doing business" if they merely enjoy the "right to do business." It is difficult to understand how having the "right to do" something can sensibly be "doing" that something. The Legislature, as a result of

(1) continued from page 18

constitutions is a restriction rather than a grant of power to the legislature, and in view of the rule that that body has unlimited power with regard to taxation except as restricted by the constitution itself or by the United States Constitution. In re Madera Irr. Dist. (1881) 32 Cal. 296, 23 Pac. 372; Beals v. Amador County Supervisors (1889) 35 Cal. 624.
this amendment, has, under the guise of defining terms, actually changed the nature of the tax imposed upon some corporations from an excise tax on the doing of business to a license tax on the right to do business. The 1929 act and the 1931 amendments were enacted pursuant to the provisions of Section 16 of Article XIII of the State Constitution. Although that section authorizes the Legislature to define various terms, including the term "doing business" it is doubtful whether that body can constitutionally provide for a different tax from that authorized simply by the engaging device of defining terms. It would seem, therefore, that unless under Section 16, or under authority independently thereof, the Legislature can impose a license tax upon the right to do business the 1931 amendment is of questionable validity. The practical results of the amendment, if valid, are to set at rest any question as to whether or not business corporations that merely perform acts going to the maintenance of corporate existence are "doing business" (the question whether or not a particular corporation, e.g. a holding company, is a "business corporation" within the act is apparently not affected by the amendment) to increase the number of corporations subject to the minimum tax of $25 and probably in some cases to subject domestic corporations, not actually doing business, to a greater tax than the minimum because of their receipt of dividends declared out of income from business done without the state.

The validity of the 1931 amendment (which was adopted by the two thirds vote prescribed in section 16) assuming that it provides a different method of taxing corporate franchises from that expressly set forth in paragraph 2 (a) of Section 16, and assuming that paragraph 2 (b) impliedly limits the Legislature and makes Section 16 the sole source of legislative authority to impose taxes on the kind of corporations referred to therein, will depend upon (1) whether a corporation which would be taxed under the amendment was taxable under Article XIII, Section 14d; (2) whether this different method is "provided by law" when done under the guise of defining the terms of the old method; and
whether this new method is "authorized in" the State Constitution. If the source of legislative authority to impose this tax is Section 16 the amendment as regards foreign corporations fails to meet the first requirement and as regards such corporations it is therefore unnecessary to consider the other two requirements. The case of People v. Alaska S.S. Co. (1920) 182 Cal. 202, definitely held that foreign corporations qualified to do intrastate business in this state but not exercising such right were not taxable under Section 14d, and, as noted above, taxability under Section 14d is a condition precedent to taxability under Section 16.

Foreign corporations doing exclusively interstate business in the state are of course not subject to a franchise tax. (Alpha Portland Cement Co. v. Mass. (1925) 268 U.S. 203). As to domestic corporations the amendment complies with the first requirement, for the theory of the old franchise tax as set forth in the cases seems to support the contention that such corporations were taxable under Section 14d although not actually doing business. (People v. Ford Motor Co. (1922) 188 Cal. 8, at p. 10; Miller & Lux v. Richardson (1920) 182 Cal. 115; People v. Alaska S.S. Co. (1920) 182 Cal. 202 at 205. See also a direct statement to this effect in The Matter of Magalia Mining Co. Opinion of the State Board of Equalization January 7, 1930). Assuming that by changing the definition of terms the Legislature is providing by law for a new method of taxing corporate franchises, the question presented by the third requirement is whether this new method is authorized in the Constitution. What is meant by "any other method authorized in this constitution?" Do these words mean that the other method must be expressly set forth in the Constitution, or do they refer to any method that is constitutional? The only methods expressly authorized in the Constitution for the taxation of corporate franchises which were taxable under Section 14d are the methods set forth in Section 16 and in Section 14d. The tax expressly set forth in Section 16 is upon corporations only that are "doing business." The tax provided in Section 14d is a property tax and
franchises taxable thereunder must be taxed at their full cash value. (Miller & Lux v. Richardson, supra) It is arguable whether a tax on the right to do business can be considered a property tax and whether measuring the value of the right by the net income of the corporation or by a flat tax of §25 is taxing such franchises at their full cash value. If the words "authorized in this constitution" mean "constitutional" the method employed need not be expressly authorized in the Constitution and the amendment is within the authority of the Legislature for a license tax on the right to do business is apparently constitutional. (Kaiser Land Co. v. Curry, 155 Cal. 638; Los Angeles v. Los Angeles etc. Co., 152 Cal. 765)(1) It may be argued, however, that this interpretation would render superfluous the words "authorized in this constitution" for obviously any method of taxation must be constitutional regardless of express conditions so stating.

It may be argued that Section 16 does not impliedly limit the authority of the Legislature to impose other taxes on corporations, including corporations of the kind referred to in Section 16; in other words that the Legislature has authority independently of that section to impose the tax contemplated by the amendment. (Kaiser Land Co. v. Curry, supra). Suppose the Legislature desired to impose a license tax on foreign corporations having the right to do intrastate business in California but not exercising such right or desired to impose a license tax in addition to that contemplated by Section 16 on corporations taxable thereunder. That section provides that the tax therein provided for shall be in lieu of the tax imposed by Section 14d of Article XIII, but does not state that it shall be in lieu of any other tax. Likewise, the different method sanctioned by paragraph 2b of Section 16 is in lieu of the method expressly set forth in paragraph 2a of Section 16 but is in lieu of no other tax. It would seem reasonable to hold, therefore, that Section 16 applies only to the particular tax provided for

(1) See Footnote (1) supra -16-

pp 12 -13
therein, but imposes no limits upon any additional or different tax the Legislature may impose on corporations. According to this argument a license tax on foreign corporations of the type mentioned and on domestic corporations generally, would be valid under the general legislative authority and the limitations of Section 16 would have no bearing upon the validity of the tax. An objection to this argument in support of the 1931 amendment, assuming that the legislature has authority independently of Section 16 to impose a license tax, may be based on the insufficiency of the title of the amendment. The title of the amendment reads as follows: "An act to amend sections 5, 8, 9, 10, 25, 32, 33 and 35 of the bank and corporation franchise tax act, approved March 1, 1929, relating to bank and corporation taxes." The title of the Bank and Corporation Franchise Tax Act referred to in the title just quoted reads as follows: "An act to carry into effect the provisions of Section 16 of Article 13 of the constitution of the state of California, relating to bank and corporation taxes." An act which is not passed to carry into effect the provisions of Section 16 and which is valid only because not passed under Section 16 is probably not valid under such a title in view of the requirements of Article IV, Section 24 of the State Constitution, that "Every act shall embrace but one subject, which subject shall be expressed in its title......"

In the light of the argument just given it would seem that the only way to reach corporations that are not actually "doing business" is to enact a separate act imposing a license tax upon them.

Recommendations:

(1) It may be that the state should omit any definition of doing business. But since Section 16 states that the Legislature "shall" define corporations it is probably desirable to define the term. The following is submitted as a more understandable definition than the present: "Doing business means any transaction with any person or persons or any transaction concerning any property through any agency whatever acting for any bank or corporation."
(2) Enact a separate statute imposing a license tax on the right to do business of business corporations not taxable under the Bank and Corporation Franchise Tax Act, or otherwise taxed on their franchises, if the legislature desires to reach such corporations. The tax should be nominal for otherwise it will discourage incorporation in this state.

(3) All definitions should be in the same section, e.g. the definitions in section 5 and section 11.

Are Holding Companies Taxable Under the Act?

It is questionable whether holding corporations are included in the taxable classes mentioned in Section 4. Whether they are or not will depend upon the answers to two separate questions: (1) Are holding companies "business" corporations? (2) Do holding companies "do business"? Both questions must be answered affirmatively to render such corporations taxable under the act. If the 1931 amendment to the definition of "doing business" is valid and if they are "business corporations" any doubts as to whether or not they are "doing business" are removed for it is difficult to think of a "business corporation" not having the "right to do business." That amendment, however, has little bearing upon the answer to the first question. The answer to the second question, on the other hand, would seem to depend entirely upon the answer to the first question. If holding companies are not business corporations and if they have only the right to carry on their activities as such non-business corporations, the right to carry on such activities -- in other words, the right to carry on something that is not business -- cannot be the right to do business and thus cannot be doing business within the meaning of the 1931 amendment to the definition of those words. The problem thus resolves itself into a determination of whether or not holding companies are business corporations.
Are Holding Companies Business Corporations? In view of the fact that the wording of the statute incorporates the wording of Section 5219 it would seem that judicial determination of the term "business corporation" as used in that section would determine the definition of the term as used in the California statute. However, since there has been no decision upon this point under Section 5219, we must turn to other decisions for assistance in determining the nature of a business corporation and we find numerous cases supporting the view that any corporation whose purpose is that of personal material gain of a pecuniary nature to its members is a business corporation.

McLeod v. Lincoln Medical College of Cotner University (1903) 69 Neb. 550, 553, 93 N.W. 256, 263

The character of a corporation is determined from its articles of incorporation and the statute authorizing its formation. In this case it is apparent from both the articles of incorporation and the provisions of section 15, chapter 16, Compiled Statutes, that this organization is an educational and not a 'business' or 'trading' corporation for the pecuniary profit of its members.

Greenough v. Board of Police Commissioners of Town of Tiverton (1909) 30 R.I. 312, 319, 74 Atl. 785, 789.

"Is it embraced within the provisions of 'Class I.—Business Corporations'?" The definition of the noun 'business' according to Webster's Internat. Dict. is: (3) 'Financial dealings; buying and selling; traffic in general; mercantile transactions.' A corporation organized for such purposes is therefore a business corporation.

Flint v. Stone Tracy Co. (1911) 220 U.S. 107, 71, 31 Sup. Ct. 342, 357:

"A business is that "which occupies the time, attention, and labor of men for the purpose of livelihood or profit."

People v. Board of Trade of Chicago (1875) 80 Ill. 134, 136:

This organization is not maintained for the transaction of business or for pecuniary gain, but simply to promulgate and enforce among its members correct and high moral principles in the transaction of business. It is not engaged in business but only prescribes rules for the transaction of business."
Dairy Marketing Association of Ft. Wayne ( ) S.F. (3) 286,288

"... a corporation transacting business for gain as its
chief and ultimate purpose is a business corporation."

Is the purpose of a holding company personal material gain of pecuniary
nature to its members? The federal court decisions under the Federal
Capital Stock Act of 1909 may have some bearing upon an answer to this
question. (In Del Norte Company v. Wilkinson) ( ) 28 F (2) 876
involving a corporation whose activities were limited to the holding of
stock in another company and protecting its capital investment the court
held:

"There is not a suggestion that during any of those years
its capital was in any sense 'employed' or, as we may
put it, 'worked' for the purpose or in the pursuit of
profit or gain in any fair sense, or that any income,
revenue, or profit in a true sense has been realized."
See also Rose v. Nunnally Investment Company (3.O.A. 5th 1927) 22 F.
(2d) 102, in which the court stated:

"The capital invested and reinvested, and not the ac-
tivities of plaintiff, earned the profits. In maintain-
ing its old investments, and in making new investments,
plaintiff was only enjoying the fruits of its ownership,
and neither these old or new investments were used to
further business opportunity or standing .... "(italics added).

"If the only substantial corporate activity is the owner-
ship and preservation of real and personal property, the
receipt of its ordinary income, which arises from the
property itself rather than from the active use and man-
agement of it, and the distribution of such income to the
stockholders with only such corporate organization and
activity as is necessary thereto, there is not such a
doing of business as is meant by the Act. While such
activity is 'business' in a broad sense, a tax upon such
business would be in substance one on the mere ownership
of property, becoming thus a direct tax .... "

If the California courts follow the theory underlying these cases, and
other federal cases arising under the Federal Capital Stock Act of
1909(1) that the use of its corporate powers and the working of its capital

Clallam Lumber Co. v. U.S. ( ) 34 F.(2d) 344; Zolnne v. Minneapolis
Syndicate ( ) 55 L.Ed. 498; Van Swambeek v. Sargent Land Co.( )
61 L.Ed. 480; U.S. v. Miplaing Mines Co.( ) 220 Fed. 431;
Argonaut Consol. Min. Co. v. Anderson ( ), 42 F (2nd) 829,832; Automatic
Fire Alarm Co. of Delaware v. Bowers ( ) 51 Fed. (2d) 118,120.
These cases hold that corporations whose activities consist simply in
holding stock and distributing dividends therefrom are not doing business.

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to secure a profit is the test of whether a holding company is a business corporation the conclusion will be reached that holding companies that simply hold stock and collect the income therefrom are not taxable under the act. On the other hand it may be argued that these corporations are not organized for charity, that certain advantages arise to the members thereof, that if no gain or benefits were derived therefrom they would not be created, and that if the members thereof desire these benefits they should pay the price in the form of a franchise tax exacted by the state for the privilege of having such corporations.

The statute as it now reads creates a situation of doubt that can only be settled by court decision. It is submitted that the act itself should definitely state whether or not such corporations are taxable thereunder. If they are not taxed the minimum tax of $25 will not be collected from them nor will they be subject to tax on the dividends which they receive from other corporations declared out of earnings from non-California business. On the other hand if they are taxed under the act the tax will fall principally upon dividends declared out of earnings from business done outside this state since the act in Section 8 (h) allows a deduction for dividends declared out of income from business done in this State. Furthermore, to tax holding companies under the act would lead either to discrimination against domestic holding companies or the abandonment by them of their California charters. It is doubtful whether foreign holding companies holding stock in this state would be held to be doing intra-state business in the state and

Note (1) cont. from page 20
If these cases are sound it is difficult to see how corporations organized to do something that is not business can be business corporations. It may also be argued that these decisions are binding upon the California courts since the legislature has adopted the federal classification of corporations and the terms "business corporations" and "doing business" as used in Section 5219, it has necessarily adopted the definitions of these terms established by decisions of the federal courts; that although there have been no decisions defining these terms as used in Section 5219, where a word or expression has

(cont. on page 22)
even if they were stock could easily be held outside the state and the dividends distributed therefrom. If the tax can easily be avoided by becoming a foreign corporation and holding stock outside the state the tax simply drives corporations of this kind out of the state and the problem resolves itself into a determination of whether or not California does or does not want holding companies.

Recommendations:

This question should be definitely settled in the statute. In the light of the above discussion it is recommended that holding companies should not be taxed under the act.

Proposed Amendment:

Add to Section 5:

The term business corporation does not include corporations organized to hold the stock of other corporations and that do not trade in the stock or securities held and that engage in no other activities than the receiving and distributing of dividends from such stock.

Proposed amendment if it is felt that these corporations should be taxed:

Add to Section 5:

The term business corporation includes holding companies.

(1) cont. from page 21

acquired a judicially settled meaning, in subsequent legislative enactment such a word or expression will be presumed to have that meaning in the statute. United States v. Merriam ( ) U.S. Sup. Ct. 64 L.Ed. 240, 244; Kepner v. United States ( ) U.S. Sup. Ct. 49 L.Ed. 114, 132.
Are Non-Profit Corporations Taxable Under the Act?

If non-profit activities are the means of furthering a non-business purpose as in the case of charitable and fraternal organizations, corporations engaged in such activities probably do not come under the act. However, where the non-profit activity is in furtherance of a business or mercantile end (as in the case of a cooperative marketing association) corporations engaged in such activities seem to be taxable as other corporations organized for financial, "mercantile, manufacturing or business ends." The statute seems to support this view by implication for subdivisions (k) and (l) of Section 8 regarding cooperative associations and subdivisions (i) and (j) of the same section provisions for these corporations, necessarily assume that they are taxable, otherwise the special provisions would be unnecessary. The most important practical effect of this conclusion, as it affects these corporations, is that, if there is no net income after the statutory deductions are allowed, the provision for a minimum tax of $25 on every corporation applies. The statute perhaps should settle any doubts on this question.

Recommendation:

The wisdom of listing exempt corporations as is done in Section 103 of the Federal Revenue Act of 1928 and section 201 of the Model Business Income Tax of the National Tax Association should be carefully considered. The disadvantage of making such a list, if the experience of the federal government is any guide, (See Klein Federal Income Taxation, pages 1000-1031) is that it will invite just as much litigation to determine whether certain corporations meet the exemption conditions as is invited under the act as it now reads.

Section 6:

The California act should follow the federal act in making an exception for the deduction of amounts received under a life insurance contract paid by reason of the death of the insured where the beneficiary is a transferee of the policy for a valuable consideration.
The California statute should also have a provision that if amounts paid by reason of the death of the insured are held by the insurer under an agreement to pay interest, interest payments should be included in gross income.

Proposed amendment

Add to paragraph (a):

"but if such amounts are held by the insurer under an agreement to pay interest thereon, the interest payments shall be included in gross income."

Add to paragraph (b):

"In the case of a transfer for a valuable consideration, by assignment or otherwise, of a life insurance, endowment, or annuity contract or any interest therein, only the actual value of such consideration and the amount of the premiums and other sums subsequently paid by the transferee shall be excluded from gross income under paragraph (a) of this section.

Stock Dividends; Subscription Rights

The act makes no specific provision for stock dividends or subscription rights. They are not taxable under the federal act (Fed.Rev. Act of 1926, sec. 115 (f) Miles v. Safe Deposit and Trust Co. of Baltimore (1922) 259 U.S. 347, 42 Sup. Ct. 483) It is uncertain whether they are taxable under the California act. Section 6 of the statute includes among the items that must be included in gross income "except as hereinafter otherwise provided.... all dividends received on stocks". The exception refers to dividends declared out of earnings from California business (see section 8h) and has no bearing upon the present question. Section 16 of Article XIII of the constitution and section 4 of the act contemplate a tax measured by "net income". California courts might follow the opinion of the United States Supreme Court in Eisner v. Macomber (1920) 252 U.S. 189, 40 Sup. Ct. 189, that stock dividends for the purpose of income taxation are capital and not income and thus
not within the contemplation of the constitutional section or statute. Although this is believed to be the better view the California courts might follow the contrary rule of Trefry v. Putnam (1917) 227 Mass. 532, 116 N.E. 904, L.R.A. 1917 ns. 806. This problem should be definitely settled by the statute and not left to conjecture.

Liquidating Dividends

A somewhat similar question, due to the same ambiguity of the statute and its failure specifically to cover the point may arise in the case of dividends which represent a distribution of capital, e.g. "liquidating" dividends and dividends from depreciation and depletion reserves. However, there should not be the same doubt on this problem regardless of whether stock dividends are or are not "income" for surely a return of capital admitted to be such is not income. The statute, however, should set at rest all doubts on questions of this kind.

Proposed Amendment:

Add to Section 6:

"Stock dividends or subscription rights shall not be included in gross income, but gain may be derived or loss sustained by the shareholders from the sale of such stock or the sale of such rights. The amount of gain derived or loss sustained from the sale of such stock or rights or the sale of the stock or rights in respect to which the stock or rights are issued or the sale of the stock acquired with such rights shall be determined as provided in Sec.19".

See discussion of section 19 for treatment of liquidating dividends.

Section 8:

Subdivision (c):

The deduction for federal income taxes should be abolished. The reasons given above for abolishing the personal property tax offset also apply here. Furthermore, income taxes of other states are not allowed as a deduction. Why should the federal income tax be different from an income tax of another state?
Under the present wording of subdivision (c) franchise taxes of other states measured by net income are probably deductible. That subdivision provides that taxes on income or profits paid or accrued within the taxable year imposed by the authority of any state, etc., are not deductible. The theory of franchise taxes measured by net income, and this is particularly true of the California tax, is that the subject taxed is the corporate franchise and not the income or profits by which the tax is measured.

Proposed amendment:

(1) Abolish deduction for federal income taxes by inserting the following after (1) "the government of the United States or"

(2) The statute could easily be changed to close the loophole permitting deductions of franchise taxes measured by income by inserting in subdivision (c) between the words "on" and "income" the words, "according to or measured by".
Effect of Abolition of Federal Income Tax Deduction

Economic analysis with supporting statistics prepared by Mr. McColligan to be inserted here.

Federal income tax deduction has reduced yield ________%; or $______.
Section 8 - (Subdivision f)

This subdivision now reads as follows:

Exhaustion, wear and tear and obsolescence of property to be allowed upon the basis provided in sections 113 and 114 of that certain act of Congress of the United States known as the "Revenue Act of 1928" which is hereby referred to and incorporated with the same force and effect as though fully set forth herein, or upon the basis provided in section 19 hereof. (Italics added)

An ambiguity arises from the use of the word "is" in this subsection. According to a strict grammatical construction the whole Revenue Act of 1928 is incorporated in the California statute. Obviously this was not the intention of the legislature for if it were many of the provisions of the California act would be rendered meaningless or superfluous and others would conflict with the provisions of the federal act. The legislature undoubtedly intended to incorporate only sections 113 and 114 of the federal act. To make the grammar of the section conform to that intention the word "is" should be changed to "are" and doubts on this point definitely settled.

A further problem arises as to whether sections 113 and 114 are incorporated only for the purpose of determining the allowance for exhaustion, wear and tear and obsolescence or for all purposes covered by these sections. Section 113 sets forth the federal scheme for determining the gain or loss from the sale or other disposition of property. This scheme is not consistent entirely with the plan set forth in sections 19 to 21 in the California act for determining such gain or loss. If both plans are incorporated in the statute a hopelessly confused situation results. The act should provide that these sections of the federal act are incorporated only for the purpose of the subsection.

Proposed amendment:

(f) Exhaustion, wear and tear and obsolescence of property to be allowed upon the basis provided in sections 113 and 114 of that certain act of the Congress of the United States known as the "Revenue Act of 1928" which are for the purposes of this subsection hereby referred to and incorporated with the same force and effect as though fully set forth herein, or upon the basis provided in section 19 hereof. (Italics indicate changes)
Section 8 Subdivision (g)

In the case of mines discovered between February 28, 1913 and January 1, 1928, it may be to the taxpayer's advantage to use the fair market value as of January 1, 1928, as a basis rather than discovery value. Considerable doubt is raised by the statute, however, as to the authority of the taxpayer to use the January 1, 1928 value in such instances. The discovery value basis was probably intended only for mines discovered after January 1, 1928. Literally construed the statute limits the taxpayer to the discovery value basis or cost and makes no distinction between mines discovered before or after January 1, 1928. The statute should definitely settle this question.

Proposed amendment:

The third paragraph of 8 (g) should read as follows:

"The basis upon which depletion is to be allowed in respect of any property, except as hereinafter provided for oil and gas wells and mines discovered after January 1, 1928, shall be as provided in sections 113 and 114 of said revenue act of 1928, or upon the basis provided in section 19 hereof."

In the first sentence of the fourth paragraph change "February 28, 1913" to "January 1, 1928."

Why Discriminate Against Oil Wells?

The act clearly discriminates against oil and gas companies since they are the only corporations deprived of the opportunity of basing depletion deductions on January 1, 1928 values. It may be contended that this discrimination amounts to a denial of equal protection of the laws.
In view, however, of the extensive power of the state to classify various callings, trades and businesses for purposes of taxation it is very unlikely that such contention will be upheld.

A more serious objection, perhaps, may be raised by oil and gas companies whose tax accrued prior to February 27, 1931, the effective date of the amendment. Section 4 of the act provides that taxes accrue under the act on the first day after the close of the taxable year. Corporations whose tax accrued prior to February 27, 1931, computed their tax under the provisions of the statute which allowed a deduction for depletion based on January 1, 1928, values. The tax on such corporations, it may be argued, became a determined and accrued liability before the amendment became effective and the statute cannot be applied retroactively to change it. It is submitted, however, that the retroactivity is more apparent than real. The tax is not a tax on the income earned by such corporations during the taxable year prior to February 27, 1931, but is a tax on the privilege of doing business during the succeeding taxable year. In other words, the privilege taxed is a present and continuing privilege, the amount of the tax being measured by the transactions in a prior period. The tax imposed in 1931 is not a retroactive tax but a tax for the current taxable year. It is difficult to see on what basis a taxpayer can claim that, regardless of legislative action, current taxes must be figured on the same basis on which past taxes have been assessed, or in fact on what grounds he can complain if the rates of current taxes were increased or if, indeed, additional taxes were imposed during the same year on the same subject.

Recommendations:

Although it is believed that the 1931 amendment regarding oil and gas wells is valid it is difficult to see the justification for the discrimination against these companies. In other words why should not the same provision apply to all corporations taxable under the act? Applying the provision to all taxable corporations raises no
more or different legal problems from those raised in the case of oil
and gas companies. This problem will be fairly adequately taken care
of if the recommendation made below under the discussion of section
19 regarding the change in the basic date is adopted.

Section 8 (h)

The purpose of the proviso in this section is to prevent double
taxation, and the presumption is that if the income out of which the
dividends are declared is earned in this state it will have been in-
cluded in the measure of the tax on the corporations earning such in-
come. However, if the corporation which declares such dividends is
not taxable by this state the presumption should not operate. Some
corporations like federal reserve banks and federal land banks are not
taxable but yet distribute to banks large amounts of dividends from
business done in California.

Proposed Amendment:

Insert after phrase "within and without this State" the words
"by corporations taxable under Article XIII of the Constitution
of the State of California."

Section 10:

The 1931 amendment is ambiguous. It provides that "income from
tangible, personal property which is not deductible under the provisions
of subsection (h) of section 8 hereof shall be subject to allocation."

This amendment may be construed as designed to modify the broad
provisions of Section 8h and to provide that only dividends properly
attributable to California should be included in taxable income. In
view, however, of the questions raised on this problem and the ruling
of the Attorney General prior to the amendment that dividends were not
subject to the prescribed allocation formula of Section 10 (Opinions
of the Attorney General to Chairman, Committee on Constitutional Amend-
ments No. 7467; 7467a, dated March 18, 1931 and April 2, 1931) it may
be held that the purpose of the amendment was to subject dividends to
the prescribed formula along with other allocable income. The statute should be clearer on this point.

It is submitted that the ruling of the Attorney General that dividends are to be apportioned to California if the shares from which they were declared have a situs here is satisfactory and should be incorporated in the statute.

Proposed Amendment:

(1) Repeal the last sentence of the first paragraph of Section 10.

(2) Add the following to section 8 subdivision (h):

"Dividends received by foreign corporations whose principal place of business is outside of California, provided that it can be conclusively shown that such dividends have no relation to income derived from business transacted in California and are not in any sense or in any amount reasonably attributable to business done within this state."

Section 11:

All definitions should be put together in one section. See section 5

Section 12:

The Franchise Tax Commissioner probably has authority to permit changes from one taxable year to another but the question is by no means free from doubt and the statute should settle the doubt and provide for returns for a period of less than twelve months resulting from change of accounting period.

Proposed amendment:

Add the following to Section 12:

(a) If a taxpayer changes his accounting period from fiscal year to calendar year, from calendar year to fiscal year, or from one fiscal year to another, the net income, shall, with the approval of the Commissioner be computed on the basis of such new accounting period subject to the following provisions.

(b) If a taxpayer, with the approval of the commissioner, changes the basis of computing net income from fiscal year to calendar year a separate return shall be made for the period between the close of the last fiscal year for which return was made and the following December 31. If the change is from calendar year to fiscal year, a separate return shall be made for the period between the close of the last calendar year for which return was made and the date designated as the close of the fiscal year. If the change is from one fiscal year to another
fiscal year a separate return shall be made for the period between the close of the former fiscal year and the date designated as the close of the new fiscal year.

(c) Where a separate return is made under paragraph (b) on account of a change in the accounting period then the income shall be computed on the basis of the period for which separate return is made.

(d) If a separate return is made under paragraph (b) on account of a change in the accounting period, the net income, computed on the basis of the period for which separate return is made, shall be placed on an annual basis by multiplying the amount thereof by twelve and dividing by the number of months included in the period for which separate return is made. The tax shall be such part of the tax computed on such annual basis as the number of months in such period is of twelve months.

Section 13:

Corporations Whose First Taxable Year is a Period of Less Than Twelve Months Not Properly Provided For

The treatment of a corporation that commences to do business after the effective date of the statute and chooses as its first taxable year a period less than twelve months (which will often be the case as most corporations keep their books either on a calendar year basis or on the basis of a fiscal year ending June 30, and few corporations commence business on either January 1, or July 1) is different under the 1931 amendment from under the provisions of the 1929 act. Under the 1929 provisions of the act the tax for the succeeding taxable year was based upon the same net income on which the tax for the first taxable year was based, or in other words the tax for the entire succeeding year of such a corporation would be figured upon the income of only part of a year. Under the statute as amended in 1931, the tax for the fractional part of the year is computed in the same manner as formerly but "the net income to be used as the measure of the tax for the second taxable year shall be in the same proportion to the net income for the first taxable year as the number of months in the second taxable year bears to the number of months covered by the return for the first taxable year" but in no case may the term "doing business as defined in the act be so construed as to enable a corporation to pay a less amount than the
minimum tax of $25.00, nor shall a period during which the corporate powers have not been exercised be considered as a base for the computation of the tax. In other words, the tax for the succeeding year will be based partly upon fictitious income, i.e. upon an estimate of what the income for the whole year would have been computed upon the assumption that the income for each of the remaining corresponding fractions of the year would have been the same as the income for the fraction of the year in which the corporation actually did business. For example, suppose that during the first taxable year the corporation did business from October 1, to December 31, or one quarter of a year and that its net income for this period was $500. The estimated income for four quarters, or the whole year, is four times $500 or $2,000, which is the base upon which the tax for the second taxable year is computed. It is obvious that this method may work unfairly upon those corporations whose income is largely seasonal. Suppose that in the example given the last quarter is ordinarily the only portion of the year in which income is earned. An arbitrary assumption that the corporation would have earned as much income in each of the other three quarters seems clearly unjustified. The constitutional provision in pursuance of which the act was passed authorizes a tax according to the "net income. It is doubtful whether fictitious income is "net income" within the meaning of the constitutional provision. If it is not, the problem that then arises is similar to that discussed above regarding the statute's new definition of doing business, i.e. it will be necessary to determine whether levying a tax measured by such income is providing by law for another method of taxing franchises of the corporations taxable, "authorized in this constitution according to paragraph 2b of the constitutional section or is within the legislative authority independently of that section. Furthermore, to tax some corporations according to actual net income and others by fictitious net income it might be contended, raises a very serious question as to denial of equal protection of the law. However, since this results from the
election by the corporation of its first tax date a period less than
twelve months, the contention does not have much force.

**Proposed Amendment**

Amend the second paragraph of Section 13 to read as follows:

A bank or corporation which commences to do business within the
limits of this state after the effective date of this act shall
prepay the minimum tax hereunder which payment must be made
before the bank or corporation files with the Secretary of State
its articles of incorporation or duly certified copy thereof as
the case may be. Upon the filing of its tax return—two months
and fifteen days after the close of its first taxable year its
tax for that year shall be adjusted upon the basis of the net
income received during that taxable year, a credit being allowed
for the prepayment of the minimum tax. Said return shall also,
in accordance with sections 23 to 26 inclusive be the basis for
the tax of said bank or corporation for its second taxable year,
if its first taxable year is a period of twelve months. In every
case in which the first taxable year of a bank or corporation con-
stitutes a period of less than twelve months said bank or corpo-
ration shall pay as a prepayment of the tax for its second taxable
year an amount equal to the tax (after the offset allowance has
been computed) (1) for its first taxable year, the same to be due
and payable at the same times and in the same manner as if that
amount were the entire amount of its tax (after the offset al-
lowance has been computed) (1) for that year; and upon the filing
of its tax return two months and fifteen days after the close of
its second year it shall pay a tax for said year based on its
net income received during that year, allowing a credit for the
prepayment but adding interest at the rate of six per centum
of any excess over the prepayment; but in no event shall the
tax for the second taxable year be less than the amount not sub-
ject to offset (1) of the prepayment for that year, and said return
for its second taxable year shall also, in accordance with sec-
tions 23 and 26 inclusive be the basis for the tax of said bank
or corporation for its third taxable year.

**Illustration:**

Suppose a corporation commences to do business in this
state July 1, 1932, electing to report on a calendar year basis,
its taxable year ending Dec. 31. It pays the minimum tax upon
the commencement of business and on March 15, 1933, files a
return reporting its income for the period July 1 – Dec. 31, 1932.
Suppose the tax amounted to $500 on the basis of its net in-
come for that period; it will be given a credit for the prepay-
ment of the $25 minimum tax and will pay $475 for the privilege
of having done business from July 1 – Dec. 31, 1932. The sum of
(1) To be inserted if offsets are not abolished.

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$500 will be due as a prepayment of the tax for the second taxable year and will be payable in installments, etc., i.e. $250 on March 15, 1933 and $250 on September 15, 1933, just as if that were the total tax for that year. Suppose that the return for the second taxable year discloses a tax liability of $1000; a credit of $500.00, or the amount of the prepayment, will be given, and $500 plus 6% interest or $530 will then be due and payable. The return for the second taxable year will also be the basis for third taxable year, in other words $1000 will be the tax for the third taxable year.

If the corporation chooses a twelve months period for its first taxable year, the income returned for such period will be the basis for the tax for both its first and second taxable years.

Section 13 (Continued)

The statute is very liberal in the third paragraph of section 13 in allowing a reduction in the tax in cases where the corporation withdraws from business before the end of its fiscal year. The tax is imposed for the privilege of doing business during a particular taxable year and is not on net income but "measured by net income." The corporation pays a tax for the privilege of doing business for a twelve month period. The fact that it does not see fit to exercise its privilege for the full period is not of itself sufficient justification to apportion the tax and give a refund for the period the privilege is not exercised. One paying the price of admission to a theatre has the privilege of seeing the entire performance, but if he leaves before the performance is finished he has no justifiable claim for a refund of part of the admission price.

Proposed Amendment

If the legislature desired to remove this liberal provision the following could be inserted in the place of the third paragraph of section 13:

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"Taxes levied under this act shall not be subject to abatement or refund because of the cessation of the business or corporate existence of any bank or corporation during the year for which said taxes have been assessed."

If the provision for reduction in the tax in cases where a bank or corporation dissolves or withdraws from the state during any year and the provision for offset of taxes in sections 3, 4 and 26 are allowed to remain, a change should be made in the method of determining the tax liability for the months prior to dissolution or withdrawal.

Under the present provisions of the Act it would seem that a bank or a corporation dissolving or withdrawing during a year would be entitled to the full offset provided in sections 3, 4 and 26 from its tax for the months preceding such dissolution or withdrawal, notwithstanding the fact that only a proportion of the net income for the previous year is used in computing said tax.

This result follows from the language of section 26 which provides:

Sec. 26. Offset for local taxes. A corporation subject to the tax herein provided for shall receive an offset against said tax, subject to the limitations provided in section 4 hereof, for real and personal property taxes paid upon its property to any county, city and county, city, town or other political subdivision of the State during the taxable year. Every bank and banking association subject to the tax herein provided for shall receive an offset against said tax, subject to the limitations provided in section 3 hereof, for taxes paid upon its real property during the taxable year to any county, city and county, city, town, or other political subdivision of the State.

It is to be observed that the offset is allowed against the tax without regard to the section under which the tax is computed. In the case of a bank or corporation which dissolves or withdraws during any year the "tax" provided for in the Act is the tax provided for in the third paragraph of Section 13.

The full offset is undoubtedly allowed against the "tax" provided for in sections 1, 2 and 4, and, as no exception is made for a partial offset from the "tax" provided for in section 13, the full offset granted by Section 26 must be allowed from this "tax" also.
The following example will illustrate how the present system operates. Suppose a corporation has a net income during one taxable year of $1,000,000, and dissolves six months after the close of said taxable year. The tax for the six months prior to dissolution is computed by taking one half of $1,000,000, that is $500,000 and multiplying this amount by 4%, the amount thus obtained being $20,000. Suppose further that the corporation has an offset allowance of $15,000 for real and personal property taxes paid in the preceding year. The full amount of such allowance under the terms of the act is offset from the $20,000 calculated above. The result is that the corporation's tax for half a year is but $5,000 plus 4% of the offset (last paragraph of section 26) or $5,800 whereas if it had exercised its corporate franchise during the entire year, its tax would have been $25,000 plus 4% of the offset, $1,000,000 x 4% or $40,000 less $15,000 plus 4% thereof or $25,600. Thus for exercising its corporate franchise for half a year, the corporation pays approximately only one-fifth the amount it would have paid had it exercised its franchise during the entire year.

It would seem only reasonable that for the months prior to dissolution or withdrawal, a bank or corporation should pay a tax at least in an amount not less than that proportion of the tax it would have paid had it exercised its franchise during the entire year which the number of months prior to dissolution or withdrawal bears to the entire year. To meet this condition the corporation in the example above would have had to pay one half of $25,600 or $12,800 rather than $5,800.

Recommendation:

If the recommendations heretofore made with regard to the abolition of offsets and the treatment of banks and corporations that dissolve or withdraw during any year are not followed the third paragraph of section 13 should be amended to read as follows:
"Any bank or corporation which is dissolved and any foreign corporation which withdraws from the State during any year shall pay a tax hereunder for the months of its fiscal year which precede such dissolution or withdrawal, according to or measured by such proportionate part of the net income of the preceding taxable year as the number of months of the year prior to such dissolution or withdrawal bears to the number of months of the preceding taxable year. Provided, however, that in the case of any bank or corporation which is dissolved, or which withdraws from the State during any year, the offset from the tax for the months prior to such dissolution or withdrawal shall not exceed that proportion of the offset computed under section 26 which the number of said months prior to such dissolution or withdrawal bears to the number of months of the preceding taxable year but shall not exceed the amount of real and personal property taxes paid during said preceding taxable year. In any event, each such corporation shall pay a minimum tax not subject to offset of $25 for such period.

The present provisions of this section relating to the computation of the taxes of banks or corporations which dissolve or withdraw from the State or which commence to do business in the State make no exception in the case of corporate reorganizations, consolidations or mergers. Hence, simply because of a change in the corporate structure by which a business is operated, the taxes due the State for the privilege of operating that business in a corporate form will vary in amount from what they would have been had such change not occurred.

For example, suppose "A", a corporation reporting on a calendar year basis, operates a business which yields a net income of $500,000 in 1932, and a net income of $300,000 in 1933, half, or $100,000 of which is produced in the last six months of 1933. Its tax for the year 1933 computed at the rate of 4% of the net income for the year 1932 will be $20,000. Its tax for the year 1934 computed at the same rate on the basis of the net income for the year 1933 will be $8,000. Its total tax for the years 1933 and 1934 will be $28,000. Now suppose a reorganization occurs in 1933 pursuant to which "A" dissolves or withdraws from the State, and "B" corporation is organized and takes over the business, on June 30, 1933. "A"'s tax for the first six months of the year 1933, computed at the rate of 4% of that proportion of the net income of the preceding taxable year as the number of months of the year prior to such dissolution or withdrawal bears to the entire preceding taxable year" will be $10,000. If "B" reports on a calendar
year basis, its tax for its first taxable year, i.e., the last six months of 1933, computed at the rate of 4% of the net income for said year, i.e., $100,000 will be $4,000. Its tax for its second taxable year, i.e., 1934, computed at the rate of 4% of "net income" which is in the "same proportion to the net income for the first taxable year as the number of months in the second taxable year bears to the number of months covered by the return for the first taxable year" will be $8,000. Thus the total tax for the years 1933 and 1934 will be but $22,000 as compared to $28,000, the amount it would have been had a reorganization not been effected in 1933. Now suppose the business yields a net income of $200,000 in the year 1932, and a net income of $500,000 in the year 1933, half or $250,000 of which is produced in the last six months of 1933. If "A" is not reorganized, its tax will be $8,000 for the year 1933, and $20,000 for the year 1934, or a total of $28,000 for the two years. If, however, a reorganization similar to the one mentioned in the above example occurs, "A"'s tax for the first six months of 1933 will be $4,000, "B"'s tax for the last six months of 1933 will be $10,000, and for the year 1934 will be $20,000. In other words, the tax for the two years 1933 and 1934 will be $34,000 or $8,000 greater than it would have been had no reorganization occurred.

In case of a consolidation of two or more corporations pursuant to which the consolidating corporation dissolve or withdraw from the state and a new consolidated corporation comes into existence, the taxes of the consolidating corporations for the months of the year prior to dissolution or withdrawal will be computed in the same manner as the tax of a corporation which dissolves or withdraws from the state pursuant to a reorganization is computed for the months of the year prior to dissolution or withdrawal. Likewise, the taxes of the consolidated corporation for its first and second taxable years will be computed in the same manner as the taxes of a corporation which comes into existence pursuant to a reorganization are computed for its
first and second taxable years. Hence, a similar variation in taxes will result in case of a consolidation as will result in case of a reorganization.

Where a corporation merges with an existing corporation and thereupon dissolves or withdraws from the state, its tax for the months of the year prior to dissolution or withdrawal will be measured by a portion only of the net income of the preceding taxable year. The balance of the net income for the preceding year, and the entire net income for the months of the year prior to dissolution or withdrawal will not be used as a measure of any franchise tax. The surviving corporation's tax for the taxable year in which the merger occurs will be measured only by the net income of the taxable year preceding the year in which the merger occurs, which obviously will not include any of the net income of the business of the merged corporation. Its tax for the taxable year succeeding the year in which the merger occurs will be measured by the net income of the year in which the merger occurs, including the net income of the business of the merged corporation for such year which is earned subsequent to the merger. But even if the merger had not occurred, this income would have been used as a measure of a tax either on the surviving corporation or on the merged corporation. Consequently, whenever a merger occurs, the taxes due the state will be less, because of the merger, than they would have been had the merger not occurred.

Recommendation

It seems only reasonable that the taxes due the state for the privilege of operating a business under corporate form should not vary because of a change by way of reorganization, consolidation, or merger, in the corporate structure by which that business is operated, but should be measured by the same income they would have been measured by had a reorganization, consolidation or merger not occurred. If the recommendation heretofore made to the effect that taxes levied under
the act should not be subject to abatement or refund because of the cessation of business or corporate existence of any bank or corporation during any taxable year is followed, then this result can be effected by adding to the second paragraph of Section 13, whether or not it is amended as heretofore recommended, a provision to the effect that the said second paragraph shall not apply to a bank or corporation which commences to do business in this state pursuant to a reorganization or pursuant to a consolidation of two or more banks or corporations, and then insert the following between the second and third paragraphs of Section 13:

"Where a bank or corporation commences to do business in this state pursuant to a reorganization of a bank or corporation, it shall pay no tax for its first taxable year, but its tax for its second taxable year shall be adjusted upon the basis of its net income for its first taxable year, and also upon the basis of the net income of the reorganized bank or corporation for the months of the taxable year prior to the reorganization. Every such bank or corporation in its return filed for its first taxable year shall specify all such facts with respect to the reorganized bank or corporation for the months of the year prior to the reorganization as the commissioner may require in order to carry out the provision of this paragraph. The term 'reorganization' as herein used shall include (1) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred; or (2) a re-capitalization; or (3) a mere change in identity, form, or place of organization, however effected.

"Where a bank or corporation commences to do business in this state pursuant to a consolidation of two or more banks or corporations, it shall pay no tax for its first taxable year, but its tax for its second taxable year shall be adjusted upon the basis of its net income for its first taxable year and also upon the basis of the net income of the consolidated banks or corporations for the months of their taxable years prior to the consolidation. Every such bank or corporation in its return filed for its first taxable year shall specify all such facts with respect to the consolidated banks or corporations for the months of their taxable years prior to the consolidation as the commissioner may require in order to carry out the provisions of this paragraph.

"Where a bank or corporation, or two or more banks or corporations, merge with another bank or corporation, the tax of the surviving bank or corporation for its taxable year succeeding its taxable year in which the merger occurs shall be adjusted upon the basis of its net income for its preceding taxable year and also upon the basis of the net income of the merged banks or corporations for the months of their taxable years prior to the merger. Every such surviving bank or corporation in its return for its taxable year in which the merger occurs, shall specify all such facts with respect to the merged banks or corporations for the months of their taxable years prior to the merger as the
EXPLANATION

The following examples may be helpful in understanding how the above recommendation will operate if followed, provided, of course, that the recommendation heretofore made with respect to the abatement or refund of taxes in case of the cessation of business or corporate existence of any bank or corporation during any taxable year is also followed.

(1) Suppose "A" a corporation reporting on a calendar year basis has $500,000 net income for 1932 and $200,000 net income for 1933, half or $100,000 of which is earned in the first six months of 1933. Its tax for 1933 calculated on the basis of its net income for 1932 will be $20,000. Its tax for 1934 computed on the basis of its net income for 1933 will be $8,000. Now suppose a reorganization occurs on June 30, 1933, pursuant to which "X" corporation is organized and all of the assets of "A" are transferred to "X". Even though "A" ceases doing business in the state or dissolves or withdraws from the state during the year 1933 its tax for 1933 will not be subject to abatement or refund. Consequently its tax for 1933 will be $20,000. "X" will not pay any tax for its first taxable year, but its tax for its second taxable year, the year 1934 if it reports on a calendar year basis, will be measured by its net income for the first taxable year, $100,000, and also by the $100,000 net income of "A" for the months of the year 1933 prior to the reorganization. Its tax for the year 1934 so computed will be $8,000. Thus the taxes of the two corporations for the two years 1933 and 1934 will be $28,000, the amount "A"'s taxes would have been had the reorganization not occurred.

(2) Suppose "B" a corporation reporting on a calendar year basis, has a net income of $200,000 for 1932, and a net income of $400,000 for 1933 half or $200,000 of which is earned during
the first six months of 1933. "B"'s tax for 1933 will be $8,000, and for 1934 will be $16,000. Its total taxes for the two years will be $34,000. Now suppose "A" and "B" consolidate on June 30, 1933, thus forming "Y" corporation, and thereupon dissolve or withdraw from the state prior to the close of the year 1933. The taxes of "A" and "B" for the year 1933 will be the same as they would have been had the consolidation not occurred, i.e. $20,000 and $8,000 respectively, or a total of $28,000 "Y" will pay no tax for its first taxable year, but its tax for its second taxable year, the year 1934 if it reports on a calendar year basis, will be measured by its net income for the first taxable year in the amount of $300,000 ($100,000 from "A"'s business and $200,000 from "B"'s business for the last six months of 1933) and also by the $100,000 net income of "A" and the $200,000 net income of "B" for the months of the year 1933 prior to the consolidation. Thus its taxes for the year 1934 will be $24,000. The total of the taxes of the three corporations for the two years 1933 and 1934 will be $42,000. The taxes of "A" and "B" for the two years also would have been $42,000 if the consolidation had not occurred.

(3) Suppose "A" merges in "B" on June 30, 1933, instead of consolidating with "B" and thereupon dissolves or withdraws from the state prior to the close of the year 1933. "A"'s tax for the year 1933 will be $20,000, and "B"'s tax for the year 1933 will be $8,000. "B" tax for the year 1934 will be measured by its net income for the preceding year which will amount to $500,000 ($100,000 of which is attributable to the business of "A" for the last six months of the year 1933, and $400,000 of which represents the amount of net income "B" would have earned during the year 1933 had the merger not occurred) and also by the $100,000 net income of "A" for the months of the year 1933.
prior to the merger. As so measured, its tax for the year 1934 will amount to $24,000. Thus the taxes of the two corporations for the two years 1933 and 1934 will amount to $42,000 which is the same amount they would have been had the merger not occurred.

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If the recommendation heretofore made with respect to the abatement or refund of taxes in case of the cessation of business or corporate existence, of any bank or corporation during any taxable year is not followed, then the following should be added to the first sentence of the third paragraph of Section 13:

Provided, however, that the taxes levied under this Act shall not be subject to abatement or refund because of the cessation of business or corporate existence of any bank or corporate existence of any bank or corporation pursuant to a re-organization, consolidation, or merger.

The fourth paragraph of section 13 provides that if any bank or corporation discontinues actual operations within the state in any year and thereafter has no net income but does not dissolve or withdraw from the state, it shall in the succeeding year and thereafter until dissolution, withdrawal or resumption of operations pay an annual tax to the state of $25.

In so far as this paragraph operates to require a $25 tax in cases where a bank or corporation does not have any income for the preceding year it is subject to various objections.

As applied to foreign corporations this paragraph is of doubtful constitutionality for the reasons given above in the discussion of the definition of "doing business".

As applied to banks this provision is probably not constitutional because not in pursuance of the constitutional provision (Section 16 of Article 13 of the state constitution) under which the act was passed which makes no provision for a minimum tax with regard to banks but which contemplates a tax on banks
according to or measured by net income. A minimum tax when there is no net income would obviously not be measured by net income. Furthermore, as applied to national banks it is probably unconstitutional for a similar reason because not in pursuance of the provisions of Section 5219 of the Revised Statutes of the United States that such banks may be taxed "according to or measured by their net income." It may be argued that although this provision is unconstitutional with respect to national banks it is valid as regards state banks under paragraph 1 (b) of Section 16 of Article 13 which gives the legislature power to provide for a tax on banks in lieu of a tax measured by net income. The answer to this argument, however, is contained in the proviso to paragraph 1 (b) that "such form of taxation shall apply to all banks located within the limits of this state." In other words a minimum tax to be in the state. It cannot apply to national banks valid under paragraph 1 (b) must apply to all banks in view of the restrictions in Section 5219 consequently it cannot apply to state banks.

Furthermore, it should be observed that if a bank continues operations and has some net income, although not in an amount sufficient to give rise to a tax of $25. the paragraph of section 13 here discussed would not be applicable for the reason that it applies only if the bank or corporation "discontinues actual operations" and "thereafter has no net income." It is rather difficult to explain why a bank that discontinues operations and has no net income should pay a greater tax than a bank that continues operations and has net income.

Insofar as domestic corporations are concerned, it would seem that this paragraph of Section 13 is superfluous inasmuch as corporations are subjected to a minimum tax of $25. per year under section 4 of the act.
Even if the purpose of this paragraph is to obtain only a minimum tax of $25 from each of the banks or corporations affected thereby that purpose is not likely to be accomplished because they may use their off-set allowance against this tax for the same reasons given above in the discussion of the third paragraph of Section 13.

Recommendation: To safeguard against this contingency the words "not subject to offset" should be inserted in this paragraph immediately after the words, "annual tax" if this paragraph is retained.

It is probable that one of the purposes of this paragraph is to nullify the effect of the statutory definition of "doing business" as amended in 1931, to include "the right to do business". Prior to the 1931 amendment to the definition of doing business, if a bank or corporation discontinued actual operations in any year and did not resume operations thereafter, it paid no tax for the year succeeding such discontinuance, regardless of whether it dissolved or withdrew from the state, and regardless of whether it realized a net income in the year in which it discontinued operations, for the reason that as it did not do business during such succeeding year, it was no longer taxable under the act. For example, suppose a corporation did business from January 1, 1929 to November 31, 1929, and then discontinued all operations. Suppose further that during this period it received, let us say, a net income of $100,000. No return of this income was required. Since the 1931 amendment defining doing business to include the right to do business, a corporation that discontinues business during a year and does not dissolve during that year remains subject to the Act and is required to file a return for that year and for all succeeding years until it is dissolved. For example, a corporation engages in business transactions from January 1, 1932, to November 31, 1932, at which time it discontinues actual operations. During this period it received $100,000 net income. If the corporation does not dissolve during the year 1932, it must make a return in 1933 of the $100,000 earned during
the year 1932, and, unless a different result is required by the fourth paragraph of section 13, it will have to pay a tax for the year 1933 based on the $100,000 earned during the year 1932 for the privilege of "doing business" in the statutory sense during the year 1933 even though its place of business is closed down, all of its employees discharged and no business transactions of any kind are entered into. It may be that the purpose of the fourth paragraph of section 13 is to require only a $25 tax from this kind of bank or corporation and to exempt it from a tax computed on the basis of the net income received during the year 1932. If this is the purpose of the provision that purpose is not adequately provided for in view of the language used. To obtain the benefit of the exemption certain conditions are prescribed: (1) The bank or corporation must discontinue operations; (2) it must thereafter have no net income; (3) it must not dissolve or withdraw from the state. In other words if after such discontinuance it receives some net income no matter how small the amount thereof may be, or if it dissolves in the year succeeding such discontinuance of operations a tax based on the preceding year's net income must be paid. It is difficult to see any reason why the presence of these facts should subject the bank or corporation to a greater tax than would be exacted if no net income were thereafter received or if it did not dissolve or withdraw.

If the recommendation regarding the repeal of the 1931 amendment to the definition of doing business is followed this paragraph will no longer be necessary to accomplish the purpose of exempting banks or corporations, that discontinue actual operations, from a tax in the succeeding year based upon the net income of the year in which the operations are discontinued. On the other hand, if that recommendation is not followed and the legislature is to be taken seriously as actually meaning that "doing business" includes the "right to do business" consistency would seem to demand that such banks or corporations be
treated no differently from any other bank or corporation that is doing business within the meaning of the act or more specifically within the meaning of other parts of the definition of doing business.

Recommendation:

Repeal the fourth paragraph of Section 13.

Section 14

Consolidated Returns Provision Ambiguous and Probably Invalid

The apparent purpose of permitting consolidated returns is to tax as a business unit what in reality is a business unit. The California statute, however, is seriously defective in not clearly providing for the computation of the tax in the case consolidated returns are filed. Sections 1, 2, and 4 of the act specifically provide that "every" bank and "every" taxable corporation shall pay a tax according to or measured by "its" net income. Section 13 sets forth the method of computing the tax on corporations commencing to do business in the state after the effective date of the act and choosing as a taxable year a period less than twelve months, and section 14 provides that in the case of a bank or corporation which is a member of the affiliated group for a fractional part of the year the consolidated return shall include the income of such bank or corporation for such part of the year as it is a member of the affiliated group. If a corporation commences business as a member of the affiliated group and also commences business during a fractional part of the taxable year of the group will its tax be computed according to Section 13 or will that section be superseded and the new corporation's income and losses be merged in the income add losses of the old members of the group and its tax for its first taxable year incorporated in the tax on the group as a unit and will losses incurred by some of the corporations before the new corporation joined the group offset the income of the new member? Section 14 simply permits the filing of consolidated returns but omits to
provide for computing the tax when such returns are filed. Such fail-
ure, it may be argued, leaves sections 1,2,4 and 13 in full force
and effect so that although consolidated returns are filed the tax
is nevertheless to be computed upon the net income of each corpo-
ration in compliance with those sections. In other words by failing
to provide that the tax shall be computed upon the consolidated net
income of the group the provisions for consolidated returns is ren-
dered meaningless and it would seem the property tax offsets and los-
ses of one corporation may not offset the net income or reduce the tax
on the other corporations. It may be contended that the words "con-
solidated returns" as used in Section 14 necessarily involve consol-
idating the net income and taxing such income as a unit as if the af-
iliated group were a single corporation. Some support for this con-
tention may be found in Section 26 of the act which states that, "Where
a consolidated return has been made under section 14 hereof the offset
allowable against the tax liability of the consolidated group may in-
clude said property taxes paid during said period by all corporations
which are included in the consolidated group subject to the limits-
tions of Section 4 hereof." But if this contention is sound other
difficulties must be met. Upon whom is the tax assessed when con-
solidated returns are filed? Is it assessed against the parent cor-
poration, against each corporation in proportion to the net income
properly assignable to each, is the tax apportioned among the cor-
porations as directed by the parent corporation or as they may agree
among themselves or are the members severally liable for the tax as-
sessed upon the group? Sections 1,2,4 and 13, perhaps afford the only
direct answers to these questions.

Is the parent corporation the only one liable for the tax and is
it the only one that may be sued, does the lien apply only to its prop-
erty and is it the only one subject to the suspension provision of Sec-
tion 32? The act fails answer these questions specifically.
Even if it be determined that the statute authorizes the computation of the tax on the consolidated net income of the group, thereby permitting the losses and property tax offsets of one corporation to offset the net income and reduce the tax of other corporations a very serious constitutional question must be met. The constitutional section in pursuance of which the act was passed makes no provision for consolidated returns but provides that taxable corporations shall be taxed according to or measured by "their" net income. Corporations that are allowed to offset their net income by the losses of other corporations are obviously not being taxed according to "their" net income. If it be held that the statute does not impose the tax set forth in the constitutional section the problem that will then arise will be similar to that discussed above in connection with the new definition of doing business, namely, whether levying such a tax is providing by law for another method of taxing franchises "authorized in this constitution" according to paragraph 2b of Section 16 or is within the legislative authority independently of that section.

**Consolidated Returns Provision Probably Invalid as Applied to National Banks**

If section 14 permits affiliated groups to be taxed as if they were a single corporation an interesting problem is presented by the 1931 amendment to that section withdrawing the right of banks to file a consolidated return with non-banking corporate members of the affiliation. The effect of the amendment is to prevent banks from writing off against their net income the losses of their non-banking corporate associates from eliminating intercompany profits, and from reducing their taxes by the offsets of local taxes paid by such associates. Section 5319 of the United States Revised Statutes provides that the rate of tax on national banks "shall not be higher than the rate assessed upon other financial corporations nor higher than the highest of the rates assessed by the taxing state upon mercantile, manufacturing and business corporations doing business within its limits." The word
"rate" as used in Section 5219 under the share method of taxation authorized thereby has been held to apply not only to the arithmetical measure or percentage of tax but also the basis of assessment, discrimination as to either being a violation of that section. There is no reason to doubt that the same interpretation will be given the word "rate" as used in the income tax methods authorized by that section.

Inasmuch as not only other financial corporations but in fact all taxable corporations other than banks are allowed deductions and offsets not allowed national banks, there seems to be a clear violation of the conditions of the federal statute.

Section 5219 also presents another question if the consolidated returns provision is interpreted to permit losses of members of the banking group to offset income of other members and to permit the real property tax offsets of members to reduce the tax on other members. Section 5219 authorizes a tax on national banks according to or measured by "their" net income. If some national banks are permitted to offset their net income by losses of other banks, national or state, or to reduce their tax by the real property tax offsets of other banks a plausible argument can be made that they are not being taxed according to or measured by "their" net income and that the provisions of Section 5219 are being violated.

The act imposes a franchise tax on the privilege of doing business as a corporation. Yet some corporations may avoid entirely or greatly reduce the tax on their franchise if they are permitted to offset losses and deductions of other corporations. This consequently reduces to a great extent the revenue which would otherwise be obtained under the act. Consolidated returns may perhaps be justified under a direct net income tax but it is difficult to see their place under a franchise tax imposed for the privilege of doing business as a corporation. The consolidated returns provision encourages the multiplication of corporations and the segregation or separate incorporation of activities which would normally
be carried on as branches of one concern. If a corporation or the group in control thereof wish to avail themselves of the privilege of incorporating the various departments of their business why should they not pay the price for such privilege?

Recommendation:

Proposed Amendment

If the state desires to continue to allow the privilege of filing consolidated returns it is recommended that the following, for purposes of clarity and definiteness, be added to Section 14:

If a consolidated return is made subject to the provisions of this section the tax imposed under this act shall be computed as a unit upon the consolidated net income of the group. Except as hereinafter provided the parent corporation and each subsidiary, a member of the group during any part of a consolidated period shall be severally liable for the tax (including any deficiency in respect thereof) computed upon the consolidated net income of the group. If a subsidiary by reason of a bona fide sale of stock for fair value has ceased to be a member of the affiliated group its liability shall remain unchanged, except that if such cessation occurred prior to the date upon which any such deficiency is assessed such deficiency in the case of such former subsidiary shall be reduced to an amount equal to such part as may be allocable to it upon the basis of the consolidated net income properly assignable to it. In no case, however, shall any demand for the payment of any deficiency be made, or any proceeding in court for the collection thereof be begun against such former subsidiary prior to the determination by the commissioner that the amount of the deficiency cannot be collected from the parent corporation and the corporation (If any) remaining members of the affiliated group.

The Commissioner shall prescribe such regulations as he may deem necessary in order that the tax liability of an affiliated group of corporations making a consolidated return and of each corporation in the group during, before and after the period of affiliation may be determined, computed, assessed, collected, and adjusted in such manner as clearly to reflect the income and to prevent avoidance of tax liability.

Further Recommendations

Corporations are allowed to make consolidated returns in cases that would not be allowed under the federal act, namely, in cases in which "at least ninety-five per centum of the stock of each of the banks in the banking group, or of each of the corporations in the corporate group is owned by the same interests or by the same stockholders." The former federal revenue acts contained a pro-
vision corresponding to the one just quoted but so many difficult
and complicated problems arose thereunder that beginning with the
taxable year 1929 it was abolished. If it was too complicated for
the federal government it is probably too complicated for Calif-
ornia and should be abolished in this state. The fewer the depart-
ures from the federal practice the fewer are the adjustments that
have to be made in the administration of the state tax.

Proposed Amendment:

Repeal the following sentence toward the close of the second
paragraph of Section 14:

"or if at least ninety-five per centum of the stock of
each of the banks in the banking group, or of each of
the corporations in the corporate group is owned by the
same interests or by the same stockholders."
Section 19:

Under this section the basis of property acquired on or after January 1, 1928, is the cost or inventory value thereof, and the basis of property acquired prior to January 1, 1928, and disposed of thereafter is the fair market value as of January 1, 1928.

An interesting problem is presented by the California statute in instances in which the original cost of the property, less depreciation actually sustained before January 1, 1928, is greater than its January 1, 1928, value and greater than the selling price, but the January 1, 1928, value is less than the selling price. The difference between the January 1, 1928, value and the selling price represents a gain for that period, although on the transaction as a whole there is no gain but in fact a loss. To include this difference between the January 1, 1928, value and the selling price in the tax base as gain or income when as a matter of fact no gain or income was realized on the investment seems unjust. Section 16 of Article XIII, in pursuance of which the statute was passed, and Section 4 of the statute, contemplate a tax measured by "net income".

These constitutional and statutory provisions may be interpreted to modify Section 19 of the statute and prevent the inclusion of items in the measure of the tax which really do not represent income. The Supreme Court of the United States was confronted with substantially an identical problem arising under the Federal Revenue Act of 1916. That act contained a provision corresponding to Section 19 of the California act, to the effect that the basis for the determination of gain or loss of property acquired before March 1, 1913, was "fair market price or value of such property as of March first, nineteen hundred and thirteen". In Goodrich v. Edwards((1921) 255 U.S. 257, 41, Sup. Ct. 390) the taxpayer acquired property in 1912, having a value of $231,600. Its March 1, 1913, value was $148,635.50. It was sold in 1916 for $289,346.25, obviously at a loss to its owner.
The court held that although the selling price was greater than the March 1, 1913, value there was no taxable gain to the taxpayer. After stating that the act provided that net income should include "gains, profits and income," and after quoting the definition of "income" approved by the court in Eisner v. Macomber (1920) 252 U.S. 189, 207, 40 Sup. Ct. 189, as "the gain derived from capital, from labor, or from both combined", provided it be understood to include profits gained through sale or conversion of capital assets", the court declared: "It is thus very plain that the statute imposes the income tax on the proceeds of the sale of personal property to the extent only that gains are derived therefrom by the vendor, and we therefor agree with the solicitor general that since no gain was realized on this investment by the plaintiff in error no tax should have been assessed against him." (See also Walsh v. Brewster (1921) 255 U. S. 536, 41 Sup. Ct. 392, in which the sale price exceeded both the cost and the 1913 value, but the 1913 value was less than the cost, but the court approved of a tax only on the actual gain.)

Just as the statute, using as it does without exception January 1, 1928, as the basic date, raises a question regarding the inclusion of items as gains when there has actually been no gain, so also it raises a question regarding the deduction of losses when there has actually been no loss. If the selling price was less than the January 1, 1928, value but equal to or greater than the cost, the difference between the January 1, 1928, value and the selling price would represent a loss for that period, but on the transaction as a whole there would be no loss, and in fact if the selling price were greater than cost there would actually be a gain, which accrued, however, prior to January 1, 1928. The Supreme Court of the United States was also presented with this problem. In United States v. Flannery (1925) 268 U.S. 93, 45 sup Ct. 420) James Flannery bought prior to March 1, 1913, certain corporate stock for less than $95,175.
If California should follow these cases in interpreting the basic date provision of the California statute the results reached would be just but the plain meaning of Section 19 of the statute would be altered. So far as that section is concerned nothing is said about actual gains or actual losses and it is arguable whether the court should add such precepts to the statute, particularly in view of the theory that the statute and constitutional section do not purport to impose a tax on actual net income but impose a tax on corporate franchises "measured by" the net income of fixed accounting periods. (See Burnet v. Sanford & B. Co. (1931) 282 U.S. 359, 362, 51 Sup. Ct. 150) If California follows the case just cited and an item represents net income within the fixed accounting period it will be included in the base regardless of whether or not there was actually a loss rather than a gain on the particular transaction.

If that be true there should be no great objection to estimating gain or loss on the sale of capital on the basis of a fixed period (January 1, 1928, to date of sale) regardless of actual gain or (1) actual loss.

(1) Both the Federal statutes involved in the above cases and the California statute prevent the taxation of gains that accrued prior to the basic date although realized thereafter. There is some doubt as to the power of Congress to impose an income tax under the Sixteenth Amendment on gains which accrued prior to March 1, 1913 (or rather February 25, 1913, the date the Sixteenth Amendment was formally proclaimed to be adopted) even though realized thereafter. See Lynch v. Turrish (1918) 247 U.S. 221, 38 Sup. Ct. 537, which did not pass on the constitutional question but held such gains were not income "arising or accruing" within the taxable year within the meaning of the Revenue Act of 1913 which contained no basic date provision limiting the tax to gains accruing after February 28, 1913, as did the 1916 and later Revenue Acts. (With regard to the constitutional question compare Town v. Eisner (1918) 245 U.S. 418, 38 Sup. Ct. 156, and Eisner v. Macomber (1920) 252 U.S. 189, 40 Sup. Ct. 158, See also, however, Lynch v. Hornby (1918) 247 U.S. 339, 38 Sup. Ct. 543). The power of a state to tax income realized after the passage of an income tax statute, although such income represents gain which accrued prior thereto, is less doubtful. See Norman v. Bradley (1931).....Ga. ........., 160 S.E. 413.

The basic date provisions in the state statute and the Federal Statutes involved in the above cases seem also to prevent the deduction of losses sustained before the basic date. In the Matter of Appeal of San Christina Investment Co. (August 4, 1928) Prentice...
Its market value on March 1, 1913, was $116,325 and he sold it in 1919 for $95,175, that is, for more than cost. Flannery died in March, 1920 and his executors in returning his income for the year 1919 deducted as a loss the difference between the sale price and the March 1, 1913, value. The Supreme Court upheld the commissioner of internal revenue in disallowing the loss claimed. The 1918 Federal Revenue Act, which was applicable to this situation, contained substantially the same basic date clause as the 1916 act quoted above. In the course of its opinion the court said:

"It is clear, in the first place, that the provisions of the act in reference to the gains derived and the losses sustained from the sale of property acquired before March 1, 1913, were correlative and that whatever effect was intended to be given to the market value of property on that date in determining taxable gains, a corresponding effect was intended to be given to such market value in determining deductible losses. This conclusion is unavoidable under the specific language of Section 202 (a) establishing one and the same basis for ascertaining both gains and losses."

And further on, after referring to Goodrich v. Edwards and Walsh v. Brewster, the court continued:

"So we think it should be held that the Act of 1918 imposed a tax and allowed a deduction to the extent only that an actual gain was derived or an actual loss sustained from the investment, and the provision in reference to the market value on March 1, 1913, was applicable only where there was such an actual gain or loss, that is, that this provision was merely a limitation upon the amount of the actual gain or loss that would otherwise have been taxable or deductible."

These cases seem to stand for the proposition that if there is a gain after February 28, 1913, it will be taxable only to the extent that it represents actual gain over the whole transaction; and if there is a loss after February 28, 1913, that portion thereof which represents actual loss over the whole transaction will be deductible. (1)

(1) See note next page.
It is conceivable that in spite of apparent inconsistencies such action would involve, as indicated in United States v. Flannery, the California courts might follow Goodrich v. Edwards and refuse to follow United States v. Flannery. In that event they might hold on the one hand that since the statute and the constitutional section under which it was passed contemplate a tax measured by net income, only actual income or actual gains may be included in the base; and hold on the other hand that it is entirely a matter of legislative discretion what deductions are allowed, and as there is no limitation on deductions in the constitutional section or statute corresponding to the implied limitation that only actual gains shall be included in the measure, and that as a plain reading of the basic date provisions of the statute allows the deduction of losses occurring after January 1, 1928, they should be allowed even though they are offset by gains which accrued prior to that time - gains which according to the plain intent of the statute are not to be considered.

Hall, State and Local Tax Service, vol. 1, par. 11,050, the State Board of Equalization denied the claim of one of the appellants that the Commissioner should have considered the actual cost of the real property acquired by it in 1914, less depreciation written off between 1914 and 1928, as the basis of the determination of the loss sustained upon the sale of the property in 1928. In Smith v. Nichols (D.C. Mass. 1928) 28 F. (2d) 629, however, which involved the Revenue Act of 1916, the court allowed the deduction of a loss which was entirely sustained before March 1, 1913. The March 1, 1913, value was lower than the cost and the selling price was also lower than cost but greater than the March 1, 1913, value, thus part of the loss which occurred prior to March 1, 1913, was in fact offset by gains occurring after that date, but the court held that the deductible loss was the difference between the cost and the selling price. This decision seems to be clearly contrary to the plain intent of the statute and unwarranted by the Supreme Court cases above discussed; and its reasoning should not be followed in interpreting the state act.

The present Federal Revenue Act (Revenue Act of 1928, sec. 113 (b) and the Rev. Acts of 1924 (sec. 204 (b) and 1926 (sec. 204(b) settle all these problems in favor of the taxpayer, allowing him to deduct the greatest possible loss and taxing him on the least possible gain. That Act (sec. 113 (b) provides: "The basis for determining the gain or loss from the sale or other disposition of property acquired before March 1, 1913, shall be: (1) the cost of such property . . . or (2) the fair market value of such property as of March 1, 1913, whichever is greater."
Recommendation:

It is submitted that if the January 1, 1928, basic date is retained, the fairest rule in this situation, from the standpoint of both the state and the taxpayer, would provide that if there is a gain after January 1, 1928, the taxability of that gain will be limited to the portion of the gain which represents actual gain accruing to the taxpayer over the whole transaction beginning with the purchase of the property; and if there is a loss after January 1, 1928, that portion of such loss will be deductible which represents actual loss sustained over the whole transaction.

Proposed amendment if January 1, 1928 basic date is retained.

Amend Section 19 to read as follows:

"For the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal or mixed, acquired on or after January 1, 1928, the basis shall be the cost thereof, or the inventoried value if the inventory is made in accordance with this act. In the case of property acquired prior to January 1, 1928, and disposed of thereafter the basis shall be cost thereof, provided, however, that (1) if its fair market price or value as of January 1, 1928, is in excess of such basis the gain to be included in gross income shall be the excess of the amount realized therefor over such fair market value; (2) if its fair market price value as of January 1, 1928, is lower than such basis, the deductible loss is the excess of the fair market price or value as of January 1, 1928, over the amount realized therefor; and (3) if the amount realized therefor is more than such basis but not more than its fair market price or value as of January 1, 1928, or less than such basis but not less than such fair market price or value, no gain shall be included in and no loss deducted from the gross income."

Omit second paragraph of Section 19 as the situation covered thereby is taken care of in the additional amendment to Section 19 discussed below.
In view of the recent great depression in property values a serious question arises whether January 1, 1928 as a basic date should be retained in the act. One of the most important practical aspects of the problem is this, namely if gains accrue from now on to property acquired by a corporation before January 1, 1928, and that property is subsequently sold and such gain realized it will not be taxed by the state unless the selling price exceeds the January 1, 1928 value of such property. The state will never obtain a tax on such gains if the present basic date is retained and if January 1, 1928 values represent a peak which will not again be reached. If gains accrue after January 1, 1928 and are realized and there has actually been a gain over the whole transaction, (that is, if the selling price exceeds the cost of the property) why should not the state tax such gain? If the basic date is changed, let us say to January 1, 1932, and gains accruing thereafter are taxed, an argument may be made that an undesirable discrimination against certain corporations would arise. Corporations that did not sell such property until after the new date became effective, for example, July 1932, would be subject to tax on such gains but corporations that sold such property before the new date, for example, December 31, 1931, would not be taxed thereon. In other words why penalize corporations that hold such property until after the new date? The answer to this question may be that the January 1,
1928 date should have been abandoned earlier and if some corporations escaped a tax that perhaps should have been imposed upon them that is no reason all other corporations should likewise be relieved from such tax. This argument against a new basic date proves too much. It would apply to any change in a statute that increased the burden upon those affected by it, and accordingly no loophole in a taxing statute should ever be closed for to close it will always discriminate against those who were not quick enough or able to take advantage of it.

Of course, it there is a gain from now on in property values, and a corporation realizes such gain, that fact alone is not sufficient justification for taxing it. Not only must there be a gain after January 1, 1932, there must also be a gain over the whole transaction, the selling price must also exceed the cost. In other words, the problem raised by Goodrich v. Edwards discussed above must be taken care of if any change is made in the basic date.

It is believed that the fewer the differences between the state act and the federal act the greater will be the convenience to the state and to the taxpayer. For that reason it may be just as well to use the basic date provided in the federal act, namely, March 1, 1913 or cost whichever is greater. The argument against such date that was advanced at the time the Bank and Corporation Franchise Tax Act was adopted is hardly applicable now in view of present low property values. It was then urged that gains which accrued between March 1, 1913 and January 1, 1928 and realized thereafter should not be taxed but that the tax should be confined to gains accruing after January 1, 1928, for to provide otherwise would penalize corporations that postponed the realization of such gains until after that date, and would be applying the tax retroactively to gains accruing before an income tax was imposed or even contemplated. If the state desired to follow the federal act and provide for exceptional cases in which gain accrued to property since March 1, 1913 and the value of such property is still greater than the March 1, 1913 value it could allow the taxpayer the alternative of using the federal date or January 1, 1932.
Such alternative would also be to the advantage of the taxpayer if January 1, 1932 values are lower than March 1, 1913 values, or lower than cost for greater loss will be deductible than if only January 1, 1932, basis were used.

Proposed amendment if the January 1, 1928 date is abandoned:

"For the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal or mixed, acquired on or after January 1, 1932, the basis shall be the cost thereof, or the inventoried value of the inventory is made in accordance with this act.

"In the case of property acquired prior to January 1, 1932, and disposed of thereafter the basis shall be the cost thereof, provided, however, that (1) if its fair market price or value as of January 1, 1932, is in excess of such basis the gain to be included in gross income shall be the excess of the amount realized therefor over such fair market price or value; (2) if its fair market price or value as of January 1, 1932, is lower than such basis, the deductible loss is the excess of the fair market price or value as of January 1, 1932, over the amount realized therefor; and (3) if the amount realized therefor is more than such basis but not more than its fair market price or value as of January 1, 1932, or less than such basis but not less than such fair market price or value, no gain shall be included in and no loss deducted from the gross income."

Provision for the federal basis could then be made as follows:

"At the option of the bank or corporation, in lieu of determining the basis as set forth in the preceding paragraph, in the case of property acquired after March 1, 1913, the basis shall be cost thereof and in the case of property acquired before March 1, 1913, the basis shall be the cost of such property or the fair market price or value of such property as of March 1, 1913, whichever is greater."
Illustration:

<table>
<thead>
<tr>
<th>Cost</th>
<th>March 1, 1913 value</th>
<th>January 1, 1932 value</th>
<th>Selling price</th>
<th>1932 basic date</th>
<th>Taxable gain or loss</th>
<th>Federal basis</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>10,000</td>
<td>15,000</td>
<td>10,000</td>
<td>20,000</td>
<td>10,000 gain</td>
<td>5,000 gain</td>
</tr>
<tr>
<td>2.</td>
<td>10,000</td>
<td>15,000</td>
<td>30,000</td>
<td>40,000</td>
<td>10,000 gain</td>
<td>25,000 gain</td>
</tr>
<tr>
<td>3.</td>
<td>10,000</td>
<td>8,000</td>
<td>5,000</td>
<td>3,000</td>
<td>2,000 loss</td>
<td>7,000 loss</td>
</tr>
</tbody>
</table>

Section 19 continued:

There is no provision in the act as it now reads for the determination of basis if the property were acquired by gift. This loophole should be closed.

Proposed amendment:

Add the following to the preceding proposed amendment to Section 19:

"If the property was acquired by gift from any donor not taxable under this act the basis shall be the basis that such property would have had if such donor or last preceding owner by whom it was not acquired by gift had been taxable under this act. If the property was acquired by gift from a bank or corporation taxable under this act the basis shall be the same as it would be in the hands of the donor. If the facts necessary to determine such basis are unknown to the donee, the Commissioner shall, if possible, obtain such facts from such donor or last preceding owner, or any other person cognizant thereof. If the Commissioner finds it impossible to obtain such facts, the basis shall be the fair market value of such property as found by the Commissioner as of the date or approximate date at which, according to the best information that the Commissioner is able to obtain, such property was acquired by such donor or last preceding owner."
Section 19 continued:

Gains and Losses on Sale of Capital assets are
Inadequately Provided for and as a Result an
Unnecessary State of Confusion Exists Under
The Statute as It now Reads.

1. The amount *to be compared with the basis for the purpose of as-
certaining gain or loss is not defined. Of course this figure must be
the amount received but there is no excuse for not stating such a
fundamental fact in the act.

2. No provision is made for adjustments on account of expenditures pro-
perly chargeable to capital account which in fairness to corporations
should be allowed.

3. There is no provision for the diminution in the basis of stock for
capital distributions.

4. If the recommendation made above regarding the use of a different
basis from fair market value as of January 1, 1928 is followed pro-
vision will have to be made for the allowance of depreciation actually
sustained before such date.

Proposed amendment:

It is recommended that the following provision, based upon
Section 111 and 115 of the federal act should be added to
whichever of the proposed amendments to section 19 submitted
above is adopted:

(a) Computation of gain or loss—Except as otherwise provided
in this section the gain from the sale or other disposition of
property shall be the excess of the amount realized therefrom
over the basis herein provided and the loss shall be the excess
of such basis over the amount realized.

(b) Adjustment of basis—In computing the amount of gain or loss
under subsection (a)—
(1) Proper adjustment shall be made for any expenditure, receipt, loss or other item, properly chargeable to capital account, and

(2) The basis, (if fair market price or value as of January 1, 1928, or January 1, 1932, if that date is adopted) shall be diminished by the amount of the deductions for exhaustion, wear and tear, obsolescence and depletion which have since January 1, 1928 (or January 1, 1932), been allowable in respect of such property under this act. In addition, if the property was acquired before January 1, 1928 (or January 1, 1932), the basis (if other than the fair market price or value as of January 1, 1928 or January 1, 1932) shall be diminished in the amount of exhaustion, wear and tear, obsolescence, and depletion, actually sustained before such date.

(c) Amount realized--The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market price or value of the property (other than money) received.

(d) Recognition of gain or loss--In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized shall be determined under the provisions of Section 20.

(e) Installment sales--Nothing in this section shall be construed to prevent (in the case of property sold under contract providing for payments in installments) the inclusion in gross income of that portion of any installment payment representing gain or profit in the year in which such payment is received.

(f) Distributions in liquidation--Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under this Section but shall be recognized only to the extent provided in section 20.
(g) Other distributions from capital—If any distributions (not in partial or complete liquidation) made by a corporation to its shareholders is not out of earnings or profits, then the amount of such distribution shall be applied against and reduce the basis of the stock and if in excess of such basis, such excess shall be included in gross income in the same manner as a gain from the sale or exchange or property. The provisions of this subsection shall also apply to distributions from depletion reserves based on the discovery value of mines.

Section 21:

This section provides that when property is exchanged for other property and no gain or loss is recognized under the preceding section, the property received shall be treated as taking the place of the property exchanged therefor. Under the preceding section (Section 20) the entire amount of gain or loss resulting from an exchange is recognized with the exceptions provided for in Section 112 of the Federal Revenue Act of 1928. One of the exceptions provided for in Section 112 applies to the situation where property is transferred to a corporation in return for stock of the corporation and immediately thereafter the transferor is in control of the corporation. No gain or loss resulting from the exchange is recognized. Under Section 112 of the Federal Act. The same is true under the State Act by virtue of Section 20.

Consequently, under Section 21 of the State Act the property transferred to the corporation is to be treated as acquiring the same basis as the stock exchanged therefor. This provision is ambiguous for the reason that it is difficult to understand how stock of a corporation prior to its being issued for the first time can be regarded as having any basis. Even if it can be regarded as having a basis, considerable doubt exists as to what the basis should be.
inasmuch as it might be the par value, the fair market value, or the value of the property obtained in exchange for it.

Furthermore, it is to be noted that this section literally construed is applicable only when no gain or loss is recognized under the preceding section. Hence, when an exchange occurs and gain resulting from the exchange is recognized under the preceding section, the basis of the property received will be the basis provided for in Section 19 of the Act which is the cost of the property. The result of this is that when some of the gain, but not the entire gain, resulting from an exchange is recognized under the preceding section, the balance of the gain which is not recognized at the time of the exchange will never be recognized. For example, suppose "X" a corporation, exchanges productive property which cost $50,000 and which has increased in value to $100,000 for like property worth $70,000 and $30,000 in cash. Under Section 112 of the Federal Revenue Act, and consequently under Section 20 of the State Act, gain to "X" only in the amount of $30,000 will be recognized. If "X" subsequently sells that property received for $70,000 no further gain will be recognized under the State Act since the basis of the property is the cost thereof, i.e. $70,000. Consequently, gain only in the amount of $30,000 is recognized although gain in the amount of $50,000 was realized by "X" from the transaction.

In view of the above, it would seem that Section 21 should be amended. It is to be noticed that Section 113 of the Federal Revenue Act contains detailed provisions regarding the basis of property received pursuant to an exchange with respect to which either no gain or loss or with respect to which some, but not the entire amount of gain resulting from the exchange, is recognized under Section 112 of that Act. Inasmuch as Section 20 of the State Act provides that gain or loss resulting from an exchange is to be recognized only to the extent it would be recognized under Sec-
tion 112 of the Federal Revenue Act, it seems only reasonable that provisions of Section 113 of the Federal Revenue Act relating to the basis of the property received pursuant to an exchange with respect to which the provisions of Section 112 of the Federal Revenue Act are applicable should be incorporated into the State Act.

However, if the provisions of Section 113 of the Federal Revenue Act are incorporated into the State Act, a provision different from that contained in Section 113 of the Federal Act should be made respecting the basis of property transferred to a corporation in exchange for stock, or in exchange for stock and money or property other than stock, where the transferor immediately after the exchange is in control of the corporation. Section 113 (a) (8) provides that in such a transfer the property transferred shall retain the same basis it had in the hands of the transferor (with certain adjustments on account of any gain or loss to the transferor which was recognized at the time of the exchange).

Since Section 113 (a) (8) provides that the basis of the property received by the transferor shall acquire the same basis as the property surrendered (with adjustments on account of any gain or loss to the transferor which was recognized at the time of the exchange), the effect of Section 113 (a) (8) is to provide that the property transferred and the property received shall have the same basis, namely, the basis that the property transferred had in the hands of the transferor. Because of this rule, double taxation will result in certain instances, and double deductions for loss will be permitted in other instances, and double deductions for loss will be permitted in other instances. For example, suppose "A" Corporation, transfers property which has a basis of $50,000 and which has increased in value to $100,000 to "B" Corporation in exchange for $100,000 of stock of "B" corporation and imme-
iately thereafter is in control of "B" corporation. The gain resulting to "A" is not recognized. Hence, under Section 113 (a) (6) the property received by "A" acquires a basis of $50,000 the basis of the property transferred. The property transferred, in accordance with Section 113 (a) (6) retains the basis it had i.e. $50,000. If "B" sells the property transferred for $100,000 it will be taxed on a gain of $50,000. If "A" sells the stock, received by it in exchange for the property transferred, for $100,000 is taxed although a gain of but $50,000 was realized from the transaction.

Suppose on the other hand that the property transferred had a basis of $100,000 and was transferred to "B" in exchange for $50,000 of "B"'s stock. If "B" sells the property for $50,000 it will be allowed to deduct a loss of $50,000. If "A" sells the stock, received by it in exchange for the property transferred, for $50,000 it also will be allowed to deduct $50,000 as a loss. Thus, deductions totalling $100,000 will be allowed although a loss of but $50,000 was sustained from the transaction.

Instead of providing, as is provided in Section 113 of the Federal Revenue Act, that the basis of the property transferred shall be the same as in the hands of the transferor, it would seem better to provide that the basis of the property transferred should be the value of the property at the time of the transfer. Under this rule, if the property transferred is sold by the transferee for an amount equal to the value of the property at the time of the transfer, neither gain nor loss will be considered as resulting to the transferee. Consequently, double taxation will not result, nor will double deductions for loss be permitted regardless of the amount for which the stock received by the transferor is sold. However, an objection to this rule can be made on the grounds that it will permit deductions for loss when loss has not in fact been sustained.
For example, suppose property which cost $50,000 is transferred when it has increased in value to $100,000. If the transferee sells the property for $50,000, a deduction of $50,000 will be allowed although over the entire transaction no loss has been sustained. This objection can be met by providing that whenever the basis of the property in the hands of the transferor is less than the value of the property at the time of the transfer, the basis of the property transferred for all purposes other than determining gain to the transferee shall be the same as in the hands of the transferor. Thus, if the property transferred is sold by the transferee for as much or more than it cost the transferor, no deduction for loss will be allowed. If this modification is made, then a further modification should be made to take care of the situation where property is transferred to a corporation in exchange for stock of the corporation and for money or property in addition to stock for otherwise the transferee in some instances, may not be allowed to deduct the full amount of loss which is actually sustained. For example, suppose property having a basis of $50,000 is transferred to a corporation in exchange for stock of the transferee and for money and property other than stock in the amount of $60,000. If the property transferred is sold by the transferee for $50,000, no loss will be allowed if the basis is the same as in the hands of the transferor although the transferee receives from the property less than the value of the money and property it actually surrendered in exchange for the property. It would seem that the basis of the property transferred for all purposes other than for the determination of gain should be the basis of the property in the hands of the transferor increased by the amount of money and the value of the property other than stock given in exchange thereof. Obviously, however, the basis so computed should not exceed the value at the
time of transfer of the property transferred. A simple way of

effecting this result would be to provide that if the basis in the
hands of the transferor is less than the value of the stock given in
exchange for the property transferred, the basis for all purposes
other than determining gain, shall be the same as in the hands of the
transferor increased by the amount of money and the value of property
other than stock given in exchange therefor.

If the above solution is followed, it will be necessary to
define the term "basis in the hands of the transferor". In case the
transferor is a bank or corporation taxable under the act, the term
can be defined to mean the basis provided for in Section 19 of the
Act which provides a basis for property acquired on or after January
1, 1928, and also a basis for property acquired prior to January 1,
1928. However, in case the transferor is other than a bank or cor-
poration taxable under the Act it will not suffice to provide that
the "basis in the hands of the transferor" shall mean the basis pro-
vided in Section 19 since that basis applies only to property ac-
quired by a bank or corporation taxable under the Act. It will also
be necessary to define the term "control". Section 112 of the Federal
Revenue Act of 1928 contains a definition of the term as used in said
Section. Inasmuch as the above solution applies only to exchanges
where either no gain or loss is recognized, or where some, but not
entire amount of gain, is recognized under the preceding section which
provides for the recognition of gain or loss with the exceptions
specified in Section 112 of the Federal Revenue Act of 1928, it would
seem proper to define the term "control" as meaning the same as it is
defined to mean in Section 112 of the Federal Revenue Act of 1928.

Proposed Amendment

Amend Section 21 to read as follows:

When property is exchanged for other property and no gain or loss
or some gain but not the entire amount of gain, is recognized under
the preceding section, the basis of the property received, except as hereinafter provided, shall be determined in accordance with the provision of Section 113 of the Federal Revenue Act of 1928 which are hereby referred to and incorporated for the purpose of this section with the same force and effect as though fully set forth herein.

When property is transferred to a bank or corporation of the classes taxable under this Act in exchange for stock of such bank or corporation, or in exchange for stock and money or property other than stock, and immediately thereafter the transferor is in control of such bank or corporation, the basis of the property transferred shall be the fair market value thereof at the time of the transfer except that if the basis in the hands of the transferor of the property transferred is less than the fair market value at the time of the transfer of the stock of such bank or corporation given in exchange therefor, then the basis of the property transferred shall be, for all purposes other than determining gain resulting to such bank or corporation from the subsequent disposition of the property transferred, the same as the basis in the hands of the transferor increased by the amount of money and the fair market value of property other than stock of such bank or corporation given in exchange therefor.

The phrase "basis in the hands of the transferor" as herein used is hereby defined to mean the basis provided for in Section 19 hereof if the transferor is a bank or corporation of the classes taxable under the Act; if the transferor is other than a bank or corporation of the classes taxable under the Act, it shall mean the cost to the transferor of the property transferred.

The term "control" as herein used is hereby defined to mean the same as the term is defined to mean in Section 112 of the Federal Revenue Act of 1928.

Proposed new section to be numbered Section 22a:

If offsets are abolished, or the rates increased, the basic date for determining gain or loss changed, or deductions allowed that
were not allowed under the old act or any other advantages or disadvantages given or imposed upon banks or corporations an adjustment will have to be made for fiscal year corporations and the tax increased or decreased accordingly. The reason for this adjustment is to prevent discrimination. For example, if the rates are increased calendar year corporations will pay the increased rates for the entire year 1933, whereas the new rates, unless an adjustment were made, would apply to fiscal year corporations only for the months of 1933 following the close of their fiscal years ending in 1933. Suppose a corporation with fiscal year ending June 30, 1933. Unless an adjustment is made it will pay a tax for the months of the year 1933, that is from January 1 to July 1, 1933, at the old rates, whereas a calendar year corporation will pay a tax for these same months at the higher rate.

Proposed amendment:

It is submitted that the following amendment, based upon section 105 of the federal act, should be added as section 22a to the California Act.

"The tax for a period beginning in one calendar year (hereinafter in this section called "first calendar year") and ending in the following calendar year (hereinafter in this section called "second calendar year") where the law applicable to the second calendar year is different from the law applicable to the first calendar year, shall be the sum of (1) the same proportion of a tax for the entire period, determined under the law applicable to the first calendar year and at the rates for such year, which the portion of such period falling within the first year is of the entire period; and (2) the same proportion of a tax for the entire period, determined under the law applicable to the second calendar year and at the rates for such year, which the portion of such period falling within the second calendar year is of the entire period."
"Any tax that has been paid under the law applicable to the first calendar year if in excess of the tax imposed by this section shall be refunded to the bank or corporation as provided in Section 27. Any tax in addition to that paid under the law applicable to the first calendar year made necessary by this section shall be immediately due and payable upon notice and demand from the commissioner."

Illustration:

Suppose a corporation with fiscal year ending June 30, 1933. The income earned from July 1, 1931-July 1, 1932 basis for the tax for period July 1, 1932 to July 1, 1933. Suppose that under the law applicable in 1932 the tax on this corporation amounted to $1,000. The proportion of such tax which the portion of the period falling within 1932 is of the entire period is 6/12 or 1/2. One-half of $1,000 is $500. Suppose that under the law applicable in 1933 the tax on this corporation, if the law had been applicable for the whole period, would have been $1,500. The proportion of such tax with the portion of the period falling within 1933 is of the entire period is 6/12 of 1/2. One-half of $1500 is $750; $500 plus $750 equals $1,250 or the total tax on this corporation. The corporation of course should already have paid the $1000 due under the old law. In other words, it will be required to pay an additional amount of $250.

Section 23:

**Franchise Tax Commissioner Is Without Authority to Extend Time of Payment of Second Installment**

Under section 15 of the act the commissioner may grant a reasonable extension of time for filing returns if in his judgment good cause exists therefor but no such extension or extensions may aggregate more than ninety days. Such an extension automatically extends the time for the payment of the first installment of the tax by virtue of Section 23 which provides: "Where an extension of time for filing
returns has been granted by the commissioner under the provisions of section 15 of this act, the first installment shall be paid prior to the expiration of such extension. If one-half of the tax is not paid on or before its due date, or the due date as extended by the commissioner it shall be delinquent and a penalty of fifteen per centum added thereto." There is no provision, however, for extending the time for payment of the second installment. Immediately following the language just quoted it is provided: "If the balance is not paid at the time it is due and payable it shall be delinquent and a penalty of five per centum added thereto." The time for paying this balance is provided in the same section as follows: "The balance of the tax shall be due and payable on or before the fifteenth day of the ninth month following the close of the taxable year" but nothing is said about extending the time for paying such balance.

Proposed amendment:

Insert after the third paragraph of Section 23:

"At the request of the taxpayer, the commissioner may extend the time for payment of the amount determined as the tax or any installment thereof, or any deficiency for a period not to exceed ninety days from the date prescribed for the payment of the tax or any installment thereof or deficiency. In such case the amount in respect of which the extension is granted shall be paid on or before the date of the expiration of the period of the extension. As a condition to the granting of such extension the commissioner may require the taxpayer to furnish a bond in an amount not exceeding double the amount of the tax or installment thereof or deficiency. If any installment is not paid in full on or before the date fixed for its payment either by this act or by the commissioner in
in accordance with the terms of an extension the whole amount of the 
tax unpaid shall be paid upon notice and demand from the commissioner.

Comment:

The last sentence protects the state if the taxpayer is 
in a precarious financial condition and may enable the com-
missioner to collect the tax before all resources of the tax-
payer are exhausted.

Section 23 (continued).

Extenuating circumstances often exist which make the imposition
of penalties unduly severe. The following proposed amendment follows
the federal practice and makes it possible to alleviate hardship in
meritorious cases.

Proposed amendment:

Insert the following as a paragraph between the third and fourth
paragraphs of Section 23:

"The commissioner, with the advice and consent of the State
Board of Equalization and State Controller may compromise the
penalties and interest provided for in sections 23 and 24 of
this act."

Amend the fourth paragraph of section 23 to read as follows:
"All taxes, interest, and penalties imposed under this act and
sums offered in compromise must be paid to the commissioner
at Sacramento in the form of remittances payable to the Treas-
surer of the State of California, and he shall transmit said
payments daily to the State Treasurer.

Amend the last paragraph of Section 23 to read as follows:
"All moneys received by the State Treasurer as bank and cor-
poration franchise tax collections shall be deposited by him in
a special fund in the State Treasury, to be designated the
bank and corporation franchise tax fund, and moneys in said
fund shall, upon the order of the State Controller, be trans-
ferred into general fund of the State, or be drawn therefrom
for the purpose of refunding to taxpayers hereunder. Sums offered in compromise hereunder shall be deposited with the State Treasurer in a special-deposit account in the name of the commissioner. Upon acceptance of such offer in compromise the amount so accepted shall upon the order of the commissioner be transferred by the State Treasurer from such special deposit account to the bank and corporation franchise tax fund. Upon the rejection of any such offer in compromise the commissioner shall certify to the State Board of Control the amount thereof which shall be refunded to the maker of such offer.

Section 25:

One year limitation on additional assessments is entirely too short. It renders it practically impossible to make adjustments on the audit of the federal return and thus enables the taxpayer to escape the payment of taxes rightfully due the state which the commissioner could not reasonably be expected to assess within one year. The limitation is two years in the federal act (Federal Revenue Act of 1928, sec, 275a) but should be somewhat longer in the state act to permit adjustments on the audit of the federal return. A three year time limit is recommended.

Proposed amendment:

In last paragraph of section 25 change the words "within one year" to "within three years".

Under the act as it now reads the taxpayer has 150 days from the determination by the State Board of Equalization of an appeal within which to bring an action for the recovery of the tax. The commissioner, on the other hand, has only sixty days, from such determination, to appeal to the courts. It is believed that the 150 day allowance is unnecessarily liberal and that the 90 day provision in section 30 is sufficient. This situation could be remedied by making the determination of the deficiency final upon the determination by the state board.
Proposed amendment:

Amend the fifth sentence of the third paragraph of Section 25 to read as follows:

"Said board shall hear and determine the same and thereafter shall forthwith notify the taxpayer and the commissioner of its determination, which shall be final upon the date of such notice of the determination by said Board unless within sixty days from the date of determination by said Board the commissioner shall bring an action in his name as commissioner against the taxpayer in a court of competent jurisdiction to determine the liability of the taxpayer."

Section 26:

Repeal this section if offsets abolished.

Whether offsets are or are not abolished there is one change in the interests of fairness to the state and to corporations generally that should be made. If a corporation is allowed an offset for real or personal property taxes against the franchise tax and subsequently a local subdivision makes a refund of real or personal property taxes to such corporation and if it is too late, in view of the period of limitations, for the commissioner to assess a deficiency to recover the offset allowed on account of such refunded real or personal property taxes, such corporation escapes a tax that in equity and justice it should pay, and enjoys a benefit not enjoyed by other corporations taxable under the act. If offsets are abolished the amendment should nevertheless be adopted to recover offsets previously allowed on such refunded taxes.

Proposed amendment if section 26 is retained:

Add to section 26:

"If any real or personal property taxes are at any time refunded to any bank or corporation taxable under this act said bank or corporation shall report that fact to the commissioner and shall pay a tax not subject to offset in an amount equivalent to any offset which has been
allowed against any tax imposed under this act on account of such refunded real or personal property taxes."

**Proposed amendment if Section 26 is repealed:**

In lieu of Section 26 provide:

If any real or personal property taxes are at any time refunded to any bank or corporation taxable under this act and said bank or corporation has been allowed an offset for such taxes against any tax imposed under this act, said bank or corporation shall report that fact to the commissioner and shall pay tax in an amount equivalent to any offset which has been allowed against any tax at any time imposed under this act on account of such refunded real or personal property taxes."

**Section 27:**

One year period in which to file a refund claim is unreasonably short. Just as the period in the case of the assessment of deficiencies should be extended to allow the state to obtain the benefit of the federal audit so that period should be extended to allow the corporation to obtain the benefit of such audit.

Neither this section nor any other section of the Act authorizes the crediting of an over payment of taxes on any taxes which are due under the Act but which have not been paid. It seems only reasonable that an overpayment should not be refunded until the taxpayer's tax liability to the state under the Act has been discharged in full.

**RECOMMENDATION**

Amend the first and second paragraphs of Section 27 to read as follows:

If in the opinion of the commissioner, or said board, as the case may be, a tax has been computed in a manner contrary to law
or has been erroneously computed by reason of a clerical mistake on the part of the commissioner or said board, such fact shall be set forth in the records of the commissioner, and the amount of the illegal levy shall be credited on any taxes then due from the taxpayer under the Act, and the balance shall be refunded to the taxpayer or its successor through reorganization, merger, or consolidation, or to stockholders upon dissolution.

If any tax or penalty has been paid more than once, or has been erroneously or illegally collected, or has been erroneously or illegally computed, the commissioner shall certify to the state board of control the amount collected in excess of what was legally due, from whom it was collected, or by whom paid, and if approved by that board, the same shall be credited on any taxes then due from the taxpayer under the Act and the balance shall be refunded to the taxpayer. But no such credit or refund shall be made unless a claim therefor is filed by the taxpayer with the commissioner within three years from the date of overpayment. Every claim for credit or refund must be in writing under oath and must state the specific grounds upon which the claim is founded.

Section 22:

The Lien Provisions of the Statute Create a very Confused and Undesirable situation.

It is apparently intended by the constitutional section that the new tax should accrue upon a fixed date which, if in accord with the general tax system set up in the constitutional article of which it is a part, would be the first Monday in March of that year. Apparently with this in mind the framers of the constitutional section provided that "Said taxes shall become a lien upon the first Monday of March of 1929 and of each year thereafter", thus establishing a lien date in accord with the lien date of the other taxes provided for by Article XIII. One of the outstanding
characteristics of the tax system set up by Article XIII is the fact that the accrual of the tax and the attachment of its lien are coincident. Thus, under that article, the fixing of the tax obligation on the subject of the tax and the creation of the tax lien must be regarded as occurring simultaneously, although, of course, the amount of the tax may not be ascertained until later, in which case there is a relation back to the date when the tax first accrued and became a lien. (Estate of Backesto (1923) 63 Cal. App. 265, 218 Pac. 597.) The attachment of the lien at the date of the accrual of the tax is an essential feature of a sound tax system, for no practical object could be served by having a lien attach before any tax had accrued, or by having the lien attach at a date after the tax had accrued.

Notwithstanding these basic propositions, the Bank and Corporation Franchise Tax Act provides for an accrual date which shall be "the first day after the close of the taxable year" and defines "taxable year" as the "calendar year or the fiscal year . . . . upon the basis of which the net income is computed". (Section 11) As a result, instead of providing for one accrual day, the act establishes January 1 as the accrual date for calendar year corporations and the first day of any of the other eleven months as the date for fiscal year corporations. By reason of the constitutional provision, the act could not provide that the lien should attach at the varying date of accrual, and instead was forced to provide for a single fixed lien date. The provision is found in Section 29 of the act:

"The taxes levied under this act shall constitute a lien upon all property of the taxpayer, which lien shall attach on the first Monday of each year. Every tax herein provided for has the effect of a judgment against the taxpayer and every lien has the effect of a judgment duly levied against all property of the delinquent........."
The language of this section is ambiguous. If the tax is to be a lien on the first Monday in March the provision that every tax has the effect of a judgment is superfluous if it means no more than that every tax is to have the effect of a lien. The provision that every tax is to have the effect of a judgment might be read as providing that every tax should have the effect of a lien upon accrual; however, this interpretation is precluded by reason of the constitutional stipulation that the lien attach on the first Monday in March.

Section 29 apparently, therefore, provides that the lien shall only attach on the first Monday in March. Since under the act taxes accrue before and after the lien date, it is pertinent to ask, on what March does the lien attach if the tax accrues after the first Monday in March? Does the lien relate back to the preceding March or must the attachment of the lien be delayed until the March following? The provision must operate in one way or the other and the act leaves this important question in doubt.

In so far as the language of the act is concerned, the view that the lien relates back to the preceding March is as tenable as the view that the lien attaches the March following. From the standpoint of their effect one is as undesirable as the other. If the lien is considered as attaching on the March following the accrual a bad situation results, for it means that after a corporation becomes liable for taxes a period intervenes before the lien will attach. The corporation may sell its property within that period free from any lien for the taxes due against it. For example, suppose a fiscal year corporation ended its taxable year on June 30, 1931; on the next day its tax for the next fiscal year accrued; however, the lien for that tax will not attach until the following March, i.e. March 1932. Thus the corporation has a period within which it may sell its property free of a lien for the accrued taxes. Such procedure is fundamentally contrary to sound tax policy.
The other possibility is to have the lien relate back to the prior March; for example, if a corporation's taxable year ended June 30, 1931, its tax accrued on July 1, 1931, and the lien for the tax attached on March 4, 1931, four months before the tax accrued. Thus, if the lien always related back to the preceding March the objection that the tax might be avoided could not be raised. However, the effect of such procedure upon the securing of a clear marketable title from a corporation selling its property would be extremely important, for a purchaser might find his property subject to a lien for taxes subsequently accruing against the corporation, of which he could have no knowledge without examining the accounting system of the corporation in question. A purchaser in April might subsequently find that a lien had attached the month before for taxes, accruing against the corporation, perhaps as late as January following his purchase.

From the foregoing it is evident that the lien provisions of the act create a situation of doubt, with a choice between undesirable alternatives.

Recommendation:

A fixed date is a workable provision only if the accrual date is also fixed. The situation created by the statute can only be remedied satisfactorily by a change of the lien provision in Section 16 of Art. XIII state constitution, allowing the lien to attach upon the date the tax accrues. Changing the article to provide for a uniform accrual date coincident with the first Monday in March, is not feasible if the corporation is allowed to make returns on the basis of taxable years as defined in section 11. To require all returns to be made on the same basis would be extremely inconvenient, both to the corporation and the Franchise Tax Commission and would greatly complicate the administration of the tax.
Section 31:

One year period of limitations contained in this section entirely too short for it imposes an unreasonable burden upon the Controller and Attorney General, who last year alone had to institute approximately 5,000 suits. It has been recommended that the taxpayer be given three years in which to file a claim for refund for taxes paid. The state should be allowed a similar period in which to bring suit to recover unpaid taxes. It is believed that the period for the assessment of taxes, refund of taxes and collection of taxes should be uniform.

Proposed amendment:

Change the words "one year" in the first sentence of Section 31 to "three years".

Section 32:

The provisions for the suspension and forfeiture of corporate powers for non-payment of the tax are entirely too drastic and unnecessarily complicate the relations of third persons with corporations.

Recommendation:

Repeal Section 32, and Section 33.

The lien provisions and the right to bring suit and collect unpaid taxes should be sufficient to protect the interests of the state but if further guarantees are desired the following is recommended for consideration.

The directors are the ones who are responsible for the non-payment of any tax levied by the act. Why not make them liable for delinquent taxes? To do so would be a much more effective means of insuring the collection of the tax and would not impair the rights of third persons or cause the confusion that arises under the act as it now reads.
Proposed amendment:

Amend section 32 to read as follows:

"If any installment, deficiency tax, penalty or interest computed and levied under this act is not paid on or before the due date thereof the directors of the bank or corporation on such due date shall be liable jointly and severally for the said installment, deficiency tax, penalty or interest; provided, however, that nothing herein shall be construed to relieve any bank or corporation of any liability imposed under this act."

Section 32 continued:

If the above recommendation urging the repeal of section 32 is not followed and that section is retained certain changes therein in the interest of consistency and fairness to a delinquent corporation and third persons dealing with it should be made.

The suspension provisions apparently do not apply to banks. Only domestic corporations and foreign corporations are referred to but they do not include banks for banks are expressly excluded from the definition of "corporation" in section 5 of the act.

Under the statute as it now reads a suspended corporation is without power to pay its debts or give a valid discharge of an obligation running to it. Furthermore, it is questionable whether a corporation should be deprived of the power of defending actions and preventing unwarranted claims being brought to judgment against it. The present disability, however, of commencing actions brings pressure to bear upon the corporation to pay its taxes, and if section 32 is retained probably this disability should be allowed to remain. As to actions commenced but not terminated before the effective date of suspension it may be to the interest of a defendant who foresees a favorable decision to have the matter terminated and for this reason it is suggested that with regard to such actions such defendants should have the option of having the
actions continued or dismissed.

The last sentence of this section should be more explicit. As it stands it would probably be interpreted by the courts as allowing the contract to be declared voidable at the instance of the other party to the contract only but any doubt should be settled by covering the matter specifically.

Proposed amendment to Section 32 if the suspension provisions are retained:

"If a tax computed and levied hereunder is not paid before six o'clock p.m. on the last date of the eleventh month after the due date of the first installment thereof, the corporate powers, rights and privileges of the delinquent taxpayer, if it be a domestic bank or a domestic corporation, or if it be a foreign bank or national or foreign corporation its corporate powers and rights and privileges so far as they pertain to intra-state business, shall be suspended and shall be incapable of being exercised for any purpose or in any manner except for the purpose of (1) performing, paying or settling its obligations, but this exception shall not include the power to pay dividends or make any distribution to stockholders in liquidation; (2) defending actions but such bank or corporation shall have no power to commence actions and actions which have been commenced by such bank or corporation and not terminated before the suspension herein provided for becomes effective may be dismissed at the option of the defending party to such actions; (3) receiving performance of or giving a valid discharge of any obligation or claims in its favor; (4) amending the articles of incorporation to set forth a new name and the officers, directors and stockholders or members of any such corporation may take such actions in their respective capacities as may be required by law..."
in order to amend the articles of incorporation for such purposes.

The controller shall transmit the name of each bank or corporation to the Secretary of State, who shall immediately record the same in such manner that it may be available to the public. The suspension or forfeiture herein provided for shall become effective immediately such record is made, and the certificate of the Secretary shall be prima facie evidence of such suspension or forfeiture.

Any person who attempts or purports to exercise any of the rights, privileges powers of any such domestic bank or domestic corporation except as hereinabove permitted, or who transacts or attempts to transact any intrastate business in the State in behalf of any such foreign bank, or national bank or foreign corporation shall be guilty of a misdemeanor and upon conviction thereof shall be punished by a fine of not less than two hundred fifty dollars and not exceeding one thousand dollars or by imprisonment in the county jail not less than fifty days or more than five hundred days, or by both such fine and imprisonment. The jurisdiction of such offense shall be held to be in any county in which any part of such attempted exercise of such powers, or any part of such transaction or business occurred. Every contract made in violation of this section is hereby declared to be voidable at the instance of the other party to the contract or his assigns."

(Words in italics added to the section as it now reads).

Section 32:

According to this section as it now reads a suspended corporation can apparently be reinstated by paying the amount for which the suspension occurred although taxes, interest and penalties for other years for which it was not suspended, e.g. years subsequent to the year for which it is suspended, have not been paid.
No corporation should be reinstated that has not paid up all taxes due under the act.

**Proposed amendment:**

If Section 32 is repealed, of course, this section should also be repealed, but if Section 32 is retained amend the first paragraph of Section 33 to read as follows:

"Any corporation which has suffered the suspension provided for in the preceding section may be relieved therefrom upon payment of the tax and the interest and penalties for nonpayment of which the suspension occurred together with all other taxes, deficiencies, interest and penalties due under the act together with an amount equal to twice the amount of the tax interest and penalties due the state for the year in which the suspension occurred if payment is made in any year other than such year, and upon the issuance by the controller of a certificate of reviver. Application for such certificate on behalf of any domestic corporation which has suffered such suspension may be made by any stockholder or creditor or by a majority of the surviving trustees or directors thereof; application for such certificate may be made by any foreign corporation which has suffered such forfeiture or by any stockholder or creditor thereof."

(Italics indicate changes)

**Section 36:**

Repeal this section if offsets are abolished.
Summary of Recommended Amendments to the Bank and Corporation Franchise Tax Act.

Section 3:
Repeal the second paragraph of Section 3.

Section 4:
Repeal the second paragraph of Section 4.

Section 5:
Add the following to the first paragraph of Section 5:
The term "business corporation" does not include corporations organized to hold the stock of other corporations and that do not trade in the stock or securities held and that engage in no other activities than the receiving and distributing of dividends from such stock.

Amend the third paragraph of this section to read as follows:
The term "doing business" as herein used means any transaction with any person or persons or any transaction concerning any property through any agency whatever acting for any bank or corporation.

Incorporate in Section 5 all the provisions of section 11.

Section 6:
Add the following to paragraph (a):
But if such amounts are held by the insurer under an agreement to pay interest thereon, the interest payments shall be included in gross income.

Add the following to paragraph (b):
In the case of a transfer for a valuable consideration, by assignment or otherwise, of a life insurance, endowment, or annuity contract or any interest therein, only the actual value of such consideration and the amount of the premiums and other sums subsequently paid by the transferee shall be excluded from gross income under paragraph (a) of this section.
Add at the end of section 6:

Stock dividends or subscriptions rights shall not be included in gross income, but gain may be derived or loss sustained by the shareholders from the sale of such stock or the sale of such rights. The amount of gain derived or loss sustained from the sale of such stock or rights or the sale of the stock or rights in respect to which the stock or rights are issued or the sale of the stock acquired with such rights shall be determined as provided in section 19.

Section 8:

Amend Subsection (c) to read as follows:

Taxes or licenses paid or accrued during the taxable year, other than taxes paid to the State under this act or under subdivision (d) of section 14 of article thirteen of the constitution of this State, and other than taxes, on, according to or measured by income or profits paid or accrued within the taxable year imposed by the authority of (1) the government of the United States: (2) any foreign country, (3) any State, territory, county, city and county, school district, municipality, or other taxing subdivisions of any State or Territory or possession of the United States, and other than taxes assessed against local benefits of a kind to increase the value of the property assessed, but this shall not exclude the allowance as a deduction of so much of said taxes assessed against local benefits as is properly allocable to maintenance or interest charges.

Amend Subsection (f) to read as follows:

Exhaustion, wear and tear and obsolescence of property to be allowed upon the basis provided in sections 113 and 114 of that certain act of Congress of the United States known as the "Revenue Act of 1928" which are, for the purposes of this subsection, hereby referred to and incorporated with the same force and effect as though fully set forth herein, or upon the basis provided in section 19 hereof.

Amend the third paragraph of Subsection (g) to read as follows:
The basis upon which depletion is to be allowed in respect of any property, except as hereinafter provided for oil and gas wells and mines discovered after January 1, 1932, shall be as provided in sections 113 and 114 of said revenue act of 1928, or upon the basis provided in section 19 hereof.

Amend the first sentence of the fourth paragraph to provide January 1, 1932 instead of February 29, 1913.

Amend Subsection 8 (h) to read as follows:
Dividends received during the taxable year from income arising out of business done in this State; but if the income out of which the dividends are declared is derived from business done within and without this State by corporations taxable under Article XIII of the constitution of this State, then so much of the dividends shall be allowed as a deduction as the amount of the income from business done within this State bears to the total business done.

The burden shall be upon the taxpayer to show that the amount of dividends claimed as a deduction has been received from income arising out of business done in this State.

Add as subsection (hh):
Dividends received by foreign corporations whose principal place of business is outside of California provided that it can be conclusively shown that such dividends have no relation to income derived from business transacted in California and are not in any sense or in any amount reasonably attributable to business done within this State.

Section 10:
Repeal the last sentence of the first paragraph of section 10.

Section 11:
Repeal this section and incorporate its provisions in section 5.

Section 12:
Add (a) at the beginning of the first paragraph and then add:
(b) If a taxpayer changes his accounting period from fiscal year to calendar year, from calendar year to fiscal year, or from one fiscal year to another, the net income, shall, with the approval of the commissioner be computed on the basis of such new accounting period subject to the following provisions.

(c) If a taxpayer, with the approval of the commissioner, changes the basis of computing net income from fiscal year to calendar year a separate return shall be made for the period between the close of the last fiscal year for which return was made and the following December 31. If the change is from calendar year to fiscal year, a separate return shall be made for the period between the close of the last calendar year for which return was made and the date designated as the close of the fiscal year. If the change is from one fiscal year to another fiscal year a separate return shall be made for the period between the close of the former fiscal year and the date designated as the close of the new fiscal year.

(d) Where a separate return is made under paragraph (c) on account of a change in the accounting period then the income shall be computed on the basis of the period for which separate return is made.

(e) If a separate return is made under paragraph (c) on account of a change in the accounting period, the net income, computed on the basis of the period for which separate return is made, shall be placed on an annual basis by multiplying the amount thereof by twelve and dividing by the number of months included in the period for which separate return is made. The tax shall be such part of the tax computed on such annual basis as the number of months in such period is of twelve months.

Section 13:
Amend Section 13 to read as follows:

Every bank and corporation shall within two months and fifteen days after the close of its taxable year, transmit to the commissioner a return in a form prescribed by him, specifying, for the taxable year.
all such facts as he may by rule, or otherwise, require in order to carry out the provisions of this act.

A bank or corporation which commences to do business within the limits of this state after the effective date of this act shall prepay the minimum tax hereunder which prepayment must be made before the bank or corporation files its articles of incorporation or duly certified copy thereof as the case may be with the Secretary of State. Upon the filing of its tax return two months and fifteen days after the close of its first taxable year its tax for that year shall be adjusted upon the basis of the net income received during that taxable year, a credit being allowed for the prepayment of the minimum tax. Said return shall also, in accordance with sections 23 to 26 inclusive be the basis for the tax of said bank or corporation for its second taxable year if its first taxable year is a period of twelve months. In every case in which the first taxable year of a bank or corporation constitutes a period of less than twelve months said bank or corporation shall pay as a prepayment of the tax for its second taxable year an amount equal to the tax for its first taxable year, the same to be due and payable at the same times and in the same manner as if that amount were the entire amount of its tax for that year; and upon the filing of this tax return two months and fifteen days after the close of its second taxable year it shall pay a tax for said year based on its net income received during that year, allowing a credit for the prepayment but adding interest at the rate of six per centum of any excess over the prepayment; but in no event shall the tax for the second taxable year be less than the amount of the prepayment for that year, and said return for its second taxable year shall also, in accordance with sections 23 to 26 inclusive be the basis for the tax of said bank or corporation for its third taxable year. This paragraph shall not apply to a bank or corporation which commences to do business in this state pur-
suant to a reorganization or a consolidation.

Where a bank or corporation commences to do business in this state pursuant to a reorganization of a bank or corporation, it shall pay no tax for its first taxable year, but its tax for its second taxable year shall be adjusted upon the basis of its net income for its first taxable year, and also upon the basis of the net income of the reorganized bank or corporation for the months of the taxable year prior to the reorganization. Every such bank or corporation in its return filed for its first taxable year shall specify all such facts with respect to the reorganized bank or corporation for the months of the year prior to the reorganization as the commissioner may require in order to carry out the provisions of this paragraph. The term "reorganization" as herein used shall include (1) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred; or (2) a recapitalization; or (3) a mere change in identity, form or place of organization, however effected.

Where a bank or corporation commences to do business in this state pursuant to a consolidation of two or more banks or corporation; it shall pay no tax for its first taxable year, but its tax for its second taxable year shall be adjusted upon the basis of the net income of the consolidated banks or corporations for the months of their taxable years prior to the consolidation. Every such bank or corporation, in its return for its first taxable year, shall specify all such facts with respect to the consolidated banks or corporations for the months of their taxable years prior to the consolidation as the commissioner may require in order to carry out the provisions of this paragraph.
Where a bank or corporation, or two or more banks or corporations, merge with another bank or corporations, the tax of the surviving bank or corporation for its taxable year succeeding its taxable year in which the merger occurs shall be adjusted upon the basis of its net income for its preceding taxable year and also upon the basis of the net income of the merged banks or corporations for the months of their taxable years prior to the merger. Every such surviving bank or corporation in its return for its taxable year in which the merger occurs, shall specify all such facts with respect to the merged banks or corporations for the months of their taxable years prior to the merger as the commissioner may require in order to carry out the provisions of this paragraph.

Taxes levied under this act shall not be subject to abatement or refund because of the cessation of the business or corporate existence of any bank or corporation during the year for which said taxes have been assessed.

The tax liability imposed under this act shall attach whether a bank or corporation has a taxable year of twelve months or of less duration.

Section 14:

Repeal the second paragraph of Section 14:

Section 19:

Amend Section 19 to read as follows:

(a) For the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, acquired on or after January 1, 1932, the basis shall be the cost thereof, or the inventoried value if the inventory is made in accordance with this act.
(b) In the case of property acquired prior to January 1, 1932, and disposed of thereafter the basis shall be the cost thereof, provided, however that (1) if its fair market price or value as of January 1, 1932, is in excess of such basis the gain to be included in gross income shall be the excess of the amount realized therefor over such fair market price or value; (2) if its fair market price or value as of January 1, 1932 is lower than such basis, the deductible loss is the excess of the fair market price or value as of January 1, 1932, over the amount realized therefor; and (3) if the amount realized therefor is more than such basis but not more than its fair market price or value as of January 1, 1932, or less than such basis but not less than such fair market price or value, no gain shall be included in and no loss deducted from the gross income.

(c) At the option of the bank or corporation, in lieu of determining the basis as set forth in the preceding paragraph, in the case of property acquired after March 1, 1913 the basis shall be the cost thereof and in the case of property acquired before March 1, 1913 the basis shall be the cost thereof and in the case of property acquired before March 1, 1913 the basis shall be the cost of such property or the fair market price or value of such property as of March 1, 1913, whichever is greater.

(d) If the property was acquired by gift from any donor not taxable under this act the basis shall be the basis that such property would have had if such donor or last preceding owner by whom it was not acquired by gift had been taxable under this act. If the property was acquired by gift from a bank or corporation taxable under this act the basis shall be the same as it would be in the hands of the donor. If the facts necessary to determine such basis are unknown to the donee, the commissioner shall, if possible, obtain such facts from such donor or last preceding owner, or any other person cognizant thereof. If the commissioner finds it impossible to obtain such facts the basis shall be the fair market value of such property as found
by the commissioner as of the date or approximate date at which, according to the best information that the commissioner is able to obtain, such property was acquired by such donor or last preceding owner.

(e) **Computation of gain or loss** -- Except as otherwise provided in this section the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis herein provided and the loss shall be the excess of such basis over the amount realized.

(f) **Adjustment of basis**-- In computing the amount of gain or loss under subsection (e)---

(1) Proper adjustment shall be made for any expenditure, receipt, loss, or other item properly chargeable to capital account, and

(2) The basis, if fair market price or value as of January 1, 1932, shall be diminished by the amount of the deductions for exhaustion, wear and tear and obsolescence and depletion which have since January 1, 1932, been allowable in respect to such property under the act. In addition of the property was acquired before January 1, 1932 the basis, if other than the fair market price or value as of January 1, 1932, shall be diminished in the amount of exhaustion, wear and tear and obsolescence and depletion actually sustained before such date.

(g) **Amount realized**--The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market price or value of the property (other than money) received.

(h) **Recognition of gain or loss**--In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized shall be determined under the provisions of section 20.
(i) **Installment sales**—Nothing in this section shall be construed
to prevent (in the case of property sold under contract providing
for payments in installments) the inclusion in gross income of that
portion of any installment representing gain or profit in the year
in which such payment is received.

(j) **Distributions in liquidation**—Amounts distributed in complete
liquidation of a corporation shall be treated as in full payment
in exchange for the stock, and amounts distributed in partial
liquidation of a corporation shall be treated as in part or full
payment in exchange for the stock. The gain or loss to the distri-
butee resulting from such exchange shall be determined under this
section but shall be recognized only to the extent provided in
section 20.

(k) If any distribution (not in partial or complete liquidation) made
by a corporation to its shareholders is not out of earnings or
profits, then the amount of such distribution shall be applied
against and reduce the basis of the stock and if in excess of
such basis, such excess shall be included in gross income in the
same manner as a gain from the sale or exchange of property. The
provisions of this subsection shall also apply to distributions
from depletion reserves based on the discovery value of mines.

**Section 21:**

Amend Section 21 to read as follows:

When property is exchanged for other property and no gain or loss,
or some gain but not the entire amount of gain, is recognized under the
preceding section, the basis of the property received, except as herein-
after provided, shall be determined in accordance with the provisions
of Section 113 of the Federal Revenue Act of 1928 which are hereby re-
ferred to and incorporated for the purpose of this section with the
same force and effect as though fully set forth herein.

When property is transferred to a bank or corporation of the
classes taxable under this Act in exchange for stock of such bank or corporation, the basis of the property transferred shall be the fair market value thereof at the time of the transfer except that if the basis in the hands of the transferor of the property transferred is less than the fair market value at the time of the transfer of the stock of such bank or corporation given in exchange therefor, then the basis of the property transferred shall be, for all purposes other than determining gain resulting to such bank or corporation from the subsequent disposition of the property transferred, the same as the basis in the hands of the transferor increased by the amount of money and the fair market value of property other than stock of such bank or corporation given in exchange therefor.

The phrase "basis in the hands of the transferor" as herein used is hereby defined to mean the basis provided for in Section 19 hereof if the transferor is a bank or corporation of the classes taxable under the Act; if the transferor is other than a bank or corporation of the classes taxable under the Act, it shall mean the cost to the transferor of the property transferred.

The term "control" as herein used is hereby defined to mean the same as the term is defined to mean in Section 112 of the Federal Revenue Act of 1928.

Proposed new section to be numbered Section 22 (a):

The tax for a period beginning in one calendar year (hereinafter in this section called "first calendar year") and ending in the following calendar year (hereinafter in this section called "second calendar year") where the law applicable to the second calendar year is different from the law applicable to the first calendar year, shall be the sum of: (1) the same proportion of a tax for the entire period, determined under the law applicable to the first calendar year and at the rates for such year, which the portion of such period falling within the first year is of the entire period; and (2) the same proportion of a tax for the entire
period, determined under the law applicable to the second calendar year and at the rates for such year, which the portion of such period falling within the second calendar year is of the entire period.

Any tax that has been paid under the law applicable to the first calendar year if in excess of the tax imposed by this section shall be refunded to the bank or corporation as provided in section 27. Any tax in addition to that paid under the law applicable to the first calendar year made necessary by this section shall be immediately due and payable upon notice and demand from the commissioner.

Section 23:

Insert after the third paragraph of Section 23:

At the request of the taxpayer, the commissioner may extend the time for payment of the amount determined as the tax or any installment thereof, or any deficiency for a period not to exceed ninety days from the date prescribed for the payment of the tax or any installment thereof or any deficiency. In such case the amount in respect of which the extension is granted shall be paid on or before the date of the expiration of the period of the extension. As a condition to the granting of such extension the commissioner may require the taxpayer to furnish a bond in an amount not exceeding double the amount of the tax installment thereof, or deficiency. If any installment is not paid in full on or before the date fixed for its payment either by this act or by the commissioner in accordance with the terms of an extension the whole amount of the tax unpaid shall be paid upon notice and demand from the commissioner.

The commissioner, with the advice and consent of the State Board of Equalization and State Controller may compromise the penalties and interest provided for in sections 23 and 24 of this act.

Amend the fourth paragraph of Section 23 to read as follows:

All taxes, interest and penalties imposed under this act and sums offered in compromise must be paid to the commissioner at Sacramento
in the form of remittances payable to the Treasurer of the State of California, and he shall transmit said payments daily to the State Treasurer.

Amend the last paragraph of Section 23 to read as follows:

All moneys received by the State Treasurer as bank and corporation franchise tax collections shall be deposited by him in a special fund in the State Treasury, to be designated the bank and corporation franchise tax fund, and moneys in said fund shall, upon the order of the State Controller, be transferred into the general fund of the State, or to be drawn therefrom for the purpose of refunding to taxpayers hereunder. Sums offered in compromise hereunder shall be deposited with the State Treasurer in a special deposit account in the name of the commissioner. Upon acceptance of such offer in compromise the amount so accepted shall upon the order of the commissioner be transferred by the State Treasurer from such special deposit account to the bank and corporation franchise tax fund. Upon the rejection of any such offer in compromise the commissioner shall certify to the State Board of Control the amount thereof which shall be refunded to the maker of such offer.

Section 25:
Amend the fifth sentence of the third paragraph of Section 25 to read as follows:

Said Board shall hear and determine the same and thereafter, shall forthwith notify the taxpayer and the commissioner of its determination, which shall be final upon the date of such notice of the determination by said Board unless within sixty days from the date of determination by said board the shall bring an action in his name as commissioner against the taxpayer in a court of competent jurisdiction to determine the liability of the taxpayer.

In the last paragraph of Section 25:

Change the words "within one year" to "within three years".
Section 26:

Amend Section 26 to read as follows:

If any real or personal property taxes are at any time refunded to any bank or corporation taxable under this act and said bank or corporation has been allowed an offset for such taxes against any tax imposed under this act, said bank or corporation shall report that fact to the commissioner and shall pay a tax in an amount equivalent to any offset which has been allowed against any tax at any time imposed under this act on account of such refunded real or personal property taxes.

Section 27:

Amend the first and second paragraphs of Section 27 to read as follows:

If in the opinion of the commissioner, or said board, as the case may be, a tax has been computed in a manner contrary to law or has been erroneously computed by reason of a clerical mistake on the part of the commissioner or said board, such fact shall be set forth in the records of the commissioner, and the amount of the illegal levy shall be credited on any taxes then due from the taxpayer under the Act, and the balance shall be refunded to the taxpayer or its successor through reorganization, merger, or consolidation or to stockholders upon dissolution.

If any tax or penalty has been paid more than once, or has been erroneously or illegally collected, or has been erroneously or illegally computed, the commissioner shall certify to the state board of control the amount collected in excess of what was legally due, from whom it was collected, or by whom paid, and if approved by that board, the same shall be credited on any taxes then due from the taxpayer under the Act and the balance shall be refunded to the taxpayer. But no such credit or refund shall be made unless a claim therefor is filed by the taxpayer with the commissioner within three years from the date of overpayment. Every claim for credit or refund must be in writing under oath and must state the specific grounds.
upon which the claim is founded.

**Section 31:**
Change the words "within one year" in the first sentence of Section 31, to "within three years."

**Section 32:**
Amend Section 32 to read as follows:

If any installment, deficiency tax, penalty or interest computed and levied under this act is not paid on or before the due date thereof the directors of the bank or corporation on such due date shall be liable jointly and severally for the said installment, deficiency tax, penalty or interest; provided, however, that nothing herein shall be construed to relieve any bank or corporation of any liability imposed under this act.

**Section 35:**
Repeal this section.

**Section 36:**
Repeal this section.
Summary of Alternative Amendments If Some of the Above Amendments are Not Adopted.

Section 5:

If the recommendation that holding corporations be exempt is not followed and it is found desirable to tax such corporations add the following to the first paragraph of section 5.

The term business corporation includes holding companies.

If the arguments that business trusts cannot be taxed under the Bank and Corporation Franchise Tax Act are not convincing, add the following to the first paragraph of Section 5 after the words United States, and shall include so-called Massachusetts or business trusts.

Section 13:

If the recommendations with regard to the abolition of offsets and the treatment of banks and corporations that dissolve or withdraw during any year are not followed the third paragraph of Section 13 should be amended to read as follows:

Any bank or corporation which is dissolved and any foreign corporation which withdraws from the State during any year shall pay a tax hereunder for the months of its fiscal year which precede such dissolution or withdrawal, according to or measured by such proportionate part of the net income of the preceding taxable year as the number of months of the year prior to such dissolution or withdrawal bears to the number of months of the preceding taxable year. Provided, however, that the taxes levied under this Act shall not be subject to abatement or refund because of the cessation of business or corporate existence of any bank or corporation pursuant to a reorganization consolidation, or merger. In the case of any bank or corporation which is dissolved, or which withdraws from the state during any year, the offset from the tax for the months prior to such dissolution or withdrawal shall not exceed that proportion of the offset computed under Section 26 which the number of said months prior to such dissolution or withdrawal bears to
the number of months of the preceding taxable year but shall not exceed the amount of real and personal property taxes paid during said preceding taxable year. In any event, each such corporation shall pay a minimum tax not subject to offset of $25 for such period.

**Section 13 fourth paragraph:**

If the recommendation for the repeal of this section is not followed, the words "not subject to offset" should be inserted in this paragraph immediately after the words, "annual tax".

**Section 14:**

The following changes should be made in Section 14 if privilege of filing consolidated returns is retained.

Repeal the following sentence toward the close of the second paragraph of Section 14:

"or if at least ninety-five per centum of the stock of each of the banks in the banking group, or of each of the corporations in the corporate group is owned by the same interest or by the same stockholders."

Add the following to Section 14:

If a consolidated return is made subject to the provisions of this section the tax imposed under this act shall be computed as a unit upon the consolidated net income of the group. Except as hereinafter provided the parent corporation and each subsidiary, a member of the group during any part of a consolidated period shall be severally liable for the tax (including any deficiency in respect thereof) computed upon the consolidated net income of the group. If a subsidiary by reason of a bona fide sale of stock for fair value has ceased to be a member of the affiliated group its liability shall remain unchanged, except that if such cessation occurred prior to the date upon which any such deficiency is assessed such deficiency in the case of such former subsidiary shall be reduced to an amount equal to such part as
may be allocable to it upon the basis of the consolidated net income properly assignable to it. In no case, however, shall any demand for the payment of any deficiency be made, or any proceeding in court for the collection thereof be begun against such former subsidiary prior to the determination by the commissioner that the amount of the deficiency can not be collected from the parent corporation and the corporations (if any) remaining members of the affiliated group. The Commissioner shall prescribe such regulations as he may deem necessary in order that the tax liability of an affiliated group of corporations making a consolidated return and of each corporation in the group during, before and after the period of affiliation may be determined, computed, assessed, collected and adjusted in such manner as clearly to reflect the income and to prevent avoidance of tax liability.

Section 19:

If it is desired to retain the January 1, 1928 basic date substitute that date for January 1, 1932 in the amendment recommended in the first part of this summary, and take out paragraph (c) of that amendment.

Section 26:

If the recommendation for the repeal of section 26 is not followed the following should be added to that section:

If any real or personal property taxes are at any time refunded to any bank or corporation taxable under this act said bank or corporation shall report that fact to the commissioner and shall pay a tax not subject to offset in an amount equivalent to any offset which has been allowed against any tax imposed under this act on account of such refunded real or personal property taxes.